STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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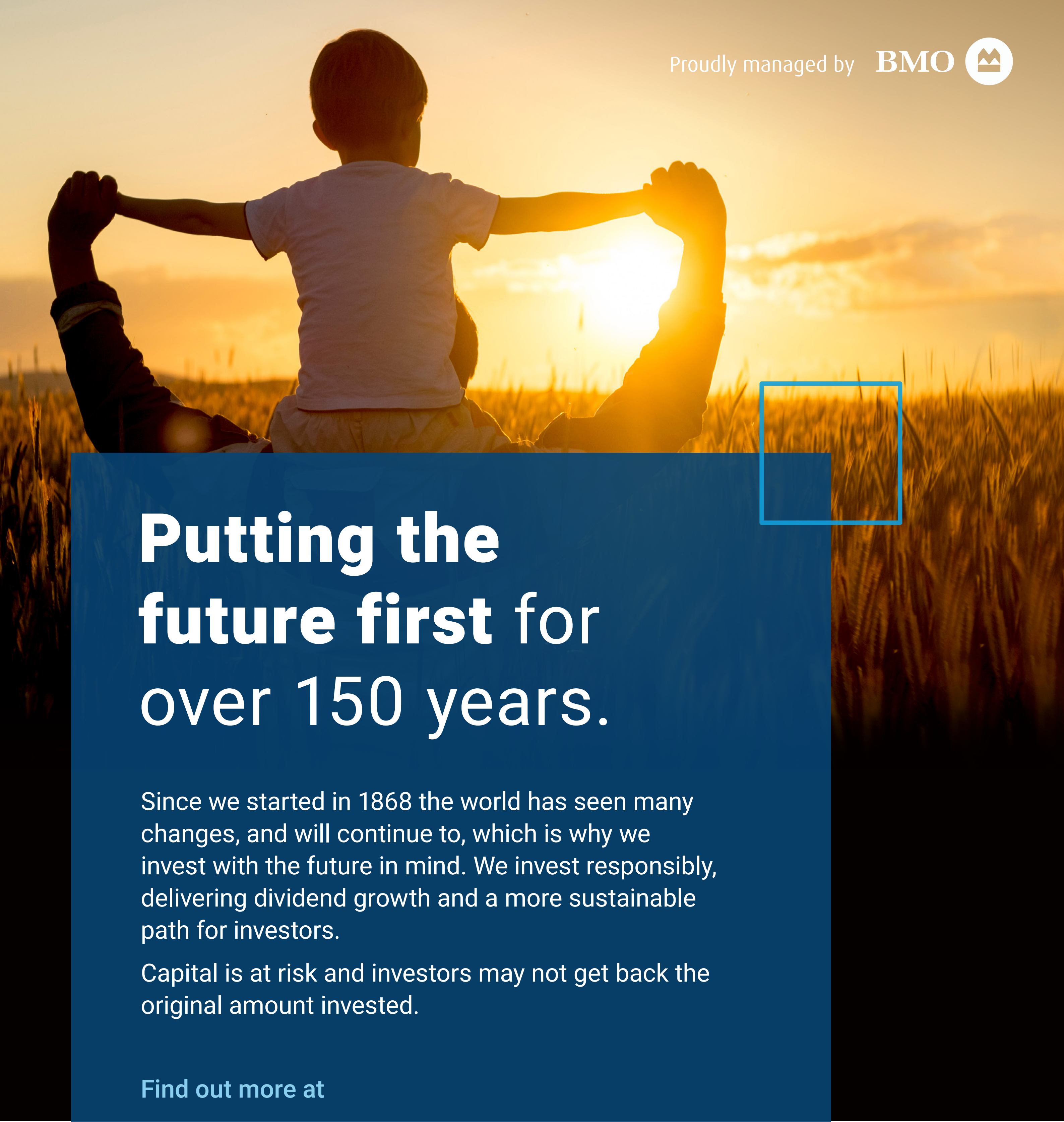
SURVIVING THE MARKET SELL-OFF

Why shares have fallen and what could happen next

Value rally: One expert says **more to come**

How **investors** might react to **interest rate hikes**

Scottish Mortgage down 33%: **buy more** or **sell out?**



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Daniel Coatsworth

The shares that could go up as the market falls

It's been a brutal start to 2022 for investors but that doesn't mean the whole market has declined

It's been a miserable start to the year for a lot of investors, leading many people to ask if we're seeing more than a simple pullback from last year's successful run for stocks and shares.

The key headwinds to markets have been clear for months, namely higher rates, an impending reduction in central bank stimulus, and rising inflation, yet investors only now seem to worry.

January has seen a clear shift in market preferences. Highly rated growth stocks have become less desirable and cheaper 'value' stocks such as banking, energy and tobacco are in fashion.

Value has prospered as an investment style a few times in recent years, but each rally hasn't lasted that long. However, Ian Lance, fund manager from value-themed **Temple Bar Investment Trust (TMPL)**, points out that historically there have been plenty of value rallies which have held in place for some time, such as 1973 to 1978, 1980 to 1988, 1990 to 1995, and 2000 to 2007.

On average these value rallies lasted about five years, says Lance, and the average return across each period was approximately 200% versus 70% for the market.

The valuation gap between growth and value stocks is wider today than at the start of those value rallies, which is why Lance believes the current value rally has legs.

It may feel as if everything is falling in value as portfolios take a bruising and many popular stocks like Amazon and Tesla experience approximately 20% share price declines in a matter of weeks. However, investors must not assume that everything loses when the market falls.

As of 24 January, 84 stocks in the FTSE 350 index of UK-listed companies were trading at a higher share price than at the start of the month. More than a third (38 stocks) of the FTSE 100 were up year to date.

In 2000 at the bursting of the dotcom bubble, the US Nasdaq index fell by 75% in the subsequent two years but shares in banks and utilities went up a lot. **British American Tobacco (BATS)** even went from £3 to £55 over the next 17 years.

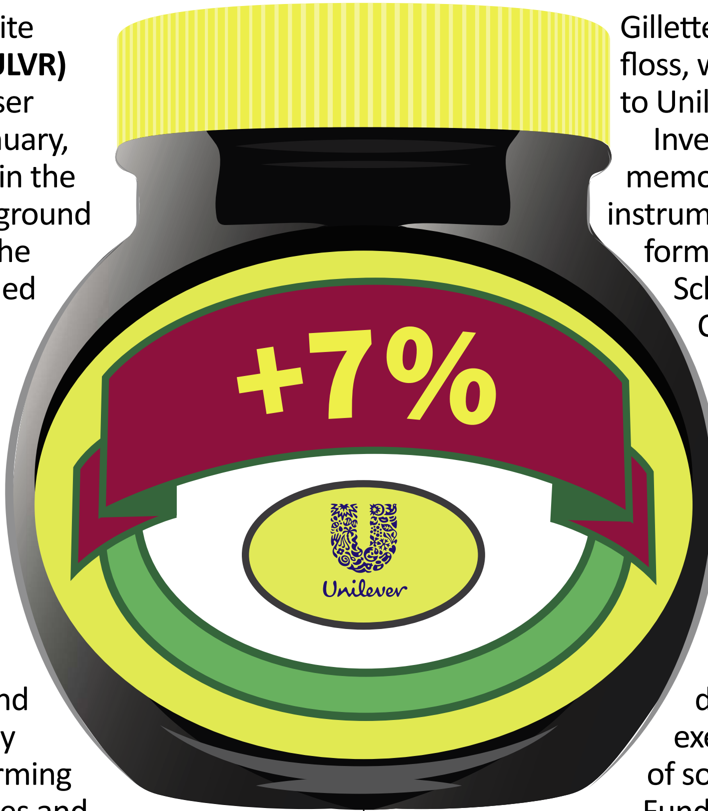
Lance suggests energy, banking and miners could be the best places to put your money to play the current value rally. In essence, this means buying shares in a few sectors which have been ignored by a lot of investors in recent years, such as oil which has been shunned on environmental grounds and banking because low interest rates made it difficult for lenders to grow earnings.

But are these stocks ones you want to own forever? Probably not. The best long-term returns have been made from quality companies held for a long time. Therefore it is worth treating value stocks as a short-term opportunity while at the same time keeping an eye out for high quality growth stocks which have been heavily sold down as this could be your chance to pick up some good names at more favourable valuations.

A word of warning: if Russia initiates a full-scale war with Ukraine then stock markets could easily take an even bigger tumble than we've seen in recent weeks, so make sure you understand all the risks before you invest given the current cocktail of market headwinds.

Unilever is the next FTSE 100 takeover target

The company appears to have lost its way under the current CEO



Domestos to Marmite maker **Unilever (ULVR)** was the biggest riser on the FTSE 100 on 24 January, gaining 7% to £39.40 and in the process recouping all the ground the shares lost following the recent revelation of its failed bid for **GlaxoSmithKline's (GSK)** consumer healthcare unit.

The catalyst for the sharp jump in the share price was an unconfirmed report that US activist Nelson Peltz had built a stake in the Anglo-Dutch group.

Peltz's activist hedge fund Trian Partners has a history of shaking up underperforming consumer goods companies and has reportedly taken a significant holding in Unilever, which last week drew the ire of its shareholders after it bid for the Glaxo business.

FOX IN THE HENHOUSE

Unilever's £50 billion offer was the latest of three approaches to the pharmaceutical giant, but shareholders were so vocal in their opposition management effectively gave up its pursuit by saying it wouldn't increase its price.

Peltz's arrival on the share register would heap further pressure on beleaguered chief executive Alan Jope, with Jefferies analyst Martin Deboo observing 'the fox would now appear to be inside the henhouse'.

Trian has had a good deal of success in unlocking value by pressing for change at the likes of Mondelez, Sysco and Procter & Gamble, the US giant behind brands including Pampers nappies, Gillette razors and Oral-B dental floss, which is seen as a direct rival to Unilever.

Investors with a longer memory may recall Peltz was also instrumental in the break-up of former FTSE 100 darling Cadbury Schweppes, which resulted in Cadbury being acquired by Mondelez.

HUNTER TO BECOME THE HUNTED?

The mooted takeover of the Glaxo unit has raised fundamental questions among investors over Unilever's strategic direction under chief executive Jope and the future of some of its assets.

Fundsmith founder Terry Smith, a long-standing core shareholder of Unilever, published what he called a post mortem on the proposed deal with Glaxo describing it as a 'near death experience' and advising management to either focus on the core business or step aside.

Smith previously argued Unilever's management had 'lost the plot', with the FTSE 100 goliath 'labouring under the weight of a management which is obsessed with publicly displaying sustainability credentials at the expense of focusing on the fundamentals of the business'.

If Peltz intends to put pressure on Unilever to break itself up into a separate staples business and a household goods business to increase value he may well find support amongst disgruntled shareholders, at which point the company would likely become a target rather than an acquirer. [IC]

Market veterans call out US stock market bubble

Dire warnings on the outlook for stocks and shares

Most expert observers see the current stock market sell-off as a healthy correction and the rotation out of high growth technology shares into economically sensitive shares as logical given rising rates.

However, two veterans of the investment world see the world rather differently and believe we are seeing the start of the bursting of a one of the largest bubbles in history.

Jeremy Grantham is co-founder and chief investment strategist at $65 billion asset manager GMO, and Carl Icahn, who recently described some stock valuations as 'crazy', owns investment vehicle Icahn Enterprises which has a market value of $11.8 billion.

Grantham is a long-time student of asset bubbles and his firm has identified over 300 of them over the last 100 years, from the 1920s stock bubble which led to the Great Depression to the Japanese property bubble of the late 1980s.

One message is crystal clear from GMO's research and it is a worrying one for investors; every single bubble over the last 100 years has fully deflated with the price moving back to the trend which existed prior to the bubble. No exceptions.

Grantham has flagged 2,500 on the S&P index as the prior trend level, implying a 43% decline from the current 4,410.

GMO defines a bubble as a two-sigma event, which is a statistical measure of dispersion or how stretched prices are around a trend. Grantham has labelled the current market a super bubble because it has reached three sigmas.

BUBBLE TROUBLE

If that weren't enough to worry about, Grantham thinks risks are multiplied by the existence of multiple bubbles.

Grantham explains that on top of the 'most exuberant, ecstatic, even crazy investor behaviour in the history of the US stock market' we also have 'the broadest and most extreme global real estate bubble in history'.

In his view when you throw in the highest priced bond markets in US history along with the lowest interest rates on record and a side helping of 'broadly overpriced commodities including oil and most of the important metals' then you have a toxic recipe for something a lot more serious than a run of the mill market correction.

Grantham argues that at some point, when pessimism rears its head again, as inevitably it does, if all these asset classes merely retraced two-thirds of their way back to historical norms, total wealth losses in the US alone could be in the order of magnitude of $35 trillion.

He suggests avoiding US stocks and turning instead to value stocks in emerging markets and several cheaper developed countries, most notably Japan. He also believes in holding some cash for flexibility and gold and silver for inflation protection. [MGam]

Grantham believes in holding some gold and silver for inflation protection.

Netflix needs to find new ways to grow revenue

An expected slowdown in subscriber growth has hurt its share price

A substantial slowdown in subscriber growth at Netflix is putting severe pressure on the share price and has raised concerns about the competitive environment faced by the business and whether it may have reached saturation point.

Netflix subscriber growth expected to slow dramatically

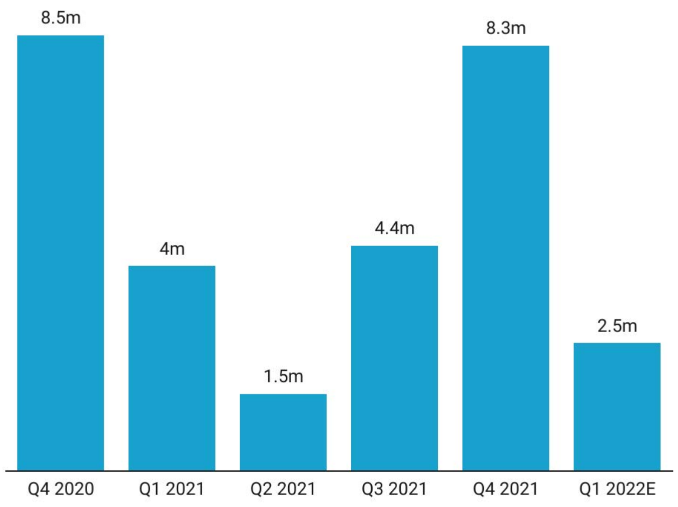


Chart: Shares Magazine • Source: Netflix • Created with Datawrapper

The company's latest update (20 Jan) saw it forecast just 2.5 million new users in the current quarter, considerably below analysts' expectations for 4 million.

Netflix faces intense competition from rival streaming companies including Disney+ and Amazon Prime Video. The former has just taken back control of hits including *Modern Family*, *How I Met Your Mother* and *Sons of Anarchy* to boost its own service.

The expected slowdown in subscribers is particularly disconcerting given it comes against a backdrop of higher content spending. This caused a contraction in Netflix's operating margin to 8% in the fourth quarter, a decline of six percentage points from the prior year.

If content is no longer a guaranteed competitive advantage then Netflix will need to focus on other areas to sustain user growth and profitability.

One option being pursued is to raise prices for the service. Netflix increased prices in the US and Canada this month from $14 to $15.50. However there is limited scope to pursue this strategy given the considerable premium this represents to the $8 per month charged by Disney+.

However a considerable opportunity exists for Netflix to build out the whole experience of games, consumer products and live events around the group's intellectual property, which naturally lends itself to great storytelling.

MULTIPLE NEW GROWTH OPPORTUNITIES

Netflix has invested considerable resources in building the technical infrastructure that has enabled it to launch games to members.

This has followed a learning period involving analysing discovery and engagement patterns to determine which games resonate with the consumer. Netflix's commitment to the gaming segment has also been reflected in its acquisition of talent in the space.

This includes the October 2021 purchase of Night School Studio, developer of the *Oxenfree* series and *Afterparty*. Moreover in July Netflix hired Mike Verdu to help lead its video game division. Previously Verdu worked as an executive at Facebook and Electronic Arts focused on mobile gaming.

The Queen's Ball: A Bridgerton Experience is a good example of how Netflix is building a franchise around live events linked to its TV productions.

Tickets for the event priced at $45 enable fans of the hit series to be transported to Regency-era London. They are able to enjoy a live concert with music and dance inspired by the TV show.

Another revenue generating move might be to consider carrying advertisements when someone watches a film or TV show. [MGar]

Big strategic moves for FTSE 100 miners Rio Tinto and BHP

M&A could be back on the agenda and there is also big news on two important projects

FTSE 100 mining group **Rio Tinto (RIO)** has endured decidedly mixed fortunes year to date.

First, the Anglo-Australian business saw its $2.4 billion lithium project in Serbia cancelled by the country's authorities. The move has prompted some to wonder if it was a form of retaliation for Serbian tennis star Novak Djokovic's deportation from Australia.

At face value the decision was instead made following pressure from environmental campaigners. Rio Tinto has few avenues to try and revive the development, which would have been Europe's largest lithium mine.

