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Daniel **Coatsworth**

EDITOR'S VIEW

Why investors haven't filled their boots on the sell-off

There remains a general sense of nervousness, yet this could still prove to be a great time to buy quality stocks

Two years ago, global stock markets experienced a significant sell-off as the pandemic caused mayhem. For some investors it was a time of stress and panic, but for many professional investors it provided a rare opportunity to pick up shares in good companies for a fraction of their value pre-Covid.

Fund managers continued to talk about this fortuitous moment well into 2021, saying it paid to look beyond the doom and gloom at the time and take a long-term view on a company.

With markets having once again pulled back, albeit nowhere near to the extent of 2020's sell-off, have investors filled their boots and loaded up with top quality names at discounted prices?

Stocks in general haven't bounced back yet and the mood of the market doesn't feel as if a lot of fund managers have raced to 'buy the dips' and take advantage of lower share prices.

Many investors who bought after the market decline in February/March 2020 took the view that some companies would either benefit from structural market changes accelerated by the pandemic or that others had been sold off too much and should quickly recover from Covid disruption.

This year, the sell-off has been driven by fears that we're at a significant turning point for markets, with central banks raising rates and reducing market liquidity.

Tightening monetary policy suggests it will be harder to make the kind of returns we've seen in the past decade from markets – it's a repricing of risk. Therefore, it is natural for investors to be more cautious and not simply flock to what's done well in the past.

The shift in market sentiment will have forced a lot of investors to rethink their portfolio.

Nick Train-run asset manager Lindsell Train has just sold approximately half of its stake in education group **Pearson (PSON)** on a day when the share price jumped on a rare bit of good news. The asset manager has yet to comment on the disposal, but this looks like giving up on a long-term underperforming stock – something I expect many investors to do as they look to shore up their defences and have a more robust portfolio.

Pershing Square's (PSH) manager Bill Ackman picked up a large holding in Netflix after its share price collapse. Otherwise, the silence among investment professionals is notable with regards to new positions following the market sell-off. Of the three managers I interviewed in late January, none of them had bought new positions for their portfolio in recent weeks.

I wouldn't be surprised to see investors think more about bear market conditions and flock to companies that have financial strength and resilience. If you've got spare cash and are confident enough to buy when markets remain volatile, it may pay to focus on quality stocks rather than ones that promise a big breakthrough in the future (so-called 'story stocks').

They may offer lower growth, but these compounders are typically where the best money is made over the long-term. Look for high cash flow generation, low capital intensity and minimal dependency on debt to grow. This article will help get you started.

Activist pressure could help drive up Vodafone's shares

One broker believes the shares could soon trade on a higher multiple of earnings

Vodafone (VOD) could potentially see its shares trade on a high multiple of earnings this year after being targeted by an activist investor.

Cevian Capital is rumoured to have built up an undisclosed stake in the mobile network operator. Reports suggest the Swedish activist fund wants to put pressure on the FTSE 100 company to sell parts of its global operations, consolidate its position in key markets, return cash to shareholders and bring more telecoms experience onto the board.

While analysts at Numis Securities remain sceptical about the extent to which Cevian Capital may be able to force Vodafone's hand, they do believe that the fund's targeting of the company could spark a re-evaluation of Vodafone's business model, strategy and scope for profits recovery.

'Vodafone's senior management has worked consistently and at pace from the start of its tenure in October 2018 to extract significant value from the firm's assets, organically and inorganically,' says Numis.

The plan has so far included spinning off mobile masts business Vantage Towers, refocusing the portfolio through a range of disposals and mergers, and positioning the company for ever-greater consumption of data.

Yet the reshaping of Vodafone has yet to result in any meaningful re-rating of its stock market valuation, with Covid-19, understandably, delaying progress, says Numis.

Vodafone's share price more than halved between the beginning of 2018 and the start of 2022. The current 128.5p level means the stock is still more than 45% off its five-year highs.

Numis believes that 'the sum of all uncertainties about Vodafone's investment proposition' does not justify it currently trading on a low price to earnings multiple of 11-times full year to March 2023, 12.4% free cash flow yield and 6.1% dividend yield.

Vodafone recently demerged its mobile masts business Vantage Towers

Based on the broker's own calculations, the out-of-favour European telecoms sector is currently trading an equivalent 13.8 PE multiple, with free cash flow and dividend yields at 9.4% and 5.5% respectively.

Several FTSE 100 companies have come under the scrutiny of activist investors with change being demanded at **GlaxoSmithKline (GSK)**, **Shell (SHEL)**, **Unilever (ULVR)**, **Aviva (AV.)** and **SSE (SSE)**, while there is also an activist investor on the shareholder register of **Sainsbury's (SBRY)**. All of these stocks apart from Unilever have seen share price gains during the past 12 months.

According to Numis forecasts, Vodafone earnings for the year to March 2023 are set to jump nearly 20% to €0.136. Numis believes that the stock could hit 180p during the next 12 months, 40% higher than the current level. [SF]

Fed signals strong economy can withstand several rate hikes

Markets have priced in faster monetary tightening which may result in fewer actual increases

The press conference which followed the Federal Reserve's meeting on 26 January continues to reverberate around the market. US stock indices dropped more than 1% and bond yields moved higher in the immediate aftermath to reflect a tougher line on interest rate hikes.

The message dashed any hope that falling stock prices and increased volatility (how much prices move around) might influence the Fed to moderate its view on tightening up its policy on financial stimulus and rates.

Bond markets have since priced in more interest rate increases while economists at Bank of America are now expecting seven rate hikes in 2022.

The Fed believes the economy is in such good shape that it can push rates higher without negatively impacting the labour market or risking a pronounced downturn.

Effectively the Fed said it can create a soft landing, which means slowing the economy enough while not causing a recession.

Investors will get a better idea of the strength of the labour market with the latest monthly jobs report on 4 February.

There are an increasing number of bond fund managers and economists who believe the Fed should have started to remove stimulus earlier.

They argue the Fed is now behind the curve and could tap too hard on the breaks to play 'catch-up' and in the process slow the economy more than intended and inadvertently cause a recession.

Most forecasters see inflation naturally falling back by the year end as base effects and reduced supply chain problems are wrung out of the system, although it is still expected to be above the Fed's 2% target.

In addition, the strong rebound in global growth is already showing signs of moderating with the International Monetary Fund recently reducing its 2022 forecast for global growth from 4.9% to 4.5%.

With bond markets already pricing in five rate hikes for 2022 and the S&P 500 index down around 6% this year, financial conditions have arguably tightened ahead of any explicit action by the Fed.

Some froth has been taken out of the market with riskier assets and meme stocks underperforming heavily. Gamestop shares are down around 60% since November and Bitcoin is around 40% off its highs.

Investors now know rate hikes will happen, possibly in March, but there is an intriguing disconnect between the market's view of where the Fed funds rate will peak, around 1.75% and the Fed's view which is 2.5%.

In other words, bond investors do not anticipate more than seven rate hikes in this cycle, implying growth will quickly fall back to trend.

As we write the UK was expected to see its first back-to-back interest rate rise since 2004, with the Bank of England announcing its interest rate decision on 3 February. [MGam]

US interest rates (Fed funds – high level)

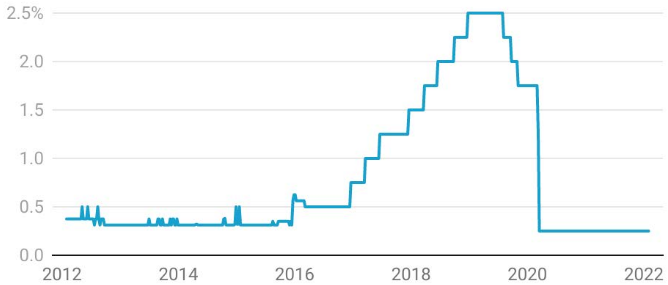


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

Air goes out of hydrogen stocks on profit taking

Despite the sector's poor performance, progress is real albeit unremarkable

After the excitement surrounding hydrogen as a route to lowering global emissions, a message reinforced at the COP 26 climate summit, the poor performance of hydrogen investments over the last year is something of a surprise.

Research by analysts at Liberum shows that over the 12 months to mid-January, the average return for fuel cell and electrolyser companies has been a loss of around 60% of their market value.

HYDROGEN STOCKS UNDER THE COSH

STOCK	12-month performance
Fuel Cell Energy	-78%
Plug Power	-69%
Ceres Power	-60%
ITM Power	-60%
Bloom Energy	-59%
AFC Energy	-53%

Table: Shares Magazine • Source: Liberum, Shares, data to 25 January 2022 • Created with Datawrapper

For the largest stocks, such as US company Plug Power, the losses have been immense. Plug Power still has a market cap of $11.9 billion, yet its shares are down 69% meaning shareholders have seen over $25 billion of value wiped out in a year.

To a degree, hydrogen stocks have been a victim of their own success. Most of the quoted names floated in 2020 and were chased up by investors.

Many share prices in the sector raced ahead and that naturally led some investors to take profits while the going was good, particularly as many of these companies aren't expected to generate positive earnings for several years. The sector then lost momentum and more investors started to lose interest.

This year's sharp rise in gas and oil prices, which reflects the pressure to meet the global economy's

immediate energy needs, together with a spike in bond yields made investors even more cautious on hydrogen stocks, a big turnaround considering the hype in 2020.

Launched on 10 February 2021, **L&G Hydrogen Economy ETF (HTWG)** has since fallen by 37% in value. Key holdings include Weichai Power and Hyzon Motors have not had a good time on the stock market over the past year.

Behind the scenes, the hydrogen economy is growing steadily if unspectacularly. UK fuel cell makers **AFC Energy (AFC:AIM)** and **Ceres Power (CWR:AIM)** continue to sign commercial agreements and talk of a 'strong pipeline of opportunities' with industrial and energy partners both here and abroad.

Hydrogen fuel and energy storage firm **ITM Power (ITM:AIM)** has a substantial backlog of projects and an even more substantial pipeline of tenders compared with a year ago and is building a second UK factory to meet demand.

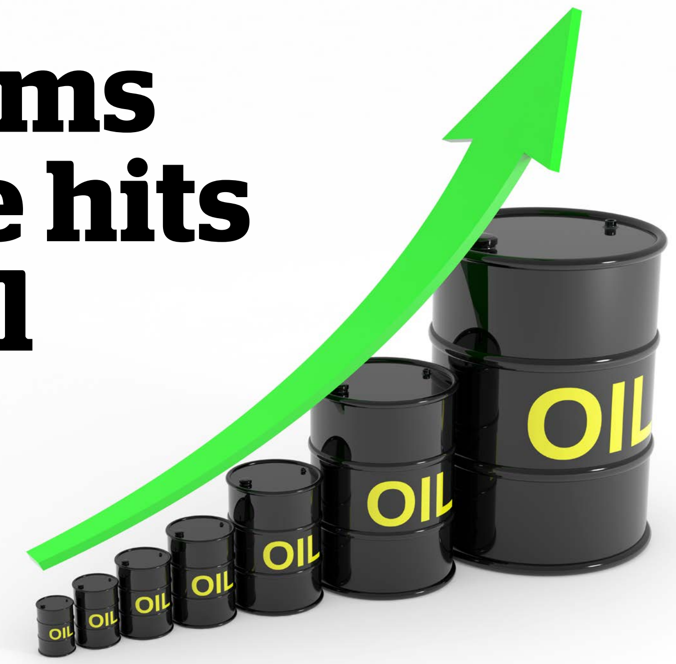
The energy giants themselves are stepping up hydrogen production, with **Shell (SHEL)** building a giant electrolyser at its site in Rotterdam utilising the skills of UK firms such as **Pressure Technologies (PRES:AIM)**.

Moreover, new companies continue to come to market hoping to reap the benefits of the investment boom in hydrogen assets.

In 2021 investment fund **HydrogenOne Capital Growth (HGEN)** and 'green' hydrogen maker **Atome Energy (ATOM:AIM)** listed in London.

How soon any of them will turn a profit, if ever, must be up for debate, but their flotations show the hydrogen theme hasn't gone away, it may just be dormant. [IC]

Oil service firms warn as crude hits $90 per barrel



Lag in recovery for industry spending as oil adds to pressures on the economy

The stresses and strains of oil market volatility and a Brent crude price at a multi-year high of $90 per barrel are becoming apparent.