Taking legal action against the Serbian government would likely create more problems than it solves. Rio is largely keeping its counsel for now and may wait for the result of elections in April and hope for a fresh hearing then.

This setback follows on from the miner's destruction of ancient Aboriginal rock shelters as part of works on an iron ore project in Western Australia in 2020, a scandal which led to the exit of the company's then-senior management team.

However, there was positive news on 25 January with the Oyu Tolgoi project in Mongolia, set to be the fourth biggest copper mine in the world by 2030.

After considerable disruption, underground expansion of the mine looks set to go ahead after project co-owner Turquoise Hill – which is 51% controlled by Rio Tinto – agreed to write off $2.4 billion worth of debt owed by the Mongolian government on its share of development costs.

However, Rio Tinto's struggles in Serbia may add to pressure to accelerate a strategic reset at the company – where chief executive Jakob Stausholm is already attempting to reposition the business to align with global decarbonisation efforts.

There may even be a clamour to follow in the footsteps of Rio Tinto's peer **BHP (BHP)** and abandon its dual listing in London and Sydney.

BHP will exit the FTSE 100 before the end of the month after shareholders approved plans to ditch its dual UK and Australian structure and move its primary listing down under.

Among the rationale for the decision was that it would make it easier for the group to use its shares in the pursuit of acquisitions. Speculation is mounting that BHP might be lining up a blockbuster takeover of **Glencore (GLEN)**, having apparently regained its appetite for substantial M&A.

Any such move might have to wait until BHP has completed the merger of its oil and gas assets with Woodside Petroleum, targeted for the second quarter of 2022.

Meanwhile, Australian iron ore firm Fortescue Metal has bought the Williams F1 battery and technology team, signalling the growing intent in the industry to cover all angles of the energy transition. [TS]

Four great reasons to buy Shell now

The energy firm offers a cheap way to play a change in the market backdrop

There are many compelling reasons to buy **Shell (RDSB)** right now.

Oil and natural gas prices are strong which will boost its earnings. The stock should benefit from the current shift in market dynamics towards 'value' stocks.

An imminent simplification process is set to make the shares more investable and the company's positioning going into an energy transition looks increasingly robust.

The current share price doesn't reflect these attributes. Using simple benchmarks, derived from consensus forecasts, Shell trades on a 2022 price to earnings ratio of 7.9 times and yields 3.8%.

HUNTING HIDDEN VALUE

Activist investor Third Point believes there is significant hidden value in the business having recently taken a sizeable stake. It thinks the entire enterprise value of Shell (debt and shares) could be supported by the parts of the business which are exposed to the transition away from polluting fossil fuels, with investors getting the remainder of the group for free.

Third Point's founder and CEO Dan Loeb has noted that, on most metrics, the company trades at a 35% discount to peers like Chevron and ExxonMobil 'despite Shell's higher quality and more sustainable business mix'.

He adds: 'Compared to peers, Shell generates a much larger percentage of its cash flow and earnings from stable businesses that have a major role to play in the energy transition.'

'STABLE BUSINESSES' EXPOSED TO TRANSITION

This is a legacy of Shell's decision over the past decade or so to target natural gas as it looked to adjust to the changing shape of energy consumption and the mounting pressure from the public, markets and governments over climate change.

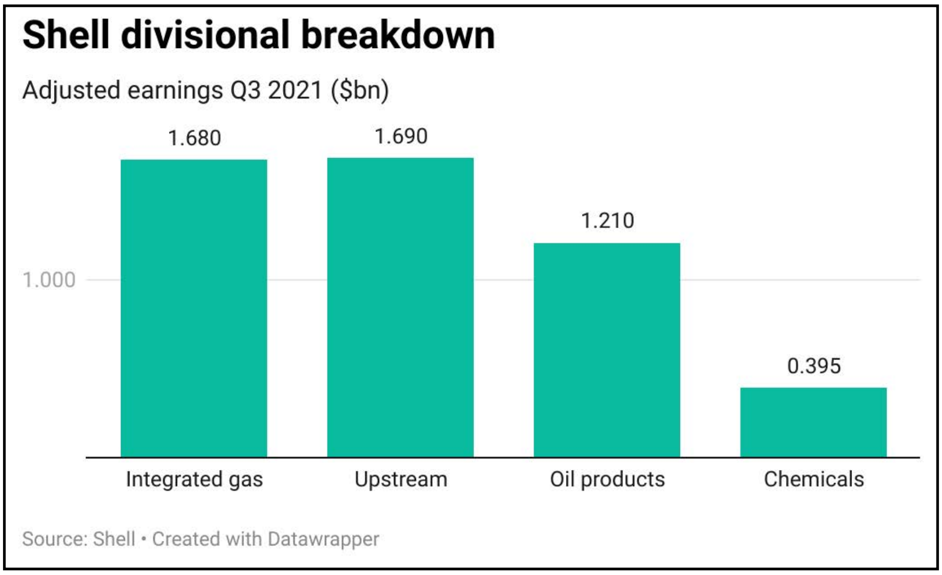
A £36 billion merger with BG in 2016 helped it reach a market leadership in liquefied

SHELL ↗ BUY
(RDSB) £17.58

Market value: £140 billion

natural gas (also known as LNG), which involves cooling gas to a liquid state so it can be shipped and stored.

In Loeb's eyes these 'stable businesses' encompass the LNG, renewables and marketing divisions, which by Third Point's estimation will generate 40% of Shell's 2022 earnings. Meanwhile the upstream (exploration, development and production of oil and gas), refining and



SHELL IN A NUTSHELL

Shell is an integrated energy company. This means it has operations in oil and gas exploration, production, marketing, refining, transportation and distribution.

It is involved in everything from drilling and finding new sources of oil and gas to selling you petrol at the pump.

Currently the group is split into five divisions: Upstream, Integrated Gas, Renewables and Energy Solutions, Downstream and Projects & Technology.

chemicals units are expected to account for the other 60%.

Third Point is calling for Shell to be broken up to help realise the neglected value in the business with, potentially, a legacy energy firm focused on cash returns and a standalone renewables, LNG and marketing outfit more focused on growth.

GOOD PLACE TO BE

Separately, Shell and the whole 'big oil' space is well placed against the current backdrop of mounting inflation and rising interest rates, which has been reflected in its outperformance of the wider market year-to-date.

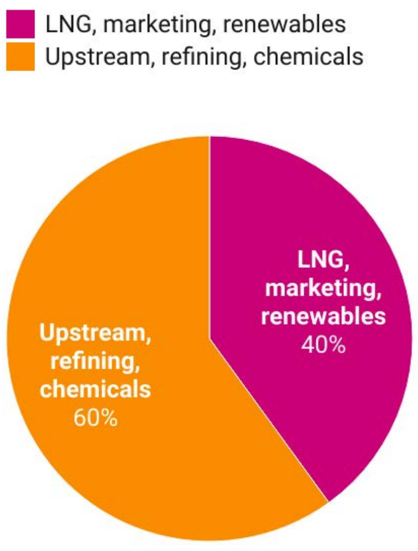
As Ian Lance, fund manager at **Temple Bar Investment Trust (TMPL)**, observes: 'The energy sector is exactly the sort of place where you want to be in today's environment of rising inflation and rising commodity prices, and yet you can access it very cheaply.

'The big energy companies trade on free cash flow yields of about 15%. This is the cash flow after tax, interest and capex, dividend by market cap, and is the money available to pay back to shareholders. That is very cheap on a historical basis.'

A reduction in Shell's dividend in 2020 and a series of divestments have helped reduce borrowings to the point that Third Point estimates the company's net debt to EBITDA (earnings before interest, tax, depreciation and amortisation) will have dipped below one times by the end of 2021.

Shell is also busily buying back shares as part of a $7 billion programme introduced to distribute the proceeds of the sale of its assets in the US oil hotspot – the Permian basin – to ConocoPhillips in 2021.

Shell: future-facing and legacy businesses' share of earnings 2022E



Source: Third Point Investors • Created with Datawrapper

A SIMPLER STORY

Having renamed the company simply as Shell, the next steps in the present corporate restructuring will be to move its tax domicile to the UK and abandon its A/B share class. These moves, set to complete before the end of this month, should help lend greater clarity to the investment case.

Formed as a combination between Netherlands firm Royal Dutch Petroleum and the UK's Shell in the early 20th century, the company has been incorporated in the UK with Dutch tax residence and a dual share structure since 2005.

The A shares are subject to 15% Dutch withholding tax on dividends and the B shares are exempt from this levy.

Having a single share class in Amsterdam, London and New York, with its primary listing in the UK, should make it easier for the company to use its own stock for acquisitions.

The next major catalyst comes in the form of fourth quarter and full year results which are scheduled to be released on 3 February. [TS]

Shell

Source: Refinitiv • Created with Datawrapper

WH Smith is the next big Covid recovery stock

The global retailer expects better trading conditions in the months ahead

Investors seeking a resilient retailer with exciting international recovery potential should buy shares in **WH Smith (SMWH)**.

Growth in the books, stationery and snacks seller's travel division was interrupted by the pandemic, but *Shares* believes WH Smith now stands a good chance of bouncing back as earnings recover.

Indeed, the World Health Organisation is optimistic we are entering a new phase of the pandemic, driven by the highly transmissible but less lethal Omicron variant, which offers 'plausible hope' for stabilisation, and a powerful tailwind for WH Smith's travel arm.

Berenberg says the retailer is 'a great business that generates excellent returns on capital' and should continue to replicate the strong returns delivered pre-pandemic in the future.

The broker forecasts a return to pre-tax profit to the tune of £65 million for the year to August 2022, ahead of £126 million in 2023 and £142 million in 2024, and it also believe dividends will resume next year at 37p which puts the stock on a forward yield of 2.2%.

Highlighting a well-positioned travel business, the broker describes WH Smith's opportunity in the US airports markets as 'huge' following the 2018 and 2019 acquisitions of InMotion and Marshall Retail respectively.

The company has recently won contracts to open new travel stores, and it has also expanded into selling medicines via a partnership with Well Pharmacy, the UK's third largest pharmacy chain.

In its latest trading update (19 Jan), WH Smith flagged an expected improvement in its travel business in the coming months and forecast better cash generation.

For the 20 weeks to 15 January 2022, WH Smith's total revenue was 85% of the same period two years earlier (before Covid struck), including 87% for the high street business, despite a negative footfall impact more recently from Omicron, and 83% for the travel arm.

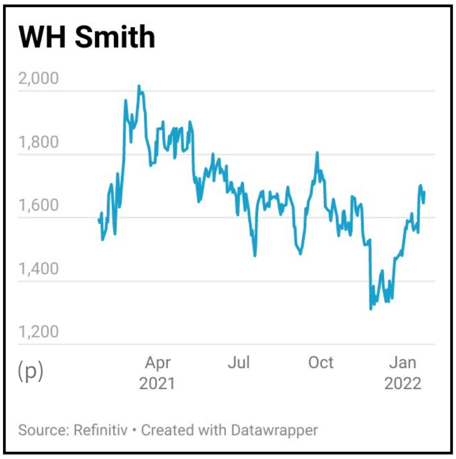
During the period, WH Smith's high street business performed well with online businesses funkypigeon.com, cultpens.com and whsmith.co.uk putting up strong showings too.

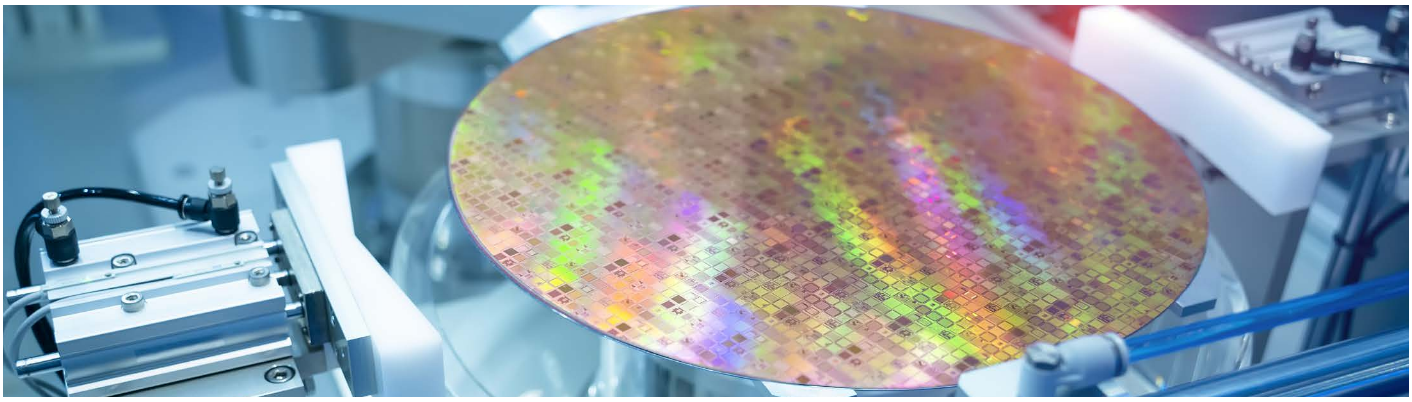
While it stressed WH Smith is a 'happy custodian', Berenberg said the retailer owns 'a hidden gem' in the fast-growing online gifting website Funky Pigeon, the UK number two after **Moonpig (MOON)**, which if it were to be sold, is already worth 'at least £200 million'.

It is also worth noting that WH Smith's largest shareholder with an 11.7% stake is activist investor Causeway Capital Management. Activists typically demand change in how businesses are run yet Causeway has so far remained silent on this front. [JC]

WH SMITH ↗ BUY
(SMWH) £16.86

Market cap: £2.2 billion





ASML

(ASML:AMS) €577.70

Gain to date: 118.3%

Original entry point:

Buy at €264.60, 23 April 2020

IT ISN'T OFTEN we recommend that readers continue to buy shares in a company when they have more than doubled but Dutch semiconductor equipment maker ASML isn't like other companies.

Recent weakness, linked to a wider market correction, has created a compelling buying opportunity.

The firm is the global leader in chip lithography machines, the kit that makes chips, and is the number one supplier to the world's largest chipmakers in the US and Asia such as Micron, Samsung Electronics and Taiwan Semiconductor.

Moore's Law, which says that the number of transistors on a silicon chip will double every two years, has driven the growth of computing power and therefore global economic growth for 30 years.

As the power of chips has grown, so their applications have expanded benefiting all kinds of industries. For example, the cost of generating solar energy has fallen by 20% every year for the last decade thanks to advances in chips, so the price per kilowatt-hour today is where a decade ago the International Energy Agency thought it would be in 50 to 100 years from now.

The current surge in demand for chips is largely due to what is known as 'edge computing', where data processing is done at or near the source of the data rather than at a remote centre.

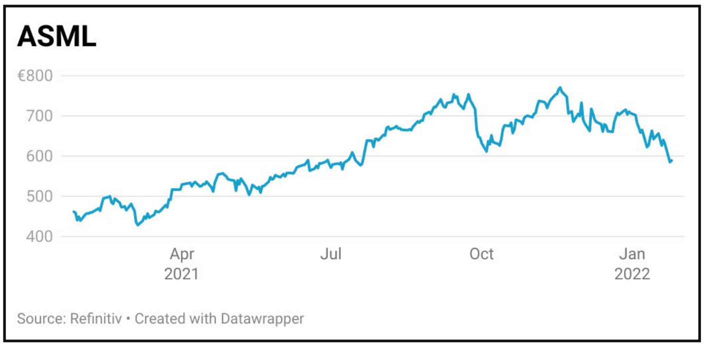
Managing traffic systems or an oil rig are prime examples of new 'edge' applications where data needs to be managed on-site and be available in real time.

ASML has been at the forefront of pushing chip-making technology forward for decades, and with its extreme ultraviolet or EUV machines the firm believes it has ensured at least another decade of progress in computing capacity, and its customers can't get enough of its equipment.

According to the company's latest update (19 Jan) it is already running at 100% of capacity and it still has orders for 50% more machines than it can make. This demand is not just for its state-of-the-art EUV machines but also for its deep ultraviolet or DUV machines which are based on 30 year-old technology.

In fact, customers are so desperate for its kit that they are asking the firm to ship it to their factories so that final testing and certification can be done in situ, which has never happened before.

Even after last year's exceptional 33% sales growth the firm expects them to grow 20% this year, meaning revenues will have doubled since 2019. That makes ASML a very rare and valuable company indeed.



SHARES SAYS: ↗

Long-term investors should keep buying. [IC]

HENRY BOOT
(BOOT) 283p

Gain to date: 0.7%

Original entry point:

Buy at 281p, 30 September 2021

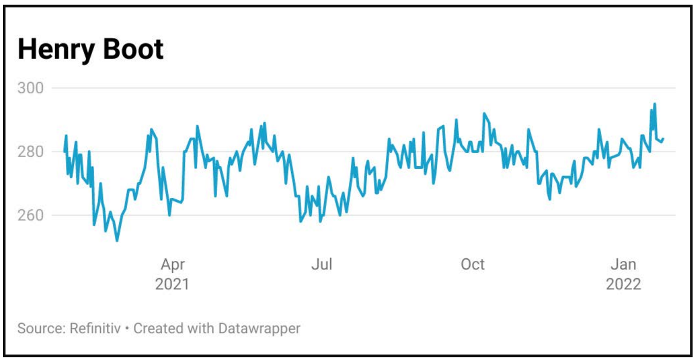
WHEN CONSTRUCTION group **Henry Boot (BOOT)** released its full year trading update on 18 January the shares popped to 300p in celebration, however since then markets have been clobbered.