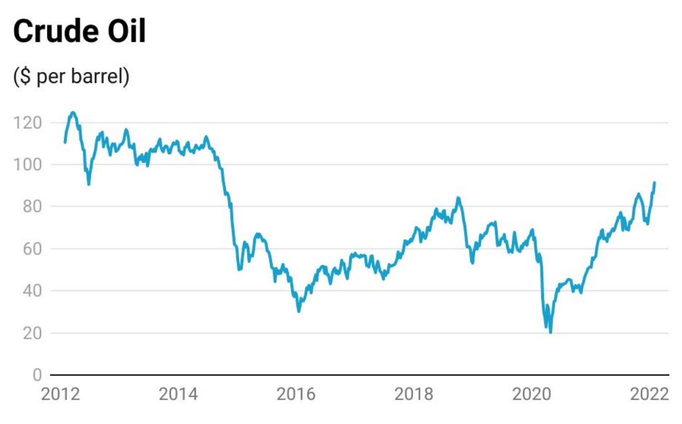


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

With the potential for conflict in commodities-rich Ukraine involving major producer Russia, many observers are expecting oil prices to hit triple digits sooner rather than later.

While ostensibly this is good news for oil and gas companies, firms which offer services to the sector are under severe pressure with Italian group Saipem and seismic survey specialist PGS recently serving up major profit warnings.

The oil services sector is being affected by both global supply chain pressures and the typical lag between a recovery in the oil and gas market and an increase in spending by commodity producers.

While oil prices are high now, they hit rock bottom in the immediate aftermath of the pandemic, leading energy firms to slash their budgets. It takes time for that money to come back, and the picture is further complicated by the larger integrated players like the UK's **BP (BP.)** and **Shell (SHEL)** shifting investment into renewables as part of the energy transition.

The surge in oil prices is likely to have a more immediate impact on the cost of fuel, with Air China warning on profit partially because of the rising price of jet fuel.

While many airlines hedge their exposure in this area, higher fuel costs could help dilute any summer recovery for the industry.

In this context it's no surprise that a higher oil price is seen as a tax on global economic growth, with the surge higher in the market a key contributor to current inflationary pressures too.

Bank of America analysts think there could be a further spike higher in the near term before pressures on supply start to ease: 'To get to where we are today, the market has drawn OPEC spare capacity down by 2.5 million barrels a day in the past year to just about 3 million barrels per day (excluding Iran).

'As summer travel peaks, spare capacity could fall an additional one to two million barrels per day, causing oil prices to spike higher. However, rising GCC OPEC capacity, a potential return of Iranian barrels, and non-OPEC supply growth should help ease oil balances over the medium term.'

Once oil prices reach a certain level, demand starts to be eroded but Morgan Stanley now believes this threshold is higher than the $90 per barrel it previously estimated, and this informs its decision to follow other investment banks in lifting its forecast for oil to $100 per barrel. [TS]

A great way to play brighter prospects for Chinese shares

Fidelity China Special Situations investment trust is the ideal vehicle if you want exposure to this part of Asia

Exuberance towards China at the beginning of 2021 gave way to disappointment and pessimism as the year progressed. A lot of the bad news is now in the price and Chinese equities are starting to look attractive again, which means now is a good time to invest in **Fidelity China Special Situations (FCSS)**.

The £1.6 billion investment trust provides exposure to the most dynamic companies in the greater China region. Its shares are trading on a 4.2% discount to the value of its underlying assets, and Chinese stocks have yet to recover from last year's widespread sell-off, meaning you're able to get in at a low level to play the rebound.

REASONS TO BE OPTIMISTIC

There are several reasons to be optimistic about the outlook for Chinese equities in 2022.

Valuations are starting to look appealing, and we are likely to be past the peak of government regulatory interference. The Chinese authorities also retain plenty of headroom to provide policy support. Recently they cut interest rates and accelerated approvals for infrastructure projects.

Although the one-year performance record for Fidelity China Special Situations has been uninspiring, returns over three, five and 10-year periods have been impressive. The trust has consistently outperformed the AIC Greater China sector over these periods.

REGULATORY OVERSIGHT DISSIPATES

The unexpected cancellation in November 2020 of Ant Financial's stock market listing signalled the inception of a government campaign to increase its control over the private sector.

A history of outperformance

	1 year	3 years	5 years	10 years
Fidelity China Special Situations	−27.4%	58.4%	80.3%	321.4%
China / Greater China AIC sector	−31.2%	53.8%	68.8%	210.5%

Source: AIC, 31 Jan 2022. Share price total return. • Created with Datawrapper

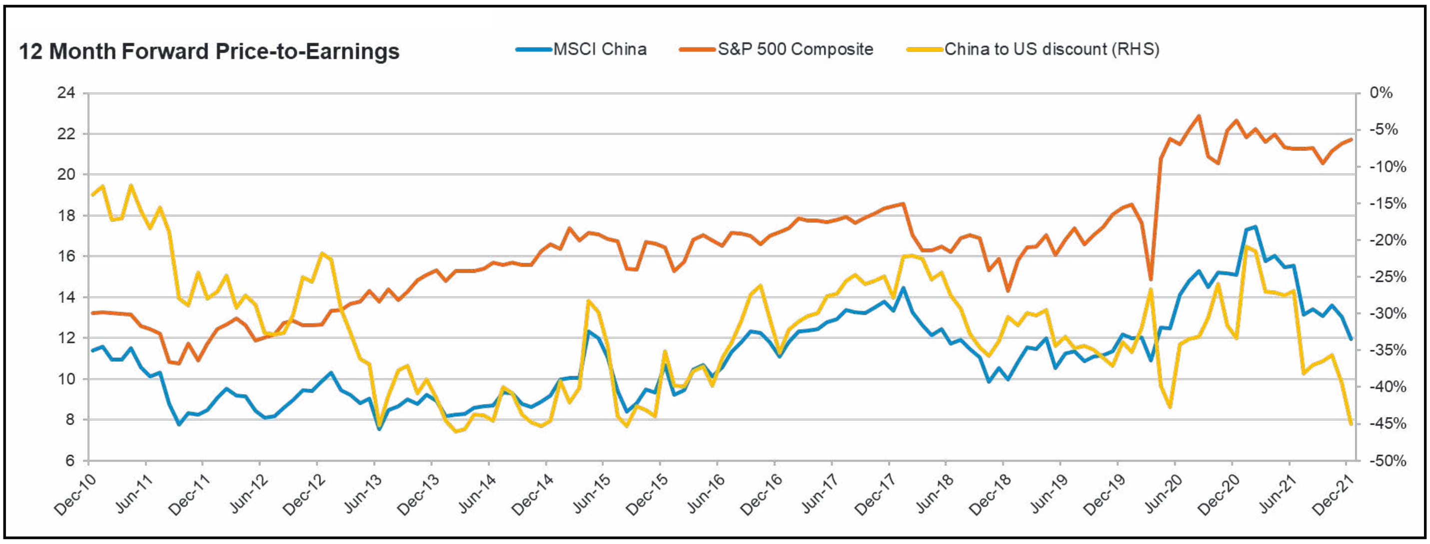
FIDELITY CHINA SPECIAL SITUATIONS BUY
(FCSS) 303p
Market value: £1.6 billion

This increasingly draconian regulatory environment has encompassed private tutoring, e-commerce, social media, fintech, ride sharing and video streaming platforms.