What matters though is the fundamentals, and all three of the group's markets – industrial and logistics, residential, and urban development – continued to see strong trading.

Demand for logistics property shows no sign of slowing, while a buoyant housing market was positive for both Henry Boot-owned Stonebridge Homes and Hallam Land Management which performed 'materially' ahead of expectations thanks to demand for residential sites.

Management indicated that pre-tax profits for 2021 would be well ahead of the £30 million consensus, leading analysts to raise their forecasts by 10% for last year and this year.

Moreover, with just £40 million of net debt there is plenty of headroom to employ more capital to get to chief executive Tim Roberts' target of £60 million of profits.



SHARES SAYS:
The shares are trading broadly in line with the group's net book value, according to analysts at Numis, which given its record of double-digit returns on equity still seems cheap. Keep buying. [IC]

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THIS IS AN ADVERTORIAL

Finding value in the microverse

Downing Strategic MicroCap offers value investors a unique approach to UK small caps...

Imagine browsing through a property website and stumbling upon a four-bedroom house for sale in a fancy part of London at the bargain price of £100,000. Assuming everything was sound, it would be hard not to purchase the property. Whether you lived there or sold it on, you'd have found something priced a fraction of its true value, making it something of a no-brainer to buy.

Sadly for us, opportunities such as this rarely seem to pop up in life, especially in the property market. But according to the team at **Downing Strategic MicroCap (DSM)**, a very different state of affairs exists for those interested in the UK's smallest companies.

Trust managers Judith MacKenzie and Nick Hawthorn believe these firms offer more opportunity to find a bargain. Unlike the capital's property market, many London-listed small caps receive little attention from investors.

The Volex value play

A good example is Volex, DSM's largest holding, where the majority was purchased at 75p. The trust managers have realized value in the stock by selling down some of their position but believe there is still plenty of upside to be gained from it.

While they may yet be disappointed, the results from the investment so far are also a strong example of how DSM's value-based approach can pay off when things pan out. A similar story may be playing out with another of the DSM's major holdings, Real Good Food, which was one of the trust's first acquisitions back in 2017.

It's also been a slightly different investment to Volex. Firstly, DSM took on both equity and debt in the company. Perhaps more importantly, its stake in the business was such that it could take a directorship role in the company and use that to try and enact the change it wanted to see.

Having a say in the business

Part of that involved encouraging the company to sell of some off its subsidiaries and return cash to lenders and shareholders. The result has been a return on the trust's initial investment of 15%, and while things may not necessarily pan out, the potential is there for more gains to come.

Although it still has exposure to Real Good Food, DSM's investment in the company thus far shows another benefit of going down the market cap scale. Aside from being able to find good value, the smaller size of these businesses mean DSM can take larger stakes in them and have more say in how they're run.

That might mean, as in the case of Real Good Food, acting more like a private equity firm and engaging with management to realise existing assets. Alternatively, it could be persuading firms to make internal changes to their business efforts or personnel.

This may take a while...

Whether DSM takes a more active approach to its investments or leaves management to the managers of the company itself, one of the challenges facing the trust and its shareholders is the time it can take for both turnarounds to be implemented and investors to cotton on to a small cap success story. The investment in Real Good Food, for instance, took several years to materialize and is still ongoing.

The other problem is due to the lack of information available about small caps. Although this works in DSM's favour by creating more opportunities to find good value companies, it also means the rest of the market can take a long time to figure out that a company is worth investing in.

As this is the ultimate driver of share price growth, there can be a longer lag in time between a company proving itself and its share price increasing than there typically is further up the market cap scale.

This may be part of the reason DSM has tended to underperform its benchmark, the Numis Smaller Companies Index since launching. But it's also something the trust managers have been telling shareholders to expect from the start.

MacKenzie and her team have said repeatedly that investors should expect to see returns over a 5 – 7 year period. They've also predicted a hockey stick-like performance over time, in which a period of underperformance is followed by strong returns.

There is no guarantee their predictions will prove correct, but heading into 2022 there are some positive signs. The majority of the trust's underlying holdings have seen insiders buying shares and DSM's own management team has been investing in the trust itself, suggesting those who know most about the portfolio are confident enough to put their own money to work.

Click **here** to read our latest research on Downing Strategic MicroCap...

SURVIVING THE MARKET SELL-OFF

Why shares have fallen and what could happen next

By **Tom Sieber** Deputy Editor

It has been a tricky start to the year for investors. Some popular stocks and funds have fallen by more than 20% in less than a month, leaving portfolios battered and bruised.

At the time of writing (25 Jan), the technology-rich Nasdaq index in the US was down 12.5% so far in 2022. This compares with the MSCI World index which is down 6.9% and the FTSE 100 which has fallen 1.9%.

It is too early to say if the sell-off is over. Markets in the US initially slumped on 24 January but ended the day in positive territory. European markets pushed ahead the day after, but stocks in China, Hong Kong and Japan went in the opposite direction. Investors need to stay alert that further pain could be around the corner.

In this article we explain why markets are behaving this way, why there is no cause for panic, as well as reflecting on how, if at all, you should respond.

Major global markets: performance so far in 2022

Index	Loss/gain
Nasdaq (US)	−12.5%
S&P 500 (US)	−8.1%
Nikkei 225 (Japan)	−7.4%
Dax (Germany)	−5.6%
SSE Composite (China)	−5.5%
Cac-40 (France)	−5.0%
FTSE 100 (UK)	−1.9%
Hang Seng (Hong Kong)	4.2%

Table: Shares magazine.
Source: Google Finance, 25 January 2022 • Created with Datawrapper

A SHIFT IN THE MARKET

There are several factors behind the market jitters including geopolitical considerations as tensions build between Russia and Ukraine, as well as oil price volatility and the ongoing threat posed by Covid-19.

However, the central concern has been inflation and interest rates. A long-delayed tightening of monetary policy, accelerated by mounting inflationary pressures, is affecting how different stocks are valued and driving a shift in the market away from so-called growth stocks and into value.

This can be seen in microcosm in the performance of two US car stocks year-to-date. Electric vehicle company Rivian Automotive created a buzz at its November 2021 stock market debut and it briefly captured a $100 billion valuation.

However, Rivian has to date only manufactured a very small number of vehicles so buying the shares at such an elevated valuation meant making big assumptions about its future growth and ability to generate cash flow.

Ford, which owns an 11.3% stake in Rivian, can already point to a healthy stream of profit and cash generation and has its own electric vehicle ambitions. Year-to-date shares in Rivian are down 37.8% versus a 6.3% decline from Ford and this example helps capture the dynamics at work in the market.

The market has really gone off businesses that don't make money and which trade on sky-high valuations. Rivan is the loss-making growth play and Ford is the profitable value play.

THE INFLATION PAIN

Interest rates are being hiked because of inflation, which itself is usually accompanied by economic growth. In this environment investors don't have to pay a high price for the long-term potential offered by sectors like technology when they can get much cheaper growth today from industries like oil, mining and banking.

It is the dominance of these sectors in the FTSE 100 which helps explain why the UK's leading stock index hasn't fallen by as much as many other major indices globally this year.

To put it even more simply you don't have to pay up for 'jam tomorrow' when you can get

Selected top FTSE 350 performers year-to-date

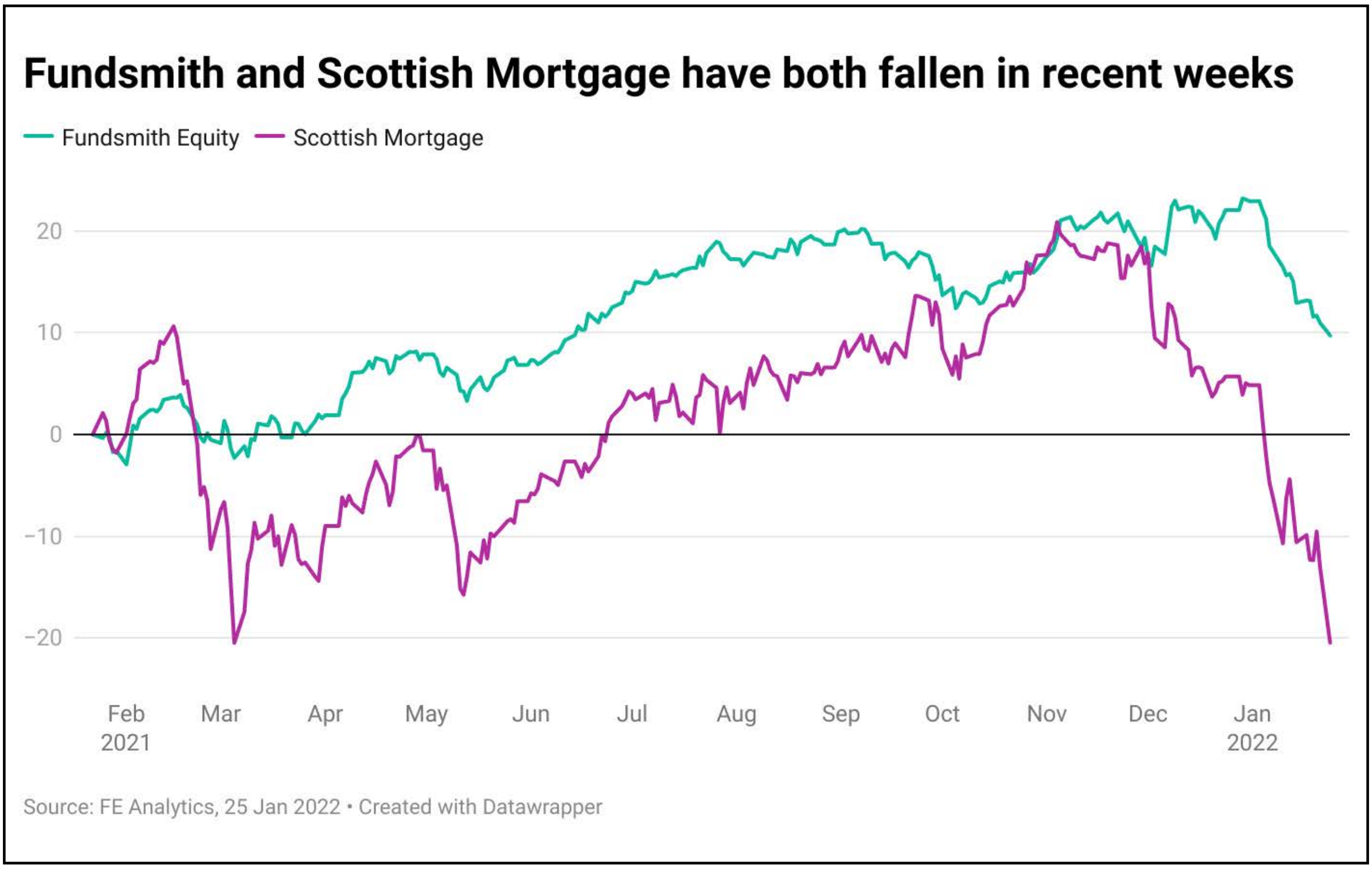
Company	Share price gain
British American Tobacco	15.7%
BP	13.9%
HSBC	13.4%
Shell	11.3%
Anglo American	9.0%

Table: Shares magazine.
Source: SharePad, 25 Jan 2022 • Created with Datawrapper

Selected worst FTSE 350 performers year-to-date

Company	Share price loss
Trustpilot	−39.2%
Oxford BioMedica	−28.5%
Auction Technology	−27.0%
Genus	−25.5%
Greggs	−24.2%

Table: Shares magazine.
Source: SharePad, 25 Jan 2022 • Created with Datawrapper



'jam today'.

The appeal of lower risk assets like cash and bonds are also boosted when rates are rising, meaning more speculative stocks can be out of favour as lower risk assets stand to deliver higher returns.

DISCOUNT RATES

There is a further technical reason why rising interest rates are bad for growth stocks. They impact the discount rate which is used to calculate what a cash flow in the future should be worth today.

The scenario now playing out is a direct reversal of the situation for the last decade or more, where rates have largely been either falling or flat.

The discount rate is based on the so-called risk-free rate, which is the yield available on government bonds (which typically goes up when interest rates are being hiked) and the extra return you expect from a riskier asset known as the risk premium.

Because this discount rate has an incremental impact over time, firms with a decent and reliable level of cash flow today are less affected by it than companies promising rapid growth and lots of cash flow in the future.

TOP FUNDS STRUGGLE

The diminished valuations of growth stocks can be used to explain why some popular and successful funds have struggled of late.

Previously vehicles like **Fundsmith Equity Fund (B41YBW7)** and **Scottish Mortgage (SMT)** benefited not just from the earnings growth delivered by the companies in their portfolio but also these shares being ascribed an increasingly higher multiple of earnings – in essence investors have been prepared to pay more to own these companies.

There is a risk that rising interest rates put the brakes on global growth and create conditions where corporate earnings fall and investors want to pay less for stocks, known as multiple contraction, which create two negative forces for a share price.

WHO HAS BEEN SWIMMING NAKED?

Fundsmith manager Terry Smith observed in his letter to investors at the beginning of January 2022: 'We find it difficult to outperform in particularly bullish periods where the market has a strong rise, as a rising tide floats all ships, including some which might otherwise have

remained stranded and that we would not wish to own.'

If, as Smith says, a 'rising tide floats all ships' then, to borrow another well-worn saying, when the tide goes out you discover who's been swimming naked. Or, put another way, which shares have been rising on little more than hype rather than anything of any substance.

Initially when there is a shift in the market, selling is often indiscriminate but that won't last forever. Not all growth stocks are created equal. There's a big difference between a company like Google-owner Alphabet which posted free cash flow of more than $18 billion in its latest quarterly update and a business such as Snapchat parent firm Snap which is still hunting for its first profit since its IPO in 2017.

Seema Shah, chief strategist at Principal Global Investors, notes: 'Investors have been rewarded by the "overweight tech" trade for the better part of the past decade. And while conditions for the sector are becoming trickier, strong companies with robust balance sheets and pricing power still have further to run. For the profitless ones, technically speaking, the period ahead may not be so pretty.'

This is reflected in the performance of a basket of unprofitable technology stocks created by investment bank Goldman Sachs whose performance has collapsed since the back end of 2021 after an extraordinary run. Cathie Wood's ARK Innovation ETF which tracks a collection of disruptive and innovative businesses, is also under severe pressure, down nearly 25% since the start of January.

A correction in these areas of the market was probably overdue and is quite a healthy development, though that offers little compensation if you are directly exposed to it.

Selected unprofitable US tech stocks year-to-date performance

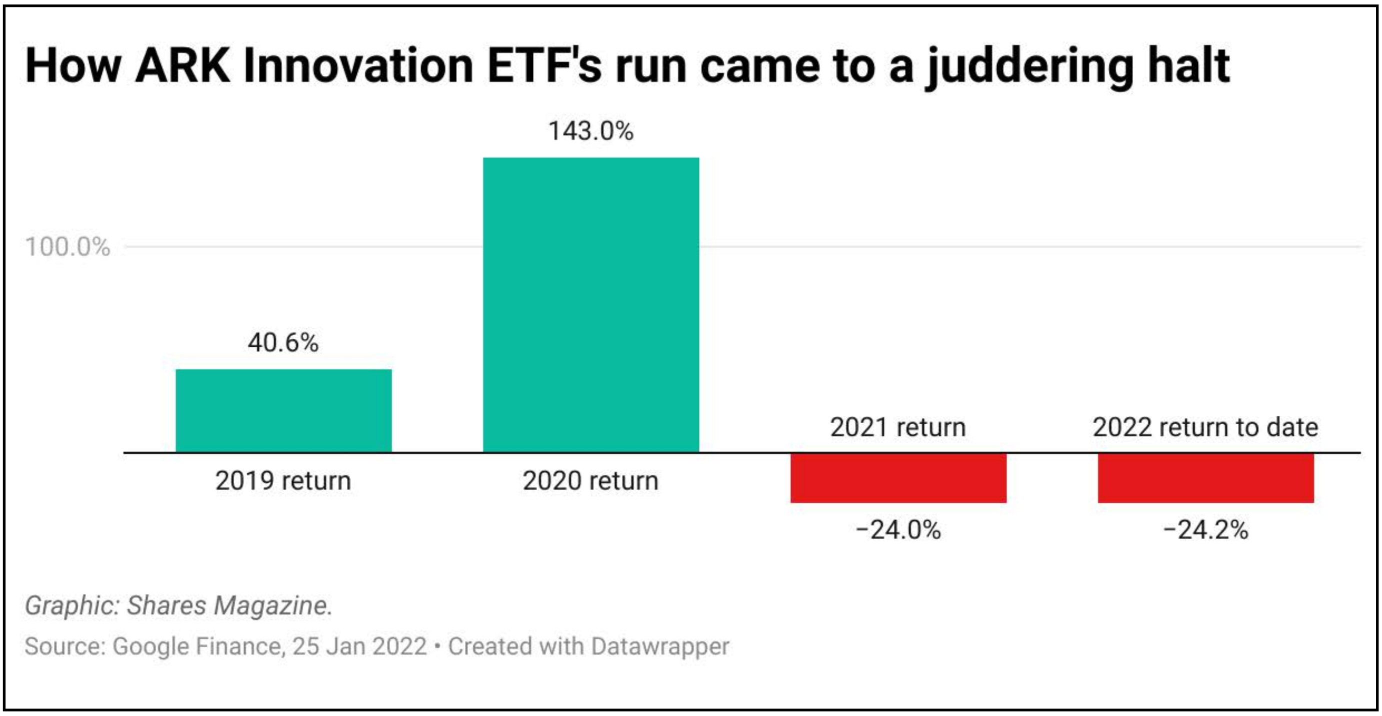
Company	Share price loss
Rivian	-38.4%
Snap	-32.4%
Peloton	-16.9%
Zoom	-16.8%
Tesla	-12.0%

Table: Shares magazine.
Source: SharePad, 25 Jan 2022 • Created with Datawrapper

BENEFITS OF A DIVERSE PORTFOLIO

The sell-off in stocks and shares, also known as equities, has acted as a reminder for investors to ensure they have a diverse portfolio. That means having a mixture of assets that hopefully don't all move in tandem.