Fidelity China Special Situations fund manager Dale Nicholls argues that from a timing and historical perspective, it is not the first time that we have witnessed heightened regulation in China.

'We only need to cast our minds back to 2018 when the government felt the younger generation was spending too much of their time playing online games and as a result halted new gaming licences.'

Nicholls suggests we may now be past the peak of regulatory intervention. He says: 'There is a good chance we are well into, if not past the peak of regulatory reforms, particularly within the technology sector – I would not expect the same degree of intensity that we saw last



Source: Fidelity, Refinitiv DataStream, 31 December 2021. RHS= Right hand side

year and at the end of 2020 to continue.'

2022 is an election year in China. In November the Party Congress is scheduled to affirm Xi Jinping for his third term as party leader. For investors this suggests a period without significant unpopular announcements.

ATTRACTIVE VALUATIONS

We are entering a new phase in the Chinese economic growth story, where we can expect a more modest period of economic growth over the coming years.

This is very much in line with new government policy initiatives to engender a more balanced economy which is less dependent on fixed asset spending, but rather high-quality manufacturing and consumption.

The MSCI China index is currently trading on a 34% discount to the US market based on 12-month forward earnings.

Nicholls says: 'History teaches us that these volatile periods usually offer the most attractive opportunities. Corporate earnings for the market are forecast to grow over 15% for the next 12 months, and the company's portfolio should grow well above this level. Meanwhile, the market overall is trading on a price earning multiple that is attractive relative to history and relative to other stock markets globally.'

SCOPE FOR FURTHER POLICY SUPPORT

The end of 2021 witnessed a rush of economists downgrading their growth forecasts for China. However, as Nicholls highlights, 'China is certainly at a different stage in the cycle with an easing bias, that history shows often supports markets. China's central bank has more levers to pull to encourage growth after the slowdown of 2021'.

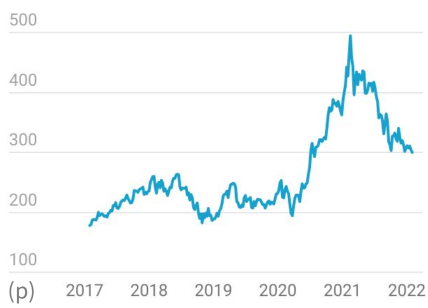
The mid to long-term Chinese growth outlook is robust given the expansion of the middle class. This has been facilitated by the increase in the urbanisation rate. In the most recent five-year plan, a target of 65% was established, up from the current level of 61%.

Within the urban population a significant cohort lack the Hukou (household registration rights and documentation). Government plans to expand the Hukou system will confer increasing rights upon a significant number of urban workers. This will act as another catalyst for consumption and economic growth.

This thesis is reflected in the composition of Fidelity's portfolio that continues to have a large exposure to companies that are focused on growing domestic consumption, supported by the ongoing expansion of the middle class.

Beneficiaries of this trend aren't just consumer stocks but also in areas like healthcare and technology that play into the theme of domestic consumption. [MGar]

Fidelity China Special Situations



Source: Refinitiv • Created with Datawrapper

Investors searching for real assets should snap up Industrials REIT

The multi-let industrial specialist has the potential for solid double-digit annual returns

There is a lot to like about multi-let industrial property in the current environment. Returns from real assets have historically beaten other sectors during inflationary spikes, says AMP Capital.

Industrials REIT (MLI) owns just under 1,800 units with an average size of roughly 3,800 square feet, meaning its portfolio is approaching 7 million square feet excluding land for development. Almost all its units are in the UK where there is an enormous lack of space in and around town centres to buy or build estates.

This shortage of space, combined with two powerful trends – the increase in e-commerce during the pandemic and the re-shoring of supply chains due to difficulties obtaining goods from abroad – is driving unprecedented growth in rental uptake and renewal prices.

In the three months to December, the average rent uplift at letting and renewal for Industrial REIT was 22% making for five consecutive quarters of 20%-plus increases.

Despite this, tenant demand – especially from firms involved in last-mile logistics as well as smaller manufacturers – is rocketing, with the amount of square feet under offer more than doubling in the course of 2021 to over 500,000 square feet for Industrials REIT.

Of this, 283,000 square feet related to new lettings while 235,000 square feet related to existing customers renewing their leases.

Strong demand combined with an increasingly high quality of customers means UK rent collections were between 91% and 96% last year and had already reached 85% for the current quarter by mid-January.

During the last quarter the firm sold its penultimate overseas asset and acquired various multi-let estates in Birkenhead, Caldicot, Coatbridge, Durham, Glasgow and Stockton-on-Tees for roughly £40 million with a net initial yield of between 6% and 7%.

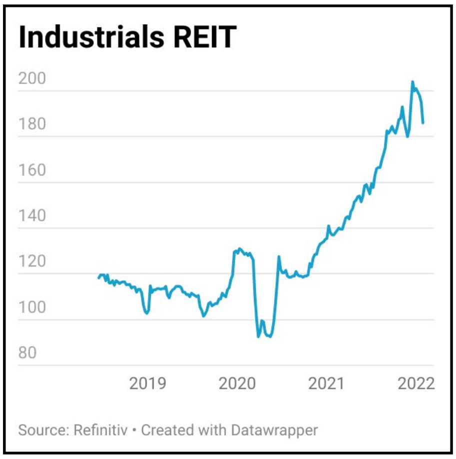
It has also recently finished upgrading more than 40,000 square feet of space at its Liverpool estate, which has immediately resulted in an uplift in rent from new and existing customers.