While equity markets have been weak this year, having exposure to bonds, gold and property would have been beneficial. For example, year-to-date, **Allianz Strategic Bond Fund (B06T936)** which invests in basket of bonds is only down 0.5%, **iShares Physical Gold ETF (SGLN)** which tracks the gold price is up 1.3% and **BMO Commercial Property Trust (BCPT)** which has positions in various offices, shops and warehouses is up 10.8%.



WHAT YOU SHOULD DO NEXT

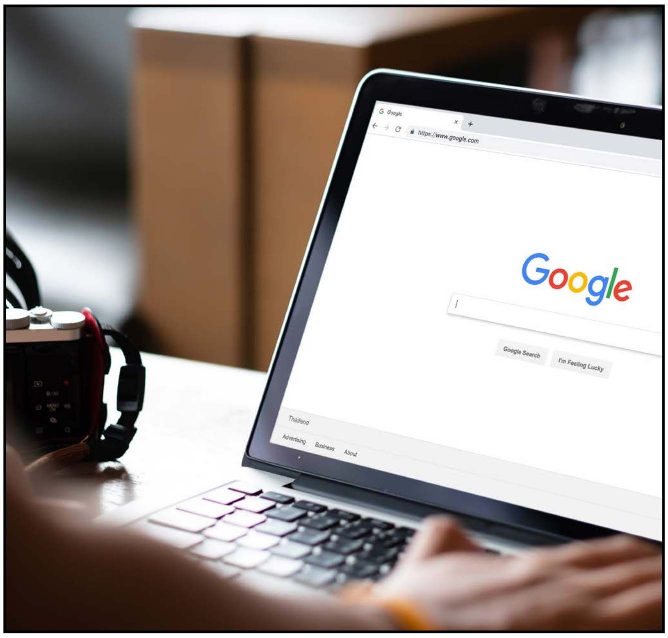
As an investor the best advice is not to over-react to short-term fluctuations in stocks and shares. However, it could be a good time to consider selling anything too speculative in your portfolio as sentiment towards this type of investment is unlikely to improve in the near term.

Any cash you can generate from these sales could then be used to take advantage of buying opportunities in quality shares caught up in the sell-off. We plan to look at some of these opportunities in an upcoming issue of *Shares*. Think hard about diversification in your portfolio and consider adding some bonds, gold and property if you don't already have any.

Otherwise, and assuming you can remain invested to give your portfolio time to recover, you should avoid selling any positions that have been weak in recent weeks. Markets have historically bounced back fast from sell offs, although there is no guarantee that will happen now.

Continue to drip feed money into the markets if that's what you are already doing. Given it is difficult to time the market effectively you are better off having 'time in the market' instead.

DISCLAIMER: Daniel Coatsworth who edited this article has a personal investment in Fundsmith Equity Fund



FAANGs year-to-date performance

Company	Share price loss
Netflix	−35.7%
Amazon	−13.3%
Alphabet (Google)	−9.9%
Apple	−9.0%
Meta Platforms (Facebook)	−8.2%

Table: Shares magazine.
Source: SharePad, 25 Jan 2022 • Created with Datawrapper

RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues

Why markets are worried about inflation

How investors might react as the Fed looks to hike rates

Well, that didn't take long. The US Federal Reserve began to pump less quantitative easing (QE) into the financial system in November and the stock market's wheels have already started to wobble after barely two months of less cheap money, let alone any move to withdraw it.

Investors can therefore be forgiven for starting to ask themselves how much the US Federal Reserve can do to tighten monetary policy before it either puts the brakes on the economy, breaks the stock market or both. In a worst case, the answer might be not very far at all.

TIGHTENING UP

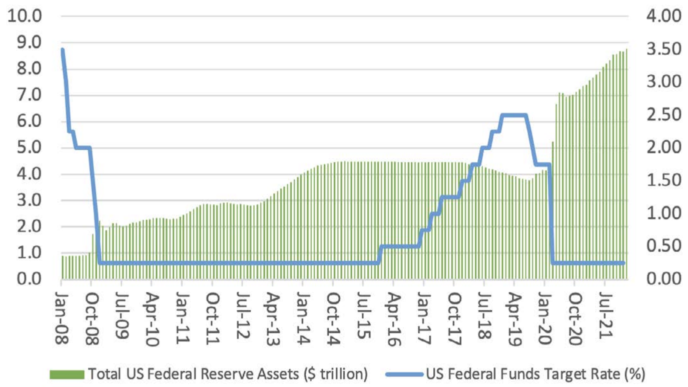
Recent precedents for tighter monetary policy (or even simply, less loose, less accommodative policy) are enough to give investors pause for thought:

- In 2013, financial markets rebelled at the very talk of tighter policy and the so-called 'taper tantrum' persuaded the Fed to back off.

- Between December 2015 and December 2018, under Janet Yellen and her successor and current incumbent Jerome Powell, the Fed raised rates from 0.25% to 2.50%.

- It also shrank its balance sheet by $700 billion, or some 17%, between 2017 and 2019. But it then stopped as the US economy began to slow, and signs of stress began to show in the US interbank funding markets in autumn 2019. As a result, the Fed's balance sheet had started to grow again several months before the pandemic prompted fresh interest rate cuts

The Fed's last two efforts to tighten policy did not get far



Source: FRED- St. Louis Federal Reserve database, US Federal Reserve

Tighter policy has four possible implications for company valuations and share prices:

- Higher interest rates may mean an economic slowdown, again because there is so much more debt in the system. As the old saying goes, economic upturns don't die of old age, they are murdered in their beds by the US Federal Reserve. In addition, consumers' ability to consume will be crimped if inflation outstrips wage growth and their incomes start to stagnate or fall in real terms.

- Higher rates reflect inflation, and faster (nominal) GDP means investors do not have to pay a premium for long-term future growth (for secular growth names like technology and biotechnology) when potentially faster, near-term cyclical growth ('value') can be bought for much lower multiples (even if it comes from oils, miners, banks).

- Inflation can eat away at corporate margins and profits. Right now, they stand both at

RUSS MOULD
AJ Bell Investment Director

pretty much record highs, as do valuations, at least in the US, based on ratios such as market cap-to-GDP and professor Robert Shiller's cyclically-adjusted price-to-earnings ratio. If earnings start falling, valuations could do so, too, if confidence wobbles. Instead of the double-whammy that helps super charge the upside, as investors pay higher multiples for higher earnings to give ever-higher share prices, markets see the opposite: earnings fall, investors pay lower multiples for lower earnings and share prices fall faster.

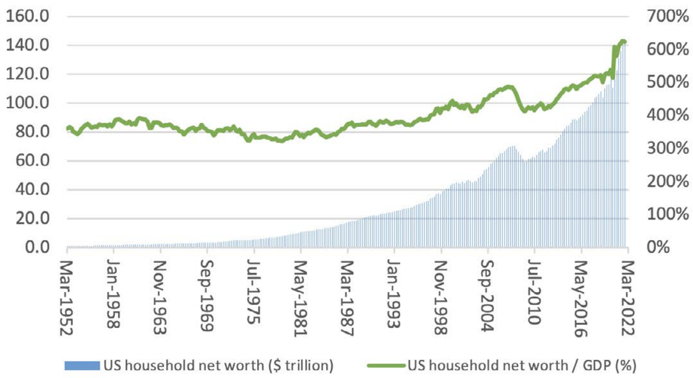
- Higher interest rates mean analysts and investors deploy an increased discount rate in their discounted cash flow models to calculate the net present value or NPV of future cash flows from long-term growth stocks. A higher discount rate means lower NPV. A lower NPV means a lower theoretical value of the stock and that means a lower share price.

All four are clearly worrying previously rampant financial markets but that in theory should not be the concern of the US Federal Reserve, or indeed any central bank. Their job is to keep inflation on the straight and narrow, to ensure it does not destroy wealth and prosperity and imbalance the economy.

But a decade and more of zero interest rates and QE – unintentionally or intentionally (judging by a string of speeches from former Fed chair Ben S. Bernanke dating back to at least 2003) – have persuaded or forced investors to take ever-increasing amounts of risk to get a return on their money.

Central banks are presumably concerned that having tried to create a wealth effect by stoking asset prices, the opposite effect could now kick in. US household wealth stands at a record high relative to GDP, thanks to booming stock and house prices. If that goes into reverse, the hit to confidence and consumers ability and willingness to consume could be considerable.

US household net worth stands at a record high as a percentage of GDP



Source: US Federal Reserve, FRED- St. Louis Federal Reserve database, M&G Bond Vigilantes

Central banks may therefore be stuck between a rock and a hard place. They will want to control inflation on one side. But their ability to jack up interest rates may be constrained by record debts and concerns about the economy, employment (and financial markets' stability) on the other. If forced to choose, this column reckons they will take their chances with inflation and even cut interest rates and resume QE if the going gets tough.

HISTORY LESSON

Investors will then have choices to make too.

If the low-growth, low-inflation, low-rates of the last decade is replaced by higher inflation, higher nominal growth and higher rates it would be logical to expect the outperformers of the last decade (long-duration assets, bonds, tech and growth equities) to struggle and the underperformers of the last decade (short-duration assets, commodities and cyclical, value equities) to have a chance of a return to favour.

A change in market leadership does not necessarily signify a collapse, even if it raises the stakes, but more volatility seems likely unless oil and gas prices start to retreat and cut central bankers, politicians and the public some slack.

Janus Henderson
INVESTORS

Why Style and Quality Matter

In a market environment characterised by uncertainty and record low yields, some investors have leaned towards riskier segments of the market. However, at what cost? This article looks at how investors have navigated the testing market in the hunt for yield and how the **Henderson Diversified Income Trust** *has stuck to its tried and tested investment approach to produce a consistent, stable, and sensible income for its shareholders.*

While 2021 was a breath of fresh air for equities, it was a challenging year for fixed income investors in general. Bonds underperformed equities as yields rose from near record levels, whilst equity markets were buoyed by optimism over a global economic recovery and strong performance - particularly from growth stocks. That being said, bonds still continue to play a crucial role in portfolios as they provide diversification and dampen volatility for those investors with exposure to equity markets.

DIVIDED RECOVERY

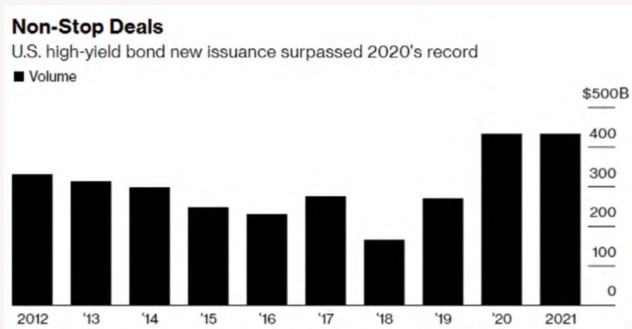
2021 provided a positive backdrop for risk assets – the rollout of coronavirus vaccines allowed economies to reopen, while fiscal and monetary stimulus boosted demand. However, as economies opened, supply struggled to cope with the supercharged recovery following the steep COVID-19 induced recession of 2020. As a result, bottlenecks emerged across supply chains, with shortages of inputs and labour weighing on the pace of recovery. Oil prices shot up and consumer prices have followed suit, with inflation reaching its highest level in decades across key markets. US inflation hit 6.8% YoY in November – a 40 year high[1] – while eurozone inflation soared to 4.9%, the highest reading since records began in 1997, two years before the euro was launched.[2]

Against the spectre of rising price levels, central banks have begun to rein in quantitative easing, and some are beginning to raise interest rates – posing a further challenge to fixed income investors: how to strike the right balance between capital preservation and income.

YIELD HUNGRY INVESTORS

Amidst such a backdrop, defensive fixed-income assets have lagged compared to riskier segments of the market[3]. For instance, despite rising towards the back end of the year, US government bonds ended 2021 down 2.3% - their worst year since 2013, while UK and eurozone government bonds returned -5.3% and -3.5%, respectively. Meanwhile, US high yield bonds returned 5.4%, while eurozone high yield bonds climbed 3.4% over the same period.[4]

Rather than sensibly searching for yield, some investors have been reaching for yield – scrambling to find higher yields, and often not paying due regard to the risks involved. In 2021, there were increased flows into higher yielding assets, including emerging market debt, high yield corporate bonds, private and alternative credit. Corporate debt issuers were also keen to take advantage of historically low borrowing costs before the US Federal Reserve began hiking interest rates. By early November, US high yield bond issuance had surpassed the record issuance of 2020, which itself exceeded the previous record set in 2012[5]. Although much of this was driven by the refinancing of existing debt.



Source: Bloomberg as at 09/11/2021

[1] Source: Source: BBC news, 10/12/2021 - US inflation hits its highest level in 40 years
[2] Source: The Guardian, 1/12/2021 - Inflation in eurozone soars to 4.9% - highest since euro was introduced

Janus Henderson INVESTORS

STYLE AND QUALITY MATTER

The Henderson Diversified Income Trust, managed by John Pattullo and Jenna Barnard, seeks to provide shareholders with a high level of income while preserving capital growth over the long term by investing in a diversified portfolio of global fixed income and floating-rate assets. The team can invest in high yield corporate bonds, investment grade corporate bonds, government bonds and secured loans, with no limits on the underlying percentages held in each. Although high yield bonds currently account for nearly 60% of its holdings, John, and Jenna focus on selecting high-quality bonds within the segment. Investment grade corporate bonds represent the next highest allocation within the portfolio, at 30%.

The Trust has a long-term track record of delivering a consistent and "sensible income" underpinned by the teams clear and disciplined investment approach. John and Jenna liken their investment approach to that of a growth manager with the equity space. As such, they invest in companies with sustainable yields, with a bias towards the sweet spot of BB and BBB-rated bonds. Historically, bonds of this quality have tended to produce the best risk-adjusted returns. So it is no surprise that the portfolio consists of large, high quality, less cyclical modern-day businesses with sustainable revenues. Some examples include exciting and innovative companies such as cloud computing firm Rackspace Technology, cybersecurity company Crowdstrike and financial services and digital business Square.

Their approach contrasts that of most bond managers, who are more akin to value managers. Value managers focus on the yield on offer, but often yields are higher whilst underlying valuations are depressed for fundamental reasons. For instance, managers with a value bias tend to favour companies with old business models heavily dependent on traditional economic activity; small British analog businesses such as food manufacturer Premier Foods and restaurant operator Pizza Express come to mind. In tough times, companies such as these - struggling against structural headwinds - may not mean revert, with their underlying revenues failing to recover to historical averages. Instead, such businesses may simply go bust, as has occurred with Pizza Express in the past.

The Trust is similarly less likely to invest in the old economy, such as big oil majors, whose fortunes are tied to volatile energy prices. Instead, the team focuses on structural winners, preferring companies like Netflix over physical cinema operators and digital businesses/data centres over physical shopping centres. Even before the pandemic, shopping centres were facing many challenges: the rise of ecommerce, shrinking foot traffic and changing consumer preferences have threatened the traditional way of shopping for decades. Covid-19 accelerated these trends and created a more digital centric consumer who expects frictionless transactions, personalized experienced, and elevated conveniences.

The teams' sensible income philosophy also means that they prefer to invest in stable businesses with a yield of 4%, for example, compared with the 6% yields typically targeted by those interested in the more risky, cyclical issuers. The higher yields from this group are much less likely to be sustainable over the long term and naturally carry a greater risk of capital loss. However, by investing in stable businesses, there is less volatility within the portfolio, resulting in a smoother ride in the rough times and sustainable income over the longer term.

STAY THE COURSE

With the market outlook remaining uncertain and challenging; a stable, and consistent income is more important than ever for many investors. Interest rates look set to rise as central banks attempt to quell inflation, while Covid-19 variants will continue to create bouts of volatility, particularly in equity markets. Therefore, those looking to achieve sensible, long-term returns from their fixed income allocation should ensure that it is well diversified and consists of good quality companies with stable yields - all be it with a reasonable amount of debt on their balance sheets. In an uncertain world - quality matters. And the Henderson Diversified Income Trust will stick to its tried and test investment approach: investing in larger, less cyclical modern facing businesses which have sustainable revenues to produce a sensible and consistent income for its shareholders.

[3] Source: Morningstar as at 03/01/2022

[4] Source: Bloomberg as at 01/01/20221. All indices are Bloomberg Barclays benchmark government indices. All indices are total return in local currency

[5] Source: U.S. Junk Bonds Set $432 Billion Record in Rush to Beat Rates: U.S. Junk Bonds Sales Set Annual Record With $432 Billion in 2021 - Bloomberg

Janus Henderson INVESTORS

GLOSSARY TERMS

Bear market
A financial market in which the prices of securities are falling. A generally accepted definition is a fall of 20% or more in an index over at least a two-month period.

Cyclical stock - A cyclical stock is a stock that's price is affected by macroeconomic or systematic changes in the overall economy. Cyclical stocks are known for following the cycles of an economy through expansion, peak, recession, and recovery. Most cyclical stocks involve companies that sell consumer discretionary items that consumers buy more during a booming economy but spend less on during a recession.

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

Growth stock - Shares of a company which generally show above-average earnings and that are expected to grow at a rate significantly above the average growth for the market.

Inflation - The rate at which the prices of goods and services are rising in an economy. The CPI and RPI are two common measures.

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

Quantitative easing - An unconventional monetary policy used by central banks to stimulate the economy by boosting the amount of overall money in the banking system.

Value stock - Shares of a company that appear to trade at a lower price relative to the company's fundamentals, such as dividends, earnings, or sales.

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

SCOTTISH MORTGAGE SHARE PRICE DOWN 33%

BUY MORE OR SELL OUT?

By **Ian Conway**
Companies Editor

It's no exaggeration to say **Scottish Mortgage (SMT)**, managed by the team at Baillie Gifford, is the UK's favourite investment trust. With assets under management of nearly £21 billion as of the end of December it dwarfs the next-biggest trusts, and its long-term performance record is unbeatable.

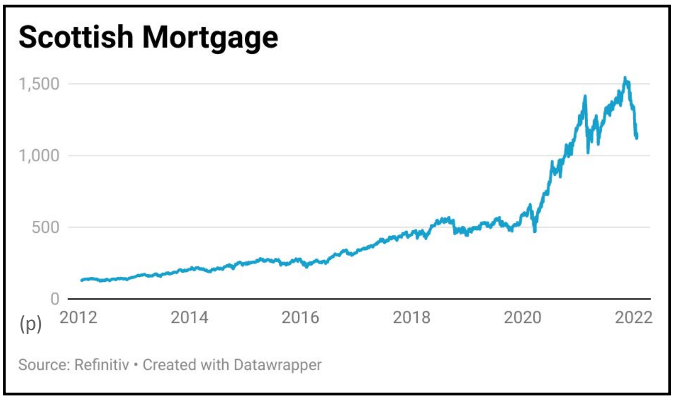
Over five years to December 2021, net asset value per share with debt at fair value increased by 333% against an 82% total return for the FTSE All-World index in sterling. Over 10 years, the increase was 1,007% against 271% for the index.

So, why have the shares performed so badly since the interim results on 17 November and what course of action should investors take after a 33% fall in the value of their investment since the peak last year?

THE RISK-FREE RATE

It is important to look at the US 10-year Treasury (government) bond for global markets and in particular the yield it offers investors.

For most investment firms, the US 10-year government bond is considered the only true

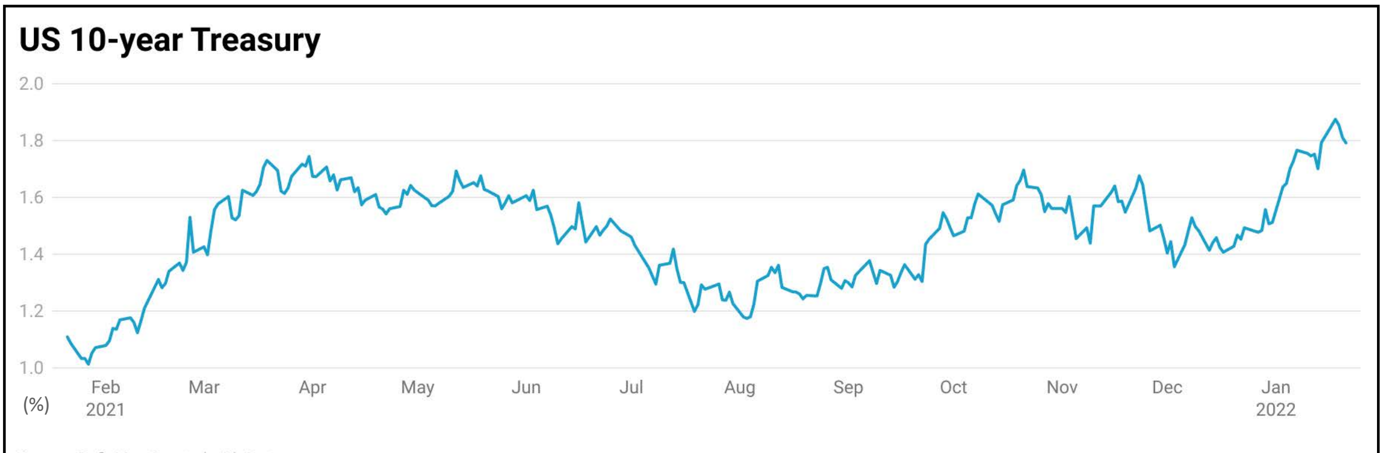


'risk-free' asset which all other investments are measured against.

Given stocks are by their nature riskier than US government bonds, they have to offer a higher return than the 'risk-free' rate on Treasuries. This doesn't just apply to Scottish Mortgage; it applies to all stocks.

The higher the perceived risk associated with an asset class, the higher the return investors will demand. For example, emerging market equities are seen as riskier than developed market equities so they should offer a higher return, which typically means a lower price to earnings multiple.

Technology stocks, especially those which must invest heavily in their business to generate growth, meaning profits are still years away, should in theory offer a higher return than boring plain-vanilla stocks as they are riskier.



Source: Refinitiv • Created with Datawrapper

The problem is that during the pandemic investors have chased growth stocks up, and especially profitless technology stocks, so their returns no longer look attractive compared with Treasury bonds.

If we then factor in a rise in the 'risk-free' rate from below 1.4% to nearly 1.9% in a matter of weeks over Christmas and the New Year as investors anticipate rising rates at the central bank, the Federal Reserve, then riskier assets begin to look even less attractive.

Given its reputation as a big investor in technology stocks where profits, in many cases, are still some way off, it's hardly surprising that Scottish Mortgage has seen its share price fall although the scale of the sell-off is surprising.

TECHNOLOGY EXPOSURE

While technology stocks were 'collateral damage' during the recent spike in Treasury bond yields, it's important to bear in mind that 'not all tech is created equal,' says Seema Shah, chief strategist at Principal Global Investors.

Profitless firms such as those represented by the Goldman Sachs Non-Profitable Technology Index are particularly vulnerable to rising rates as they derive almost all their present value from

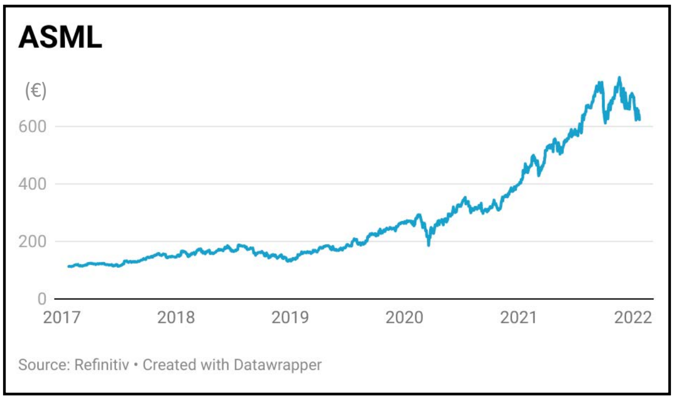
SCOTTISH MORTGAGE TOP 10 HOLDINGS

(DEC 2021)

Stock	Business	Weighting
Moderna	Healthcare	8.1%
ASML	Semiconductors	6.0%
Illumina	Healthcare	5.5%
Tesla	Electric Vehicles	5.1%
Tencent	Internet Services	4.1%
Nvidia	Semiconductors	3.0%
Meituan	Internet Services	2.7%
Delivery Hero	Food Delivery	2.6%
NIO	Electric Vehicles	2.5%
Kering	Luxury Goods	2.4%
Total		42.0%

Table: Shares magazine • Source: Baillie Gifford • Created with Datawrapper

DUTCH FIRM ASML IS THE WORLD'S LEADING MANUFACTURER OF MACHINES USED TO MAKE SEMICONDUCTORS



future cash flows.

In contrast, 'mega-cap technology firms which generate huge cash flows, have strong balance sheets, exhibit strong pricing power and offer impressive earnings delivery, are far more resilient,' argues Shah.

If we look at the top 10 holdings in the Scottish Mortgage portfolio, which at the end of December accounted for 42% of the total assets, six of the 10 stocks can be classified as technology.

The largest, Dutch firm ASML, is the world's leading manufacturer of machines used to make semiconductors with a strong record of profitable growth. Whereas making chip equipment may have been a cyclical business in the past, the industry is going through the biggest structural growth phase in its history.

Lead times for chips are up to 25 weeks compared with 10 to 15 weeks on average over the last five years, and according to ASML's chief executive Peter Wennink the firm is running at 100% capacity, yet demand is still 50% above what it can deliver.

Scottish Mortgage also has a big position in US chip maker Nvidia which makes the gold standard processors that have become essential for cloud service providers Amazon, Alphabet and Microsoft in running apps and processes.

According to Stephen Yiu, manager of the **Blue Whale Growth Fund (BD6PG78)** which also includes the stock in its top 10 holdings,

SCOTTISH MORTGAGE TOP 10 UNLISTED HOLDINGS

(SEPT 2021)

Stock	Business	Weighting
ByteDance	Internet Services	1.8%
Northvolt	EV Batteries	1.8%
Stripe	Online Payments	1.3%
Space Exploration Tech Corp	Space Technology	1.2%
You & Mr Jones	Digital Advertising	1.2%
Tempus Labs	Diagnostics	1.1%
Ant International	Internet Services	0.9%
Zipline International	Drones	0.7%
Epic Games	Gaming Platform	0.7%
The Production Board	Food Technology	0.5%
Total		11.2%

Table: Shares magazine • Source: Baillie Gifford • Created with Datawrapper

Nvidia 'lies at the confluence of three major secular trends over the next decade – artificial intelligence, augmented reality and 5G', which could drive profitable growth for years to come.

Famously, Scottish Mortgage was also an early backer of electric vehicle maker Tesla, and although it has pared its stake the investment trust still has a sizeable holding in the company's shares.

For all the hubbub around the stock, Tesla posted record sales and earnings in the third quarter of 2021 as global demand for electric vehicles enters what the firm believes is a structural shift to higher growth.

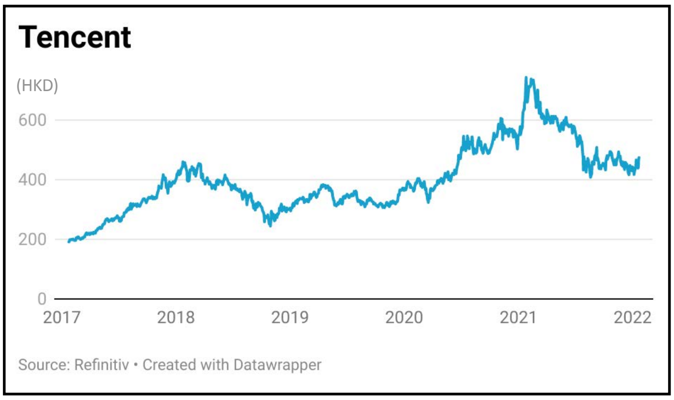
CHINESE EXPOSURE

Another concern investors may have around Scottish Mortgage is its exposure to Chinese stocks, which for the most part have lagged developed market equities over the last year for a variety of reasons.

There are three Chinese stocks in its top 10 holdings, accounting for 9.3% of the portfolio, covering sectors such as technology, social media, electric vehicles and e-commerce.

The largest holding is Tencent, the hugely successful and highly profitable internet services and gaming company, whose share price was last year hit by regulatory pressures on the business.

While its shares lost 20% in 2021, the company



itself continued to rack up increases in sales and operating profits as it adapted to the new regime and invested in new growth initiatives, and this month it was ranked the most valuable company in China.

Scottish Mortgage fund managers James Anderson and Tom Slater say they are assessing the long-term implications of China's new regulatory approach for their holdings, but they are still confident of their growth potential.

FOCUS ON HEALTHCARE

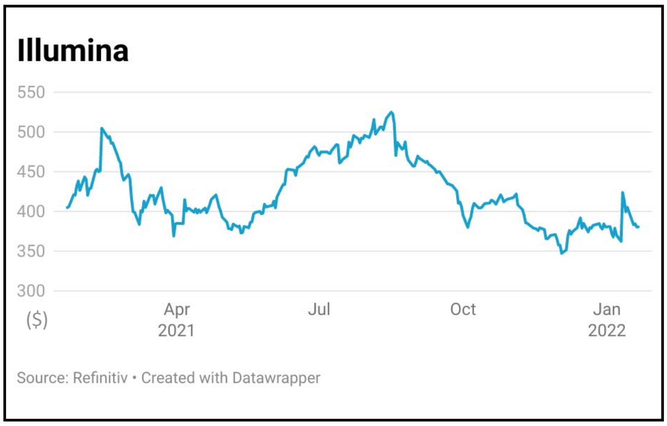
What many investors may have overlooked is Scottish Mortgage's ability, despite its size, to shift its focus as and when it finds more attractive growth areas.

A prime example is the healthcare sector, which a year ago accounted for just 12% of the fund but is now the biggest exposure at 21% of the portfolio.

Part of the increase is down to the stellar performance of some of its holdings during the pandemic, while part is due to the managers' appreciation of the intersection between medicine and technology.

The fund's two biggest healthcare holdings, in US firms Moderna and Illumina, accounted for 13.6% of net asset value at the end of December, but the managers are still enthused about their growth potential.

SCOTTISH MORTGAGE'S TWO BIGGEST HEALTHCARE HOLDINGS, IN US FIRMS MODERNA AND ILLUMINA, ACCOUNTED FOR 13.6% OF ITS NET ASSET VALUE AT THE END OF DECEMBER



Between them, Illumina and Moderna took just four days to crack the codes to Covid. Illumina took two days to sequence the novel coronavirus, with Moderna taking an additional two days to translate that sequencing into an mRNA molecule which is the basis of its vaccine.

'It is sometimes crudely assumed that Scottish Mortgage invests in technology companies, but that misses the point here, as it does with our other holdings,' say the managers.

'What we're interested in is where technology is applied to enable new ways of doing things and, by doing so, creates new business models in industries – such as healthcare – which perhaps haven't yet seen that transformational pace of progress.

'It's not just about the technology, it's that in combination with the right people driving it: it takes revolutionary thinkers with an innovative mindset to see their vision through and make this progress happen. That's what excites us about Moderna and Illumina.'

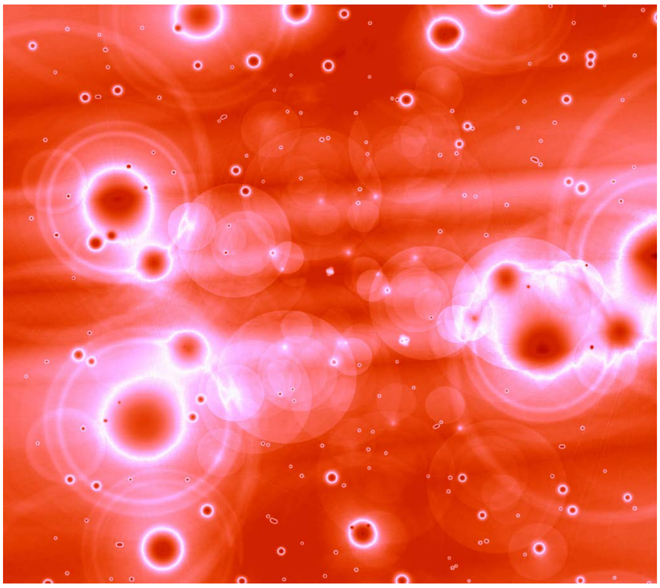
Both companies have already proved to be fruitful investments, and we note both recently raised their 2022 guidance, despite which their shares have lost ground in recent months.

Whether or not the managers add to their holdings, investors who take the opportunity provided by the sell-off to buy Scottish Mortgage shares are therefore getting exposure to both stocks at unusually low valuations.