Manager Paul Arenson is confident the firm has at least another five years of average annual increases of more than 6% in total rental income, driven by more significant uplifts at renewal or new letting, on top of which the trust is paying a 4% dividend.

The last recorded net asset value per share was 158p in September but given the changes to the portfolio – and more importantly the value of the existing portfolio in total to a potential bidder – Arenson believes the actual net asset value is north of 200p per share, based on the typical premium being paid to buy a large portfolio in the market. [IC]

INDUSTRIALS REIT
BUY
(MLI) 191p

Market cap: £552 million



BLOOMSBURY PUBLISHING

(BMY) 390p

Gain to date: 37.8%

Original entry point:

Buy at 283p 4 February 2021.

THE LATE JANUARY trading update from book publisher **Bloomsbury (BMY)** revealed that profits for the year to 28 February would be materially ahead of market expectations. This prompted a series of earnings upgrades and we think investors should play the momentum in the shares.

Trading was strong in the consumer division, both for adult and children's publishing. Moreover the group's digital arm has reached its long-term target of achieving sales of £15 million and £5 million of profit by the end of this financial year.

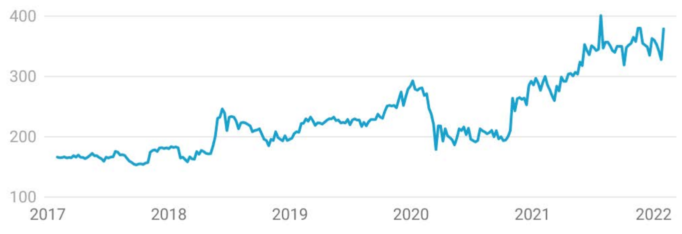
Moving forward the company is likely to benefit from two strategic acquisitions made in 2021.

Red Global Press, picked up in the spring, strengthens Bloomsbury's digital resources division. It has a backlist of more than 7,000 titles and publishes more than 100 new titles a year.

And the purchase of ABC-CLIO, announced in December, will accelerate Bloomsbury's academic publishing push in North America.

Bloomsbury Publishing is a high quality business that continually delivers and has scarcity value. It is rich in intellectual property and benefits from both geographic, format and topic diversity.

It also has a record of strong strategic planning delivered by an experienced management team.



SHARES SAYS: ↗
Still a buy. [MGar]

DOTDIGITAL

(DOTD:AIM) 154.5p

Loss to date: 9.1%

Original entry point:

Buy at 170p, 4 March 2021

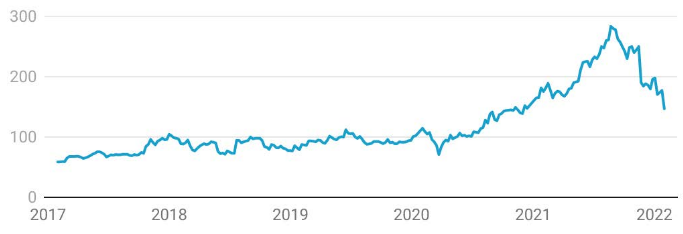
IT'S BEEN A rollercoaster year for many technology companies yet **DotDigital's (DOTD:AIM)** own ride has been particularly violent.

From gains of more than 70% in September 2021 versus our entry price to recent 20% losses, it is perhaps the sort of wild performance that some readers have come to expect from AIM-listed stocks.

We believe that AIM is less important in the DotDigital story than the pressure being placed on profit margins and the widely reported sell-off in tech and growth stocks.

The margins issue is not new. While DotDigital marketing department clients have embraced technology through the pandemic to improve customer relevancy, personalisation, and bang for buck, the wider use of lower margin SMS over social media or email platforms across the firm's Engagement Cloud platform spooked investors. There is also wage inflation.

Last month's update flagged these issues were getting back to normal, boding well for future growth. High recurring revenues, strong balance sheet and excellent cash generation appeal, and a share price recovery looks likely this year. If the shares stay at depressed levels, then DotDigital could become a takeover target.



SHARES SAYS: ↗
We continue to back the company and its shares, and investors should too. [SF]

HARGREAVES SERVICES
(HSP:AIM) 515p

Gain to date: 60.9%
Original entry point:
Buy at 320p, 25 February 2021

UNTIL THE PUBLICATION of its first half results, shares in industrial and property services group **Hargreaves Services (HSP:AIM)** were trading at just 400p, but the reaction to the numbers was bullish with the stock gaining 17% in a day.

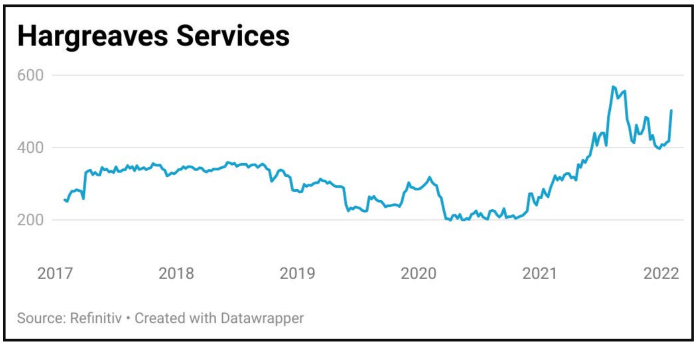
This optimism reflected the huge strategic progress the company has made during the pandemic and management's promise of materially higher earnings in the next few years.

The six-month period to 30 November showed a near 10-fold jump in pre-tax profits to £10.4 million thanks to an outstanding contribution from its German materials business.

Alongside its German operations, the firm's UK land business made significant progress on both the residential front, where it cleared nearly £10 million on the sale of a site in Edinburgh to **Persimmonn (PSN)**, and the commercial front, where it develops space for warehouses and the logistics sector.

Meanwhile, the services business has 'started work in earnest on HS2', the extension to the UK's high-speed train network, with monthly revenue of more than £2 million as the project gears up.

With a large cash pile from the sale of part of its German asset, the company is paying out a raised dividend and a special dividend for the foreseeable future.



SHARES SAYS:
Long-term investors should continue to add to this exciting business. [IC]

REVOLUTION BEAUTY
(REVB:AIM) 128.5p

Loss to date: 19.7%
Original entry point:
Buy at 160p, 9 September 2021

OUR BULLISH CALL on **Revolution Beauty (REVB:AIM)** is almost 20% in the red, yet we are sticking with the make-up, skincare and haircare brand for its global growth potential.

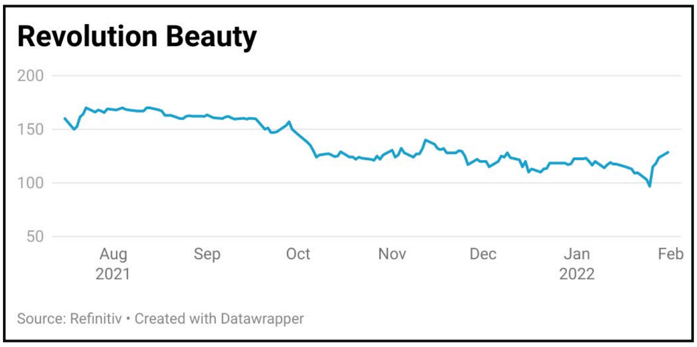
We believe Revolution Beauty will capitalise on a buoyant mass beauty market once the pandemic recedes.

News since Revolution Beauty's July 2021 IPO has been positive, with the company continuing to expand distribution with retailers and the online business growing.

However, concerns over Omicron, cost pressures and supply chain disruption have weighed on sentiment. And Revolution Beauty, which reported a widened first half loss after IPO-related costs, has been caught up in the rotation away from high potential growth stocks towards profitable value names.

Encouragingly, the shares rallied following a positive Christmas trading update (26 Jan) which highlighted 41% sales growth over the peak months of November and December, despite many of Revolution's markets going into lockdown.

Revolution Beauty also confirmed major new distribution wins with Walgreens in the US and Boots in the UK.



SHARES SAYS:
Revolution Beauty's share of the growing global mass beauty market remains small, so there's an enormous opportunity in front of the business. Keep buying. [JC]

HIPGNOSIS SONGS FUND
(SONG) 117p

Gain to date: 1.3%
Original entry point:
Buy at 115.5p, 18 June 2020

SHARES IN **HIPGNOSIS Songs Fund (SONG)** are trading at an 11-month low as the investment trust has been caught up in a spat between musician Neil Young and streaming platform Spotify.

Young has asked for his entire music catalogue to be pulled from Spotify in protest over the platform hosting podcasts by Joe Rogan who has been accused by the musician of spreading Covid misinformation.

Hipgnosis owns 50% of the worldwide copyright and income interests of Young's catalogue, and the musician has more than 6 million monthly listeners on Spotify.

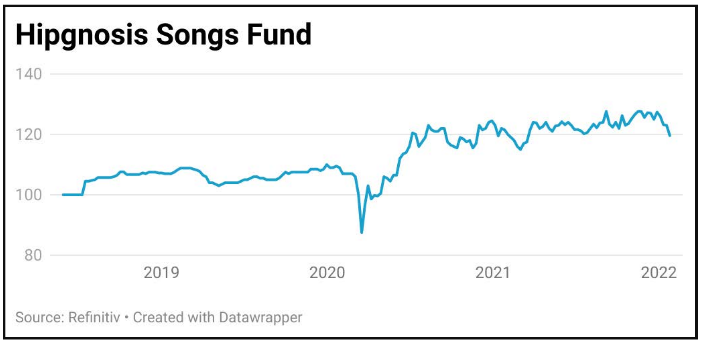
Investment bank Stifel calculates Young could generate $7.5 million a year in royalties from his catalogue, with reports suggesting Spotify accounts for 60% of all his streamed music.

Joe Rogan may have to be tamed, but with 11 million estimated listeners he is too big a deal for Spotify to cut loose.

'From Neil Young's perspective once you have taken a moral stance it is difficult to see how he will be comfortable returning to the platform without Spotify providing something in return. If the stalemate does persist for some time, we would expect that the catalogue valuation may become impaired,' says Stifel.

While streaming is important to Hipgnosis, its income is also generated by relevant songs being used in films, TV and adverts, played live, or in shops or on the radio. However, the Neil Young situation would suggest Hipgnosis has no control or say in how the songs are consumed despite owning 50% of the rights for this artist, says Stifel.

Hipgnosis should also be concerned if a substantial number of other artists take Young's side and also boycott Spotify as that could negatively impact streaming income should this involve any songs where it owns a royalty.



We've already seen Joni Mitchell (3.7 million monthly listeners) and Lloyd Cole take a stand against Spotify and further artists could follow suit, particularly as tensions were already riding high over the share of money that artists receive each time their songs are played on the platform. For years, many artists have criticised Spotify saying it doesn't pay artists enough.

The flipside is that Hipgnosis could benefit if the rates change more in favour of the artists, given it too would receive more money.

SHARES SAYS: ➔

Neil Young's boycott presents a new risk to Hipgnosis' business model, one which is already opaque given a lack of transparency over how much it pays to buy each royalty.

The key attraction for Hipgnosis' shares is dividends rather than capital gains. While it has a diversified catalogue from which to fund these cash payments to shareholders, it's clear that Hipgnosis is not a low-risk investment. Shareholders should sit tight for now, pending more clarity on the Young/Spotify fallout. [DC]

FLASH SALE

FIVE QUALITY STOCKS TO BUY NOW

By **Martin Gamble**, **Tom Sieber**, **Ian Conway** and **James Crux**

With global stock markets going through a rocky patch, triggered by the US central bank signalling the end of loose monetary policy, *Shares* believes now is an opportune time to pick up high-quality shares which may have been oversold in the broad market correction.

There is a lot of uncertainty and confusion even among professional investors and a good way to navigate this turbulent period is to focus on high quality businesses that can survive any economic scenario.

In this feature we have created screens to unearth shares which have been unduly punished in January's market sell-off but display bucket loads of quality.

HOW DO YOU DEFINE QUALITY?

Before we get to the metrics which often characterise good quality businesses it should be remembered that many aspects of quality simply cannot be measured and require a qualitative assessment.

In other words, unlike the concept of value there is no universally accepted definition for quality.

Conceptually, quality implies resilience and pricing power of a company's products which makes them stickier and harder to compete against.

Many years ago, Richard Branson's Virgin brand launched a competing coke-flavoured drink to challenge the beverage giant Coca-Cola, but despite its best efforts and strong band it couldn't dislodge the 130-year-old beverage maker.