EARLY-STAGE INVESTMENTS

While the fund can invest up to 30% of its assets in unlisted (also known as unquoted) companies, for the last two years or more that proportion has been around 20% and as of December it was 21.3%, although numerically unquoted businesses make up almost half of its holdings.

The advantage of owning shares in companies before they come to the market will be clear to long-term holders of Scottish Mortgage given its success down the years with companies like Alibaba, which has returned more than 800% on the initial investment, and Ginkgo Bioworks, which has returned more than 1,900%, not to mention Tesla.



However, it isn't unreasonable for newer investors to worry about the lack of visibility in unlisted holdings and we understand the concerns over the potential for valuations to suffer if the risk-free rate rises.

According to analysts at investment bank Stifel, valuations for around a third of the unlisted holdings are updated each month, which means the whole unquoted portfolio is revalued every quarter.

Just under half of the unquoted holdings are valued either on recent deal multiples or expected multiples where deals have been announced.

Moreover, there is no question of the managers going 'off-piste' with their unquoted holdings in terms of stock or sector selection. Each company is subjected to the same rigorous analysis, with the result that, unsurprisingly, the vast majority are in the same areas as the quoted holdings, namely technology, internet services, software, gaming, electric vehicles and healthcare.

For those that still have concerns about the fund's exposure to unlisted companies, a simple calculation may help put things in perspective. At the end of December, the top four quoted holdings, i.e those in companies which are already listed on a stock market, accounted for 24.7% of net asset value, more than the entire weighting of the 49 unquoted holdings.

ACTIVE SHARE

The managers are unapologetic about their investment approach, rightly so in our view. The team seeks out genuine outliers – superior, scaleable, long-term growth companies, both quoted and unquoted, with the potential to generate a return many times the size of their investment.

The managers say they 'think in terms of owning companies rather than renting shares and are first and foremost stock pickers, selecting investments based on an individual company's fundamental characteristics'. That inevitably means the portfolio deviates hugely from its benchmark.

This gap, known as the 'active share', is typically above 90% meaning the fund has less than a 10% correlation with the index. That means there are periods when it will underperform the index by a big margin, but as the managers say it is wrong to measure returns on a six-month or even a one-year basis as they are investing with a longer time horizon.

The managers believe 'it is only over periods of five years or longer that durable competitive advantages and managerial excellence within companies are truly reflected in returns'.

WHAT SHOULD INVESTORS DO?

We've assumed throughout the article that readers are either current holders of Scottish Mortgage or potential buyers and are therefore wondering whether they should own the shares or not.

Our view is they should, and if they have scope – in other words as long as they own the fund for the long term as part of a diversified portfolio – they should actually add to their holdings now.

It's rare for a fund of this calibre to suffer a 25% drawdown, especially in such a short space of time and when the managers haven't put a foot wrong.

Like the managers, we don't claim to have any special skill in timing markets, so rather than go all-in we would suggest setting up a regular monthly investment to feed money in and take advantage of the sell-off.

Considering the managers' exceptional track record, it's worth noting the fund's fees are among the lowest in the investment trust sector with an ongoing charge of 0.34% of assets, which for us makes it even more appealing as a long-term holding.

DISCLAIMER: The author (Ian Conway) owns shares in Scottish Mortgage Investment Trust

Nutshell was beating Fundsmith until both were hit by market sell-off

Global growth funds in general have struggled so far in 2022

A little-known global equity fund called **Nutshell Growth (BLP46Q1)** last year gave **Fundsmith Equity Fund (B41YBW7)**, one the most popular investments among UK retail investors, a good run for its money in terms of performance.

Between 1 January and 15 December 2021, Nutshell returned 27.9% versus 20.1% from Fundsmith, according to FE Fundinfo data. It also beat another widely held global fund, **Blue Whale Growth Fund (BD6PG78)** which returned 18.4% over the same timeframe, and **Lindsell Train Global Equity (B644PG0)** which essentially made no money at all for investors in the period.

Unfortunately, in the past month or so global equity funds have faced a major headwind in the form of inflation and expectations for rising interest rates, which has caused damage to investors' portfolios. All the funds named above have suffered from falling asset values.

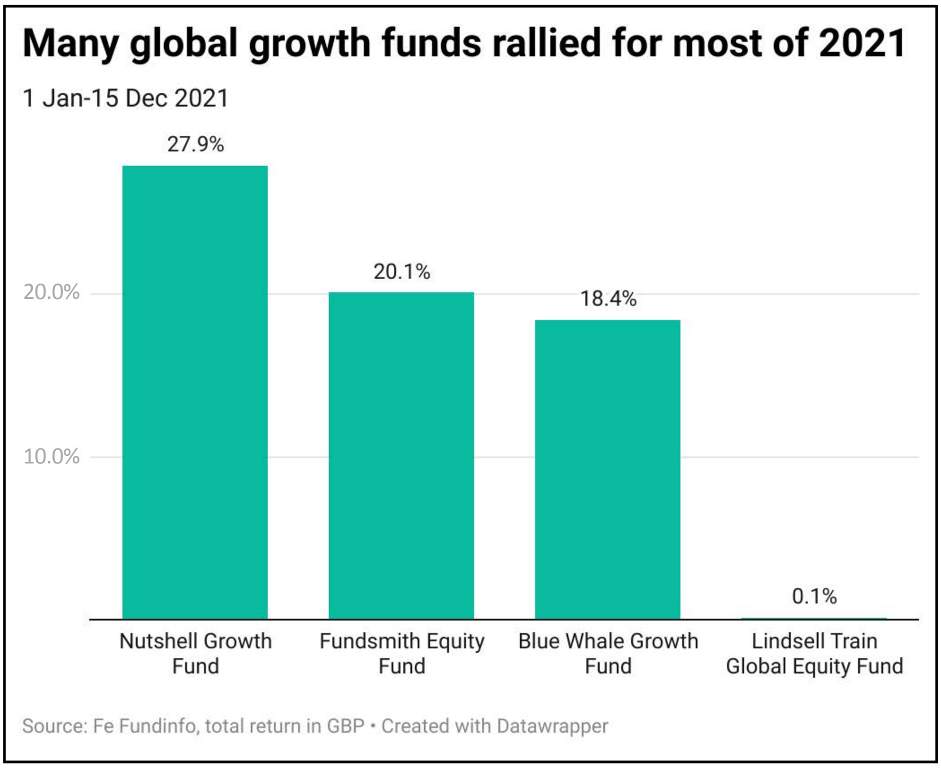
IMPACT OF RISING RATES

Many global equity funds hold stocks that trade on premium ratings because of the potential for these companies to deliver large profit growth in the future.

Higher interest rates mean analysts and investors deploy an increased discount rate in their models to calculate the net present value of future cash flows from long-term growth stocks. A higher discount rate means lower net present value, and that in turn means a lower theoretical value of the equity and therefore a lower share price.

Blue Whale, for example, has various stocks in its portfolio which trade on price to earnings multiples of around 50 times including laboratory equipment supplier Sartorius whose share price has fallen by 16% in the past month. The fund itself has declined by 10% in value since mid-December.

What's interesting is how Nutshell and Fundsmith have also fallen by roughly 8% to 10% over the same time period despite both saying they would never pay a top price to own a stock. Fundsmith's motto even includes the line 'don't overpay'.

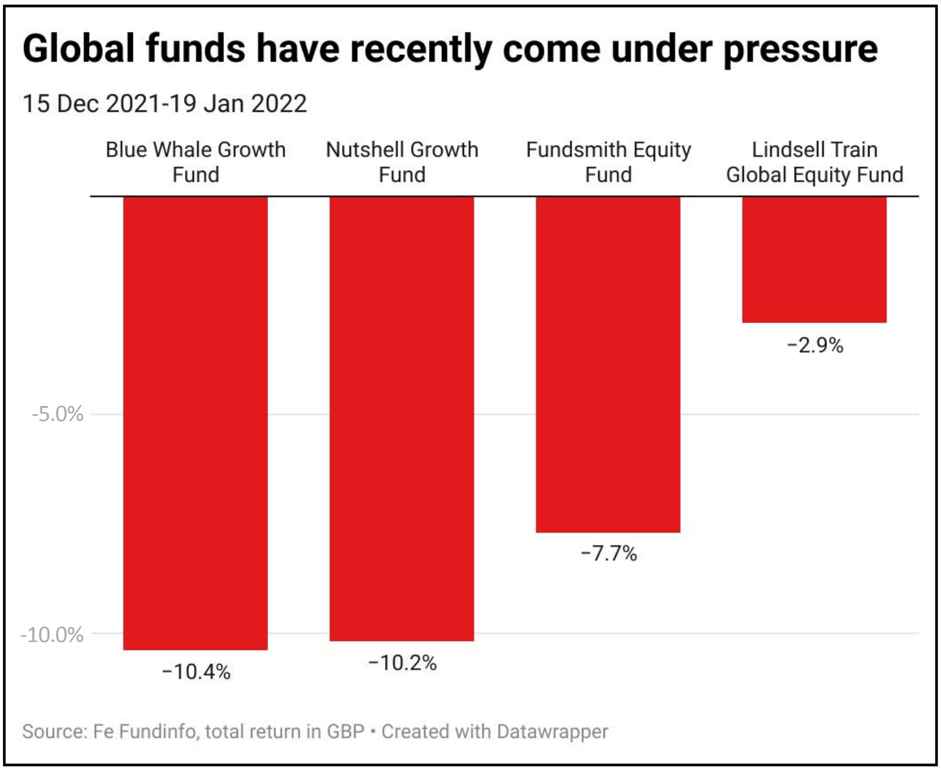


PE COMPARISONS

Fundsmith's key holdings include PayPal which trades on 33 times forecast earnings for 2022 – while less than some of the ratings seen inside the Blue Whale Portfolio, it is still quite a high level compared to the sub-10 price to earnings ratios to be found among the value stocks that are enjoying a renaissance.

Fund manager Terry Smith would probably argue that PayPal is a better-quality business than the oil, financial and tobacco stocks in the value category and which are among the top share price performers year to date.

However, the market seems to be selling down higher rated stocks indiscriminately, so anything remotely tech-related is getting hurt, whether it makes profits today or not for years to come. This might explain why Fundsmith and Nutshell have fallen in value along with their peer group.



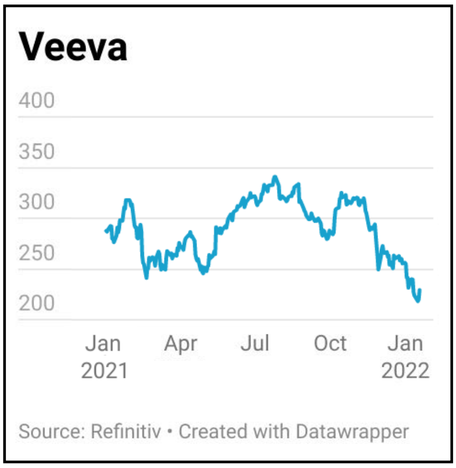
'BETTER VALUE'

Nutshell's chief executive and chief investment officer Mark Ellis told *Shares* in November 2021 that Nutshell Growth Fund's portfolio was better value than its global equity fund peer group.

'The path to zero rates made some earnings yields look attractive and price to earnings multiples have exploded for some companies,' he says. The direction for interest rates is now upwards and so the market is looking differently at a lot of stocks that were once considered invincible.

'Some of our peers are holding stocks on a PE multiple of 70, 80, 90, over 100 when historically these companies have been on more like 25 to 30-times,' comments Ellis. 'We bake that mean reversion of PE over the next 10 years into our numbers for the expected rate of return. We have a better edge on finding quality and not overpaying for it.'

Despite these comments, *Shares* notes that Nutshell's portfolio includes such names as Veeva Systems which trades on a high PE multiple of 54.7 times forward earnings. In its defence, the portfolio also features Regeneron Pharmaceuticals which trades on a mere 12.8 times earnings, and biotechnology group Amgen which is on 13-times.



TRADING IN AND OUT

Launched in May 2020, Nutshell Growth Fund is run differently to many other global funds as there is a lot of buying and selling going on. It certainly doesn't fall under the category of 'buy and hold' which one might associate with the likes of Fundsmith whose motto also includes the phrase 'do nothing' – the opposite of Nutshell.

Ellis says he recalibrates the portfolio twice a month based on various factors including valuation and momentum which are used to produce scores on stocks. 'All traditional managers buy and hold. They aren't catching the extra juice that comes with a really disciplined rebalancing technique like ours,' he adds.

'One of the dilemmas for a

GLOBAL GROWTH FUNDS: TOP HOLDINGS

FUNDSMITH	BLUE WHALE	NUTSHELL	LINDSELL TRAIN GLOBAL
Microsoft	Adobe	Adobe	Diageo
IDEXX	Alphabet	Alphabet	Heineken
Novo Nordisk	ASML	Amgen	London Stock Exchange
L'Oreal	Atlassian	Games Workshop	Unilever
Estee Lauder	Intuit	Lam Research	Nintendo
Paypal	Mastercard	Meta Platforms	PepsiCo
Meta Platforms	Microsoft	Microsoft	RELX
Intuit	Nvidia	Novo Nordisk	Mondelez
Philip Morris	Sartorius	Regeneron	Walt Disney
Stryker	Veeva	Veeva	Intuit

Table: Shares magazine • Source: Company websites, 21 Jan 2022 • Created with Datawrapper

lot of our peers is that they do a lot of work finding the rare exceptional company they really like, then they buy and hold forever. They don't know when to sell. We have this automatic valuation element to our portfolio construction that just trims around the edges.'

For example, in 2021 Nutshell had a position in the US listed version of Domino's Pizza when billionaire investor Bill Ackman took a stake through his Pershing Square vehicle and the share price jumped.

'As Domino's rallied, the free cash flow yield dropped, the PE ratio increased, a lot of the valuation metrics we look at changed and the score for those factors dropped, therefore the score of the stock dropped.

'We trimmed it on valuation factors becoming richer. When the froth came out of the stock, and it reported stronger earnings, we added back to that position.'

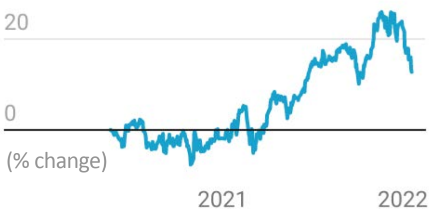
Despite this constant tinkering at the edges, Ellis argues that Nutshell's cost of trading in and out of stocks is low.

CAPITAL PRESERVATION ANGLE

Many investors might be asking if Fundsmith's recent valuation decline has gone too far. The same question could also be posed for Nutshell, particularly as it pursues an element of capital preservation in its portfolio.

As well as looking at growth prospects and valuation, the fund's research also looks at how a stock has performed historically on bad days in the market and during recessionary periods. 'We want stocks which participate less on down days and participate more on up days,' says Ellis.

Nutshell since launch in May 2020



Source: FE Fundinfo • Created with Datawrapper

Nutshell is unproven in the eyes of most investors, given it has been running for less than three years, and the current sell-off has certainly derailed its momentum. Nevertheless, this tougher backdrop is a good test for its investment process. A successful recovery could help convince more people that its fund is worth backing. [DC]

DISCLAIMER: The author (Daniel Coatsworth) has a personal investment in Fundsmith Equity Fund

By **Daniel Coatsworth**
Editor

BRIC power rankings over the last decade

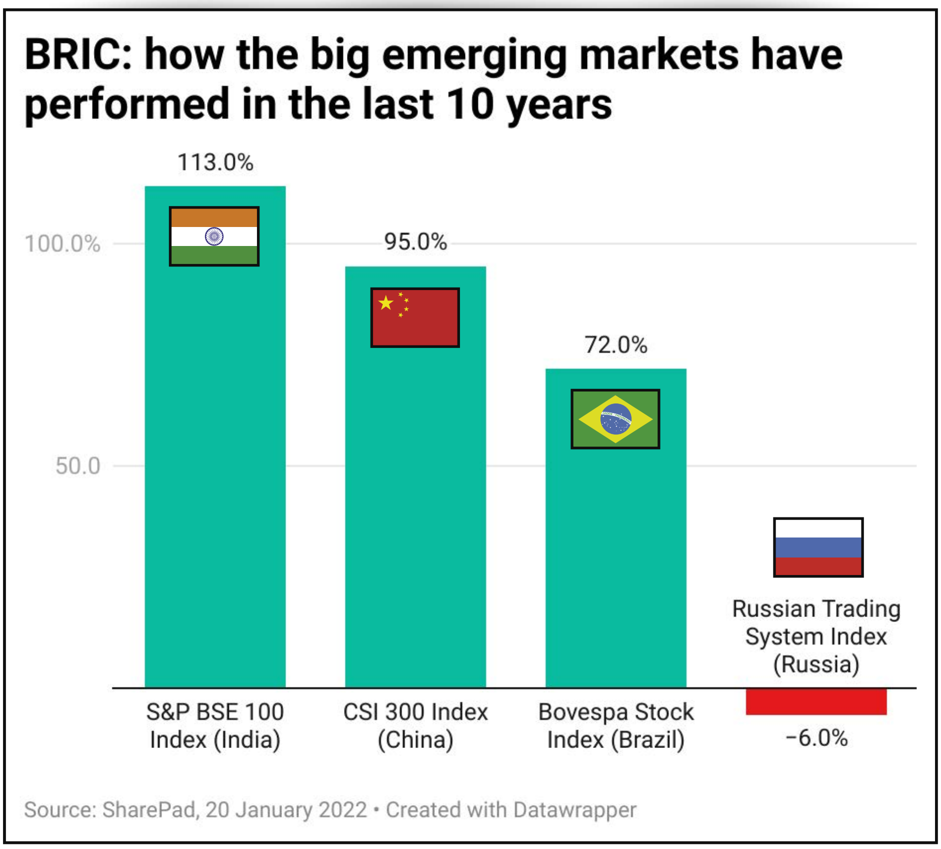
The dominant emerging markets have seen a significant divergence in performance in the last 10 years

A grouping and term first employed in the early noughties but less widely used today, the so-called BRIC countries – Brazil, Russia, India and China – nonetheless remain comfortably in the ranks of the largest developing countries by GDP and dominate emerging markets indices.