Coca-Cola's largest shareholder is famed investor Warren Buffett who once said that if you handed him $1 billion to compete against the drinks business, he would hand the money back,

SHARES' SCREEN: A selection of stocks that meet our desired criteria for a 'quality' stock

Name	5-year average free cash flow to long-term assets (%)	5-year average return on equity (%)	Gross profits to assets (%)	Free cash flow to sales (%)
888	17.1%	28.6%	115.6%	12.1%
Adobe	20.9%	32.2%	51.1%	43.6%
Bureau Veritas	9.3%	26.9%	50.4%	13.8%
Coloplast	25.3%	62.0%	84.0%	21.5%
Dotdigital	13.4%	24.9%	63.6%	17.1%
Estee Lauder	12.7%	35.7%	56.4%	14.5%
Etsy	16.3%	21.9%	52.4%	26.1%
FDM	35.8%	51.1%	93.2%	17.2%
Games Workshop	36.1%	66.5%	91.2%	28.7%
Howden Joinery	16.1%	36.7%	55.1%	16.5%
Idexx Laboratories	17.6%	130.6%	68.5%	21.1%
Kainos	25.2%	40.3%	71.9%	12.6%
Lime Technologies	15.0%	48.4%	97.8%	28.8%
Moneysupermarket.com	31.2%	42.8%	75.2%	21.2%
Nike	13.2%	39.5%	53.0%	13.9%
Pandora	28.1%	67.8%	72.7%	25.5%
Remedy Entertainment	8.0%	23.3%	81.9%	17.8%
Rollins	20.2%	30.4%	60.3%	15.6%
Shutterstock	13.7%	12.5%	55.8%	22.5%
Spirax-Sarco Engineering	10.7%	24.5%	51.8%	18.8%

Table: Shares magazine.

Source: FE Fundinfo. Total return in GB. Data at of 27 January 2022 • Created with Datawrapper

because it wasn't possible.

Buffett coined the phrase 'moat' to describe businesses which possessed certain characteristics (brands, scale, know-how) which made them more resilient and higher quality.

What Buffett also liked was the superior financial characteristics of high-quality firms – high margins, returns on equity and strong free cash flow generation.

Buffett's thinking influenced the quality metrics which are used today to identify quality companies. For this article, *Shares* has used those metrics to search for quality firms, as well as applying one less well-known quality metric, being the gross profits to assets ratio.

WHY IS THIS RATIO IMPORTANT?

The gross profits to assets ratio is best associated with finance professor Robert Novy-Marx whose research showed that firms which exhibited a high ratio, considered to represent high quality, generated significantly higher average stock returns than firms which exhibited a low ratio.

It sounds like a very simple metric, but let's dig into the moving parts. Gross profit is the value-add and defined as sales minus cost of sales. The gross margin is sales minus cost of sales, divided by sales.

A higher value-add margin reflects pricing power and arguably the success and stickiness of the product in the marketplace.

Large global brands like Nike and Apple can sell their goods at higher margins because their customers perceive them to be superior to alternative products.

The other side of the gross profits to assets ratio is totals assets, which represent all the capital investment required to run the business and generate sales.

Asset light businesses are generally lower risk because they generate higher cash flows which can be used to grow the business or pay dividends.

In essence, companies which have a high gross profit to assets ratio are considered high quality businesses. For the screening process we have looked for firms with a ratio above 50%.

SEARCHING FOR QUALITY

Shares has used Stockopedia's system to create a screen which narrows the investment universe to the most attractive quality companies which have underperformed over the last six months.

This is the criteria we used:

- 5-year average free cash flow to long term assets >/= 5%
- 5-year average return on equity >/= 12%
- Gross profit to assets >/= 50%
- Free cash flow to sales >/= 12%

We filtered the list to only have the top quartile of companies on all these measures. We then further filtered the list to only include shares which have underperformed their local market over the last six months.

From this screen we have selected L'Oreal, Nike, Coloplast and **Games Workshop (GAW)**.

For extra thoroughness, we ran a second screen on the market using Stockopedia's quality filter which scores companies across nine different quality metrics.

We looked at stocks scoring 90 or above, and again filtered by share price performance to only include companies which have underperformed over the last six months.

From this list we have chosen safety products expert **Halma (HLMA)** which has been caught up in the market sell-off, presenting a great opportunity to buy shares at a lower price in a fantastic company. It has a quality score of 91 out of 99 on Stockopedia.

A selection of stocks with the highest quality score (99) on Stockopedia

Company
Adidas

Alphabet
Burberry
Henkel
Kindred
Logitech International

Nike
Persimmon
S&P Global
Skechers USA
Sonova
Starbucks

Target
Visa
Yum! Brands

Source: Stockopedia

L'OREAL (OR:EPA) BUY

Price: €375

BUY

Market cap: €210 billion (£174 billion)

We doubt L'Oreal needs much introduction, but it is probably worth explaining why it is such a good long-term earnings compounder.

The personal car and beauty market typically grows around 5% per year and this year is estimated to be worth more than $560 billion according to consultant Statista. The biggest market is the US, which accounts for 15% or just under a sixth of global demand.

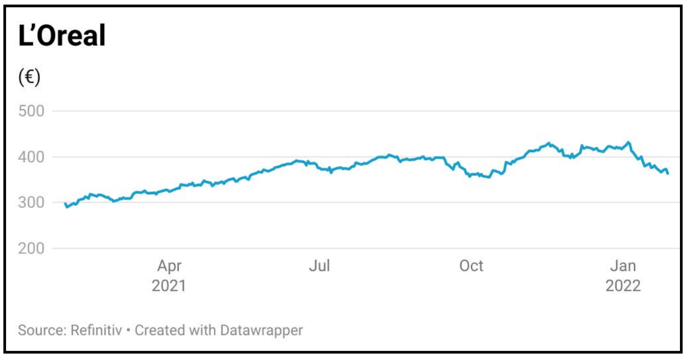
In the first nine months of last year, L'Oreal generated sales of €23.2 billion, an increase of 18% on a like-for-like basis against single-digit growth for the market, with the US accounting for €6 billion or more than a quarter of group turnover.

The group throws off so much cash that it can afford to add bolt-on acquisitions to grow its market share while at the same buying back stock to improve its per-share returns.

With its attractive margins, strong brands, control of distribution and high spend on R&D, L'Oreal typifies the 'strong moat' kind of company which appeals to Terry Smith, who owns a big chunk of the shares in his **Fundsmith Equity Fund (B41YBW7)**.

As Smith says, on the whole business returns don't change: 'Good businesses remain good, while businesses with poor returns have persistently poor returns'. [IC]

DISCLAIMER: Editor Daniel Coatsworth has a personal investment in Fundsmith Equity Fund



COLOPLAST (COLO-B:CPH) BUY

Price: DKK 947.40

BUY

Market cap: DKK 203 billion (£22.7 billion)

Danish healthcare firm Coloplast is one of the world's leading makers of products that make life easier for people with personal and private medical conditions.

Its businesses include ostomy care, continence care, wound and skin care, and interventional urology. Because its products are consumable and the conditions it treats are long-term, the firm has high visibility of revenues and earnings.

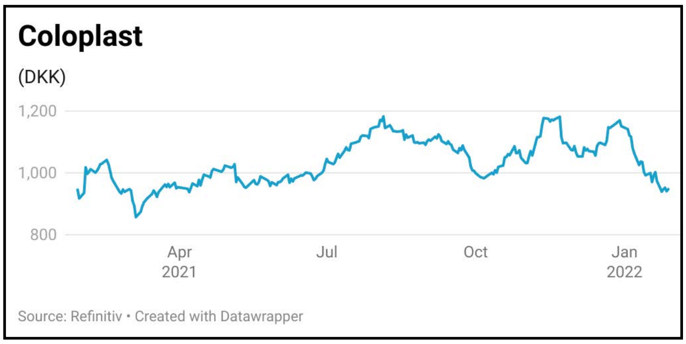
Sales are growing at 6% to 8% on an organic basis, with the recent acquisition of Atos Medical likely to push total revenue growth to 15% this year. Earnings before interest and tax is seen growing at a similar pace to the top line, generating a margin of over 30%.

Hospital activity is seen normalising in Europe and the US this year with growth in patients back to pre-Covid trends, which will drive sales of the firm's chronic and continence care products.

Outside of China, emerging markets are expected to see double-digit growth in patient numbers helping to drive growth across the firm's product range.

Christian Diebitsch, manager of the **Heptagon European Equity Focus Fund (BPT3468)**, says he first bought shares in Coloplast in 2004 and has always owned the stock since as it still fits his definition of 'a high-quality growth compounder'. [IC]

DISCLAIMER: The author (Ian Conway) and editor (Daniel Coatsworth) have personal investments in Heptagon European Equity Focus Fund

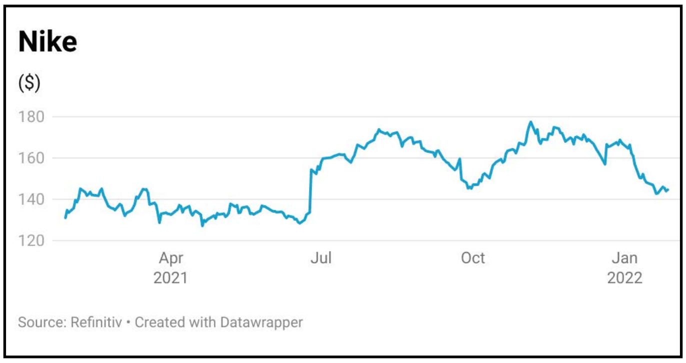


Nike (NKE:NYSE) BUY

Price: $143.99

BUY

Market cap: $228.7 billion



Shares in sportswear giant Nike have been caught up in the maket sell-off, dropping 14% from $166.67 at the start of the year to $143.99.

That correction is unwarranted, as the company famed for its iconic swoosh logo has all the hallmarks of a high-quality business.

A company with a wide economic moat, Nike should remain one of the world's preferred sportswear brands for years to come given its scale, brand strength and digital savvy.

It has a strong track record of value creation as measured by high return on capital employed and return on invested capital, metrics that indicate the presence of a sustainable competitive advantage.

The sportswear group generates premium pricing on products such as its performance athletic shoes, demonstrating its brand power.

Despite supply chain disruption, second quarter results (20 December 2021) beat expectations as Nike benefited from robust demand in its biggest market, North America, and a bumper Black Friday week.

CEO John Donahoe believes his charge is in a 'much stronger competitive position' than before the pandemic.

Increasingly selling products through its own stores and website to control brand messaging and margin, Nike has also made in-roads into the metaverse with the launch of the 3D immersive world of Nikeland on Roblox and the acquisition of virtual sneaker company RTFKT. [JC]

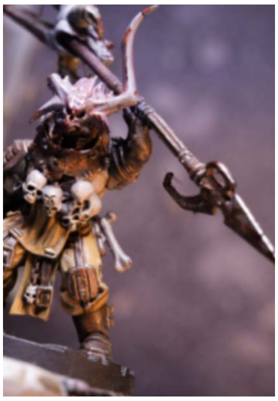
NIKE SHOULD REMAIN ONE OF THE WORLD'S PREFERRED SPORTSWEAR BRANDS FOR YEARS TO COME GIVEN ITS SCALE, BRAND STRENGTH AND DIGITAL SAVVY

GAMES WORKSHOP (GAW) BUY

Price: £77.35

BUY

Market cap: £2.6 billion



Shares in fantasy games and miniatures maker Games Workshop have dropped around a third from their highs in September 2021.

Shares believes the factors driving the stock price lower are temporary and the fundamentals and quality of the business are as strong as ever, providing long term investors with a good buying opportunity.

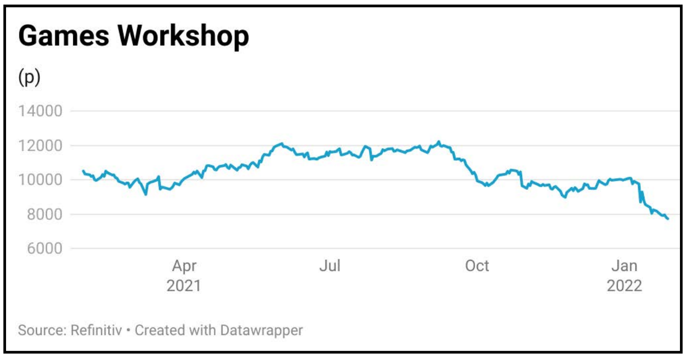
Arguably, the company has suffered from its success and reputation for under-promising and over-delivering financial results.

Over the past 18 months analysts have increased their earnings forecasts a lot, significantly raising the bar for the company to beat.

Lapping strong prior year growth provided tough