Because emerging markets are more prone to periods of volatility it is worth looking at how the stock markets in these powerhouse economies have performed over the course of the last 10 years to get a full perspective on their relative fortunes.

In assessing their performance, we have used the CSI 300 index for China as it is often considered a better gauge of the Chinese stock market than its counterpart the SSE Composite index. Think of it as a rough equivalent of the S&P 500 in the US.

Scanning through the data, the underperformance of Russia over the last 10 years is notable and reflects a poor decade for commodities, with Russia's economy and capital markets heavily tied to what has been an exceptionally volatile oil price, trading in both single digits at its lows and triple digits at its highs over the course of that timeframe.



BRIC: how the big emerging markets have performed in the last 10 years

Source: SharePad, 20 January 2022 • Created with Datawrapper

There is less to choose between the other three countries, but India is the clear winner. It has benefited from a move to more market friendly policies under Narendra Modi, who took over as prime minister in May 2014. China takes second spot while Brazil has endured weak performance of late amid political instability and a particularly devastating impact from the Covid-19 pandemic.

Emerging markets: Views from the experts

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

1. We believe China's market valuations appear to be near a floor and could be well-supported from here. We expect **China** to maintain its zero-Covid-19 stance well into the year to safeguard the success of the Winter Olympics and the Chinese Communist Party's 20th National Congress. International travel and other mobility restrictions will limit economic activity. We believe that last year's regulatory changes are partly a function of China's political cycle, which is likely to culminate in the 20th National Congress. As the political dust settles, regulatory clarity should eventually return, as it has in past political cycles. On a positive note, China's authorities have shown that they still have a strong pro-growth agenda and have no intention to choke the private sector with rules. They have the policy tools to stabilise growth and are ready to use them if needed.

2. Valuations in **Brazil** have fallen to extremely low levels, creating interesting investment opportunities. Concerns over potential fiscal laxity, rising interest rates and political uncertainty ahead of the upcoming general elections have led to the market selloff in the second half of 2021. Even then, Brazil's fundamentals appeared healthier to us than they have since its last recession. More recently, its fiscal and current accounts have improved, with higher oil prices aiding the net oil exporter. We view Brazil as a Covid-19 recovery play and its economic growth could surprise on the upside, aided by efficiencies arising from a thriving internet economy.

3. **Positive structural forces** remain apparent across emerging markets (EMs) and are likely to foster fresh investment opportunities. Digitalisation is a key theme. The consumer internet industry has so far led the way in digital transformation, though

we have also begun to see industrial internet applications take off as manufacturers tap innovation to raise productivity. The continued semiconductor shortage globally underscores the huge demand for chips coming from technology advancements, and we expect strong earnings for some of the world's largest semiconductor companies in markets such as Taiwan and South Korea. Decarbonsation is another trend to watch. Major EMs' pledges to achieve carbon neutrality are likely to intensify electrification and renewable energy efforts, creating multi-year support for relevant industries.

TEMPLETON EMERGING MARKETS INVESTMENT TRUST (TEMIT)

Porfolio Managers

Chetan Sehgal
Singapore

Andrew Ness
Edinburgh

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

The best performing emerging markets funds

Investors may be wary of putting fresh money to work within the emerging market region given its recent poor showing.

The performance of the benchmark MSCI Emerging Markets index on a one-year basis is -6.2%.

Nonetheless from a longer time perspective, a very different picture emerges. On a three, five and 10-year basis the index has generated returns of 24.7%, 41.6% and 83.1% respectively.

Moreover several funds have succeeded in outperforming the benchmark return on a longer term basis.

These include **Baillie Gifford Emerging Markets Leading Companies Fund (B06HZN2)** and **Baillie Gifford Emerging Markets Growth Fund (0602064)**.

In addition the **Fidelity Institutional Emerging Markets Fund (B9SMK77)**, and the **Goldman Sachs Emerging Markets Equity Portfolio (BYZWWN5)** have also demonstrated a strong track record of outperformance.

Baillie Gifford Emerging Markets Leading Companies is managed by Will Sutcliffe one of the more experienced fund managers in this field, and adopts a long-term approach.

China is Sutcliffe's largest individual country exposure accounting for 30.5% of his fund's allocation, followed by South Korea and India, both at 13.8%.

Financials and technology stocks account for more than half of his fund's allocation and include semiconductor manufacturer TSMC and Chinese conglomerate Alibaba.

Despite having a different fund manager in Andrew Stobart, Baillie Gifford Emerging Markets Growth is a near replica of the Leading Companies fund, with respect to country weightings and top equity holdings.

China ranks number six on the list of country allocations in Fidelity Emerging Markets with a 4.5% weighting.

Fund managers Nick Price and Amit Goel have a broader geographic spread with Taiwan, South Korea, Kazakhstan, Russia and India all receiving more significant allocations. The fund typically looks to buy mid and large cap stocks with market values in excess of $1 billion.

Fund managers Basak Yavuz and Hiren Dasani run the Goldman Sachs Emerging Markets Equity Portfolio, and they share an enthusiasm for China, with a 28.9% country allocation.

Best performing open-ended emerging markets funds ranked by 5 year performance

Fund	1yr	3yr	5yr	10yr
Baillie Gifford Emerging Markets Leading Companies B Acc	−14.1%	47.4%	82.6%	145.7%
Baillie Gifford Emerging Markets Growth B Acc	−15.1%	36.7%	72.2%	138.9%
Fidelity Emerging Markets W Acc	−6.3%	48.0%	63.2%	146.2%
GS Emerging Markets Equity Portfolio R	−10.2%	42.0%	60.3%	131.4%
Benchmark: MSCI Emerging Markets index	**−6.2%**	**24.7%**	**41.6%**	**83.2%**

Source: FE Fundinfo. 19 Jan 2022. Total return in GBP • Created with Datawrapper

By **Mark Gardner**
Senior Reporter

Capturing the opportunity in Asia's dynamic smaller companies

Hugh Young, Gabriel Sacks and Flavia Cheong, Investment Managers, Aberdeen Standard Asia Focus PLC

The Asian smaller companies sector has been a fertile place to invest as recovery has emerged across the region.

- Aberdeen Standard Asia Focus has made changes to ensure it captures emerging opportunities in the region's key markets.
- The Trust has also broadened its appeal to retail investors with a changed dividend policy, 5-yearly tender offer and lower fee.

Since the start of the economic recovery in Asia, the region's smaller companies sector has proved fertile ground for investment. It has benefited not only from economic recovery, but from the ability of dynamic companies to renew and regenerate in the face of some vast challenges. It has also offered us the opportunity to capture some of the structural shifts accelerated by the pandemic – e-commerce, digitisation or agile working.

However, the sector is constantly shifting and at Aberdeen Standard Asia Focus, we need to be alert to those shifts to ensure we give ourselves the broadest opportunity set. With that in mind, the Trust has made a number of changes.

China innovation

The first consideration has been China. China was weak in 2021 and the Trust's relatively light position in the region was a benefit. However, there can be no doubt that much of the region's most exciting innovation is emerging from China.

To date, the Trust's relatively low market capitalisation cut-off has prevented wholesale investment in Chinese smaller companies, which tend to be large simply because everything in China is on a bigger scale. We have removed the $1.5bn market capitalisation limit to accommodate more investment in China and, to some extent, in India as well so that we can invest more in the companies we like.

We have hired a native Mandarin speaker, Neil Sun, to help us analyse the 'A' shares market in

China, where we see plentiful opportunities. At the same time, Flavia Cheong joins the Trust as a co-lead manager, alongside Gabriel Sacks and Hugh Young. As head of Asia-ex Japan equities at abrdn, Flavia brings a wealth of experience and breadth of perspective that should help dissect the range of small cap opportunities across Asia.

Early stage companies
Initial public offerings (IPOs) have provided a range of opportunities in recent years. The IPO market has been particularly fertile in India, where a number of high growth technology companies have come to market. We were an anchor investor in Indian consumer intelligence platform **Affle** a few years ago and that is now amongst our top 10 holdings; we also participated in another four new issues in 2021. The IPO market has proved a good route to invest in India's growing mobile penetration and digitisation trends as the country establishes itself as a major technology hub. We were also an early investor in **momo**, the Taiwanese equivalent of Amazon, which has risen 10x on our initial investment only a few years ago.

The investment trust structure allows us the flexibility to invest in these early stage companies. It also allows us to invest in markets where there may be less liquidity, but where there are companies with the potential for higher growth, such as Vietnam. With this in mind, we have been extending our analyst coverage of private companies to uncover new areas of interest.

The importance of dividends
Technology is now the largest overall sector weighting in the Trust. However, 2021 showed the importance of a balance of sectors. There were times when high growth companies were in favour and other periods when more traditional companies were preferred. For example, 2021 was a strong year for **Pacific Basin Shipping**, which did well as trade resumed. The Trust has proved relatively defensive, capturing less of the downside as markets have fallen, while still participating in the growth of Asian markets over the period. This is how the Trust has been designed and is an important tenet of the abrdn process.

Dividend payments are an important part of this defensiveness. They increase the appeal of the Trust for shareholders, but can also provide another route to returns during turbulent times.

Encouraging participation
The Trust has also made changes to ensure that retail investors can participate fully. The 5:1 share split should allow investors to buy in smaller chunks, while a performance-linked tender offer will be triggered if the Trust underperforms the MSCI Asia ex Japan Small Cap index over five years. The Board believes this should help address the discount to NAV on the Trust.

A final change is a reduction in the running costs for the Trust with an amended, tiered management fee. Currently set at 0.96% of market capitalisation, this will drop to 0.85% for the first £250 million, 0.6% for the next £500 million and 0.5% at £750 million and above.

The Asian smaller companies market allows investors to capture 'new' Asia – its innovation and structural changes. The Trust has been re-invigorated to ensure that it is in the best possible position to harness these opportunities and for the broadest possible range of investors to benefit.

Companies selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance.

Important information

Risk factors you should consider prior to investing:

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

Other important information:

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The reasons behind Microsoft's $68.7 billion Activision Blizzard gamble

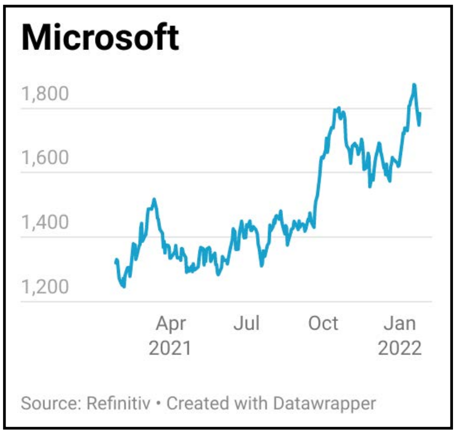
Software giant's $68.7 billion deal is about more than just gaming

Microsoft has never been afraid to take risks with big acquisitions. Past deals for Skype ($8.5 billion), Nuance ($19.6 billion) and LinkedIn ($26.2 billion), in internet communications, transcription software and professionals networks respectively, prove that. But investors can expect the aftershocks of its swoop for gaming giant Activision Blizzard to reverberate for some time to come.

Offering $95 a share, the deal values the *Call of Duty, World of Warcraft* and *Candy Crush* owner at around $68.7 billion, the largest in the brief history of the video games industry, and grossly overshadowing the $7.5 billion Microsoft paid for computer games firm Bethesda in 2021. As such it represents Microsoft's biggest gamble yet.

WHAT ARE THE IMPLICATIONS OF THE DEAL

Will this mean *Call of Duty* becoming an Xbox console exclusive? Is this predominantly a play for mobile, given social and mobile games firm King's presence in Activision's stable and Microsoft's thin pickings in that space? What does this mean for Game Pass, Microsoft's subscription service with 25 million paying users?



The questions come quicker than answers but perhaps most prominently, why is Microsoft buying Activision Blizzard given the ongoing investigation into the company's alleged history of employee abuse and harassment and the numerous lawsuits that the investigation has resulted in?

Frankly, who knows, because the official line gave no more clues than you would expect from an announcement that likely passed the desks of dozens of lawyers before being seen by the market. What we do know, as far as analysts and fund managers say, is that buying Activision Blizzard is about much more than gaming for Microsoft.

The deal gives Microsoft full access and control over gaming content generation, and should accelerate its growth potential in this field across mobile, PC and console devices. There are also strong synergistic benefits, in terms of software development and applications, and further growing the utilisation of Azure, Microsoft's cloud business.

ADDING VALUE

'The outstanding engineering talent in Microsoft can add huge additional value to games,' says Gerrit Smit, manager of the **Stonehage Fleming Global Best Ideas Equity Fund (BCLYMF3)** where Microsoft is its second largest stake.

But beyond this, with its own expertise on the metaverse, Microsoft can now create a 'multi-faceted metaverse of gaming and wider entertainment with a good chance of becoming a leader in this new field,' Smit believes.

The metaverse remains an abstract concept today but in simple terms, it is seen as the reimagined next generation of the internet, one where virtual reality, augmented reality, mobile devices, personal computers and cloud-connected servers combine to create a 3D virtual universe, one where people can socialise, relax and play, and crucially, where money can be made.

Microsoft and Facebook-owner Meta Platforms are among the metaverse's champions, but Apple, Qualcomm, Nvidia, Valve, Epic, HTC and many others share the dream of creating new ways of connecting online.

Buying Activision will possibly give Microsoft an early lead with a complete and self-sufficient future metaverse entertainment business, believes Smit, and he is not alone.

'The Xbox producer is demonstrating not only its interest in solidifying its position in the exciting gaming space, but also could be Microsoft showing its hand by making a play for a slice of the metaverse pie,' said Stephen Yiu, lead manager of the **Blue Whale Growth Fund (BD6PG78)**.

'With an extremely healthy balance sheet, investors should be pleased to see Microsoft putting its high cash reserves to constructive use,' a fair point given dismally low interest rates.

This is a deal that should be immediately accretive to earnings on completion and, if managed well, it's an acquisition where one plus one can add up to well over three over time, in Gerrit Smit's opinion.

The deal will face regulatory scrutiny, with US watchdogs on high alert over tech M&A, so expect 'plenty of noise around this transaction in the coming months,' say Berenberg analysts, but they are confident it will be allowed.

WHAT MICROSOFT'S MOVE MEANS FOR SONY

Shares in US electronics giant Sony fell 10% after Microsoft agreed to purchase Activision Blizzard.

Sony's share price fall contrasted with other video gaming shares which went up on the news, reflecting the 46% premium offered by Microsoft. The deal follows another recent sector deal with Take Two purchasing Zynga for $12.7 billion.

The logic of the deal being negative for Sony seems to have some merit in that theoretically Microsoft could make all Activision Blizzard's console games exclusive to its own Xbox which would rob Sony's PlayStation of the associated revenues.

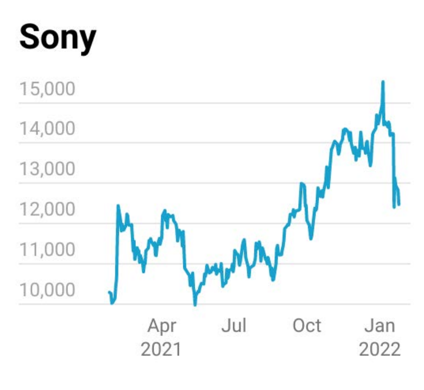
However, it is likely that regulatory scrutiny would negate such a move and Microsoft itself would also lose out on revenue, suggesting it is an unlikely scenario.

But the deal could spark further merger and acquisition activity in the sector because it transforms the landscape and potentially gives Microsoft an edge developing virtual online worlds.

Investment bank Berenberg points out that Activision Blizzard's portfolio will significantly boost Microsoft's gaming diversity, particularly in mobile and free-to-play content, where it is relatively weak.

Sony likewise has a relatively small presence in mobile which only represents around 4% of its revenues.

The implication is that Sony may feel the need to beef up its mobile and online marketplaces offerings and Berenberg suggests Electronic Arts as a potential target given the quality and breadth of its content including free-to-play and mobile games. [MGam]



Source: Refinitiv • Created with Datawrapper

METAVERSE M&A

In the meantime, investors can expect a lot more metaverse M&A as competitors jostle for position. 'We expect all big tech companies to seek deals like this,' Rolf Illenberger, managing director of VRdirect, a virtual reality experience designer. Illenberger believes that Epic Games is probably the most interesting Metaverse acquisition target around, with whispers of a stock market flotation frequently doing the rounds.

Back to Microsoft, the timing is interesting since it comes ahead of any official metaverse or virtual reality strategy from the company. This suggests that investors can expect news on this front from Microsoft in 2022 and 2023, especially when it comes to virtual reality devices. [SF]

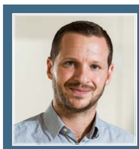
DISCLAIMER: The author Steven Frazer owns shares in Blue Whale Growth Fund referenced in this article

How can I find an old pension and should I consolidate all my pots?

A lot of people now have more than one retirement savings pot

I'm 45 years old and have worked in financial services since leaving university two decades ago. I've had five different employers and at each one I was offered a company pension.

I have lost track of a couple of the pots. What's the best way to find them? Also, would it make sense to combine these pots, and if so, what are the risks?
Julia



Tom Selby, AJ Bell Head of Retirement Policy says:

According to some estimates people on average switch employer 11 times during their working life, potentially saving in a new pension scheme each time.

The Pensions Policy Institute, a think-tank, believes the number of 'deferred' pensions – that is pensions which have been opened but are no longer being contributed to – will increase to 27 million by 2035.

This trend is expected to be accelerated by reforms which mean employers now need to automatically enrol all eligible staff into a workplace pension scheme.

In terms of finding lost pensions, new Pensions Dashboards are set to be introduced next year which should eventually allow you to see all your retirement pots in one place, online.

Until then, the Government's Pension Tracing Service is a good starting point when trying to locate missing pensions.

There are plenty of reasons why combining your pensions with a single provider can be a good idea. Most obviously, a single retirement pot is much easier to track and manage than having various pensions with different providers.

You could also benefit from lower costs and charges, increased income flexibility and more investment choice by switching provider.

Older pension schemes, for example, often charge more than modern pensions, while plenty of workplace schemes don't offer a full range of retirement income options or restrict your investments to the firm's own in-house funds.

Before transferring any old pensions, you should check there aren't any valuable benefits attached which you may lose or exit charges that will be applied. Your provider should be able to tell you if this is the case.

If you do decide to consolidate with a single provider, assuming these are 'defined contribution' pensions – where you build up a pot of money which you can access from age 55 – the process should be relatively simple.

If you have a 'defined benefit' pension valued at £30,000 or more, you will need to take regulated financial advice before transferring.

You'll just need to choose a provider with whom you want to consolidate your pensions and get the details of the pension or pensions you want to transfer over. Once you've provided the relevant details to your new provider, they should do all the legwork for you.

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.

Invesco

INVESCO ASIA TRUST PLC – UPDATE FROM NEW CO-MANAGER FIONA YANG

Fiona Yang, recently appointed to co-manager of **Invesco Asia Trust plc (IAT)**, sits down with one of IAT's non-executive directors, Vanessa Donegan, to discuss the promotion and her thoughts for the year ahead.

In this update they look at:

- Fiona's outlook for the region in 2022
- The investment trust's contrarian approach
- The role of India in the portfolio
- Managing the portfolio through Covid-19
- IAT's dividend policy
- What Fiona is looking forward to in her role as co-manager of the investment trust

GLOSSARY OF TERMS

Undemanding valuation
Valuation is the analytical process of determining the current worth of a company or a portfolio. Undemanding valuation means the current market value of an asset is worth less than what it could be worth

Tightening to easing
Also known as monetary policy tightening and easing. A tightening policy happens when central banks sell assets to reduce the money supply in the economy. An easing policy is the opposite and occurs when central banks buy assets with an aim to increase money supply in the economy.

Invesco

Price-to-earnings ratio
The price-to-earnings ratio (P/E ratio) of an index is a measurement intended to show an index's current price compared to the index' earnings. The price-to-earnings ratio (P/E ratio) of a company is a measurement intended to show a company's current share price compared to the company's earnings per share. It is often used to measure a company's value.

Price-to-book ratio
The price-to-book ratio (P/B ratio) is a measurement intended to show an index's current market value compared to its book value. The price-to-book ratio (P/B ratio) is a measurement intended to show a company's current market value compared to its book value per share.

Reserve requirement ratio
The reserve ratio, also known as reserve requirement, is the portion or percentage of a bank's deposits that they must hold onto and keep in reserve. The reserve ratio can be an important monetary policy tool that a central bank can use to increase or decrease money supply in the economy.

Prime rate
The prime rate is the interest rate that banks charge their customers with the highest credit ratings.

Credit penetration
Buying on credit refers to the practice of permitting a buyer to receive goods or services before payment. Credit penetration of a particular country can be measured by the proportion of credit in relation to GDP, the population segments that are served by the banks and also the usage of various bank instruments or products.

Structural growth
It refers to a dramatic shift in a country or a region to enable sustained long term growth. Structural growth is typically driven by powerful forces such as disruptive technologies or changing demographics and consumer behaviour.

Capex upcycle
Capex upcycle refers to an upward trend in the capital expenditure (capex) of a specific country.

Risk warnings
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.

The Invesco Asia Trust plc invests in emerging and developing markets, where difficulties in relation to market liquidity, dealing, settlement and custody problems could arise.

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 product during this period and in the future.

Oxford Nanopore takes aim at market leader Illumina

Newly listed firm's cheaper sequencing chips are enabling mass market access to the data of life

Originally backed by fallen star fund manager Neil Woodford, **Oxford Nanopore (ONT)** listed on the stock market in September 2021 at 425p per share, giving it a market capitalisation of around £3.4 billion. Despite a recent wobble the shares are up more than a quarter on their issue price to 542p.

The market value of the shares is in excess of 30 times 2021 expected revenue and the company is not expected to turn a profit until 2025 at the earliest. It's natural to ask why investors have placed such a punchy valuation on the business. What is all the fuss about?

According to Numis, Oxford Nanopore is the most advanced nanopore technology company, having developed the cheapest and most scalable DNA sequencing technology, allowing real-time analysis of genes, the building blocks of life.

The company operates in a structural growth market worth around $20 billion with some estimates suggesting a potential addressable market much higher.

The company has developed third generation gene sequencing technology and is effectively playing the role of 'David' against dominant US 'Goliath' Illumina which commands around 70% market share of the global DNA sequencing market.

Oxford Nanopore peer group comparison

	Market Cap (£bn)	EV/Sales 2022 (x)	Sales CAGR (%)
Illumina	42.2	12	21%
10X Genomics	7.4	15	45%
Oxford Nanopore	4.4	26	51%
Pacific Biosciences	1.6	11	38%

EV = Enterprise value, CAGR = Compound annual growth rate.

Source: Numis Securities, Factset, Stockopedia • Created with Datawrapper

THE BIG PICTURE

Ageing populations and spiralling healthcare costs threaten to bankrupt global healthcare systems. One way to reduce the pressures and increase quality of life is to find diseases earlier which results in better patient outcomes and cheaper overall costs.

Over the last few decades there has been an explosion of research into the study of genes, proteins and human metabolic systems to garner a greater understanding of the causes of disease.

The study of genes, known as genomics, is key to developing the holy grail: precision or personalised medicine where everyone has access to the data of life.

Historically sequencing the human genome has been very expensive. The Human Genome Project which sequenced the first human genome in 2003 cost around $3 billion. Today, the cost of sequencing the human genome has dramatically reduced to under $1,000.

NEW KID ON THE BLOCK

Technology improvements have led to falling sequencing costs which in turn has driven demand for ever greater amounts of data. Illumina has built bigger and more expensive machines to meet that demand. For example, its high-end NovaSeq 6000 costs $985,000 and weighs 481 kilos.

Illumina's success is based on technology which grew out of Cambridge University in the 1990s called SBS (sequencing by synthesis). Illumina purchased UK company Solexa in 2007 which commercialised the technology. The vast majority (90%) of the world's sequencing data has been produced with SBS technology.

Sequencing by synthesis is seen as the equivalent of the mainframes used in the computer industry before the PC and smartphone revolution. SBS is batch based and takes a long time.

Oxford Nanopore has developed the smartphone equivalent of gene sequencing devices and released the world's first commercial range of nanopore-based DNA sequencing devices called MinIONs in 2015.

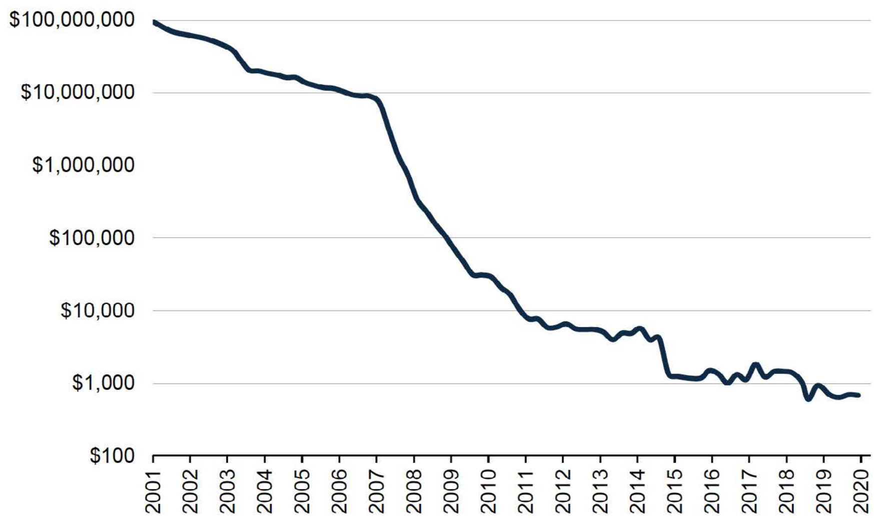
The MinION is small and portable and weighs just 90 grammes and costs $1,000. It can read long strings of DNA and provide real-time sequencing data.

The company has a long-term aim of reducing the cost to below $100 and ultimately plans to introduce a sequencing device which can be used with a smartphone instead of a PC.

A HUGE MARKET

There are more than one million scientists working in more than 100,000 laboratories worldwide that consume life science research tools, helping to drive the healthcare market's big data projects and furthering the science of genomics and proteomics (large scale study

Cost of sequencing a human genome



Source: US National Human Genome Institute of proteins).

The sequencing products market which covers instruments and consumables was worth around $6 billion in 2021 according to a report by consultants DeciBio.

The market is expected to grow to $8.5 billion by 2025 and as sequencing makes a bigger impact on healthcare, the potential addressable markets are expected to expand significantly over the long term.

For example, cancer treatments are the fastest growing therapy in biopharma and Oxford Nanopore and Health Advances have estimated that the potential opportunity in cancer is north of $100 billion, which, while large, is a fraction of the current market for cancer drugs.

WHAT IS NANOPORE SEQUENCING?

Oxford Nanopore's technology is based on high speed electronics rather than optics and produces rapid detection of molecules without the need for chemicals. Moreover, the technology enables the measurement of a range of DNA strings in real time.

The bioelectronic-based sensing technology is based on nanopores, which are tiny holes embedded in a microchip. A nanometre is one billionth of a metre.

It works by monitoring changes to an electric current as nucleic acids are passed through a protein nanopore. This method is currently the cheapest way to sequence DNA.

The company's high-end throughput PromethION machine reduces sequencing cost to roughly $3.1 per gigabyte of data which compares with Illumina's roughly $6 per gigabyte while Oxford Nanopore's solution is available at a much lower overall capital cost.

A COMPETITIVE MARKET

Oxford Nanopore's strategy is to lower the barriers to adoption of its technology by providing a range of kits which simplify preparation time and lead to greater experimental success.

The company generates revenue by selling consumables while the devices are provided free of charge. It has developed a range of devices which run the full gamut in terms of size and throughput capacity.

Oxford Nanopore has developed an e-commerce platform which supports self-service customers and a 'price stratified' pricing structure which effectively makes the technology available to a broad spectrum of scientists.

Market leader Ilumina charges upfront for its devices and requires clients to purchase minimum quantities of consumables over the contract term. This can run into millions of dollars.

Oxford Nanopore has a roadmap which aims to develop increasingly cheap and portable sequencing nanopore chips with the long-term goal of democratising access to DNA information.

Despite cost and flexibility advantages, displacing Illumina will not be an easy challenge. Switching costs are high and Illumina has an established installed base and economies of scale advantages.

However, Oxford Nanopore has built up an impressive intellectual property portfolio with more than 2,000 patents which it has defended successfully over the last five years.

The company is hoping that as more scientists, government and pharmaceutical companies use its products, their greater speed, flexibility and lower cost will drive market share gains.

Illumina and Swiss pharmaceutical giant Roche have indicated they are developing their own nanopore technologies.

Numis reckon that US listed Pacific Biosciences is the closest peer to Oxford Nanopore with genomics company 10X Genomics also sharing similar characteristics.

While Oxford Nanopore has built an impressive business and has the potential to disrupt a fast-growing market, Illumina is the clear market leader, making it a formidable competitor.

Meanwhile, other smaller competitors could make life difficult for Oxford Nanopore and there is always execution risk when dealing in technology.

By **Martin Gamble**
Education Editor

When and how do I pay for charges on investments?

You should expect to pay a fee or ongoing charge for buying and selling investments and holding them

It is common to pay fees when you put money into stocks, funds and bonds via a DIY investment platform. The initial and ongoing fees vary depending on what you own, how you invest and how much money you have invested on the platform.

For example, with AJ Bell Youinvest you will be charged £1.50 each time you buy a fund online but charged £9.95 each time you buy an investment trust, shares in a company, an ETF, gilt or bond. However, this drops to £4.95 if you bought shares on 10 or more occasions in the previous month.

On top of this you will be charged an annual 'custody' charge of 0.25% of the value of the investments in your account. If you own shares or investment trusts this amount will be capped at £3.50 a month, whereas if you own funds the charge operates on a sliding scale depending on how much is in your account: 0.25% on the first £250,000 of funds, 0.1% on the next £750,000 of funds, 0.05% on balances between £1 million and £2 million, and nothing above £2 million.

HOW DO YOU PAY FOR THESE FUNDS?

The transactional charges are incurred when you buy and sell investments.

You can either include them in the amount you're choosing to invest or exclude them. This means that if you're buying £1,000 of a fund you could chose to include the £1.50 charges in this figure, and so buy £998.50 of the investment, with the charge taking up the remainder of your sum. Or you could exclude them, and your total bill would come to £1,001.50 – £1,000 for the investment and £1.50 for the transaction charge.

The custody charge is a little trickier as it is an ongoing charge. It is based on the mid-price of the value of your investments on the last working day of each month. The charge is collected within 20 working days of the end of the previous month – in reality, it means you'll pay for January's charges around the middle of February, for example.

WHEN DO I INCUR CHARGES ON MY INVESTMENTS?

- When you buy and sell stocks, investment trusts, ETFs, funds and bonds
- When you reinvest dividends
- Some platforms have an annual custody charge
- There can be foreign exchange fees when you invest in, and receive dividends from, overseas-listed stocks
- Sometimes there might be a fee for paper-based applications
- Some platforms impose charges if you are transferring assets to another provider
- Some platforms have a divestment fee if they have to sell some of your holdings to cover charges

This money is collected from the cash in your account, and this is why you should ensure there is some money in cash in the account. However, as cash doesn't earn much (or any) interest on most investment platforms you want to be sure that you're not keeping too much in cash. Try to add up roughly what you think your custody charges will be for the next few months and ensure you have enough cash to meet them.

WHAT IF I FORGET AND HAVE NO AVAILABLE CASH?

There's no mandatory minimum cash balance on your account, so you could have zero cash. That means there would be nothing available from which to collect your custody fees. In this scenario your investment platform would sell some of your holdings in order to recover their fees.

Rather than sell a bit of each holding, they will sell enough units of your largest holding to recover their costs, regardless of whether you've made a gain or loss on this investment. By doing this you could end up having investments sold at a loss and you could also incur an additional divestment fee. As you can see, it far more beneficial to ensure you have sufficient cash in your account.

However, if you tend to have more money in your dealing account you can opt for your charges for your ISA, SIPP or Lifetime ISA account to be taken from your dealing account instead. This will only apply to the custody charges and not the transaction fees.

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

By **Laura Suter**
AJ Bell Head of Personal Finance

LIVE

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BRAVE BISON GROUP (BBSN)
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Speaker: Mark Hood, CEO
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Event details

Registration 17:15
Presentations to start at 17:40
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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

31 Jan: Porvair, React, SThree. **3 Feb:** Shell.

Half-year results:

28 Jan: Hargreaves Lansdown. **1 Feb:** Joules. **3 Feb:** Renishaw.

Trading updates:

31 Jan: Evraz. **1 Feb:** Gem Diamonds. **2 Feb:** Glencore, Severn Trent, Vodafone. **3 Feb:** BT, Cranswick, Virgin Wines. **4 Feb:** Airtel Africa.

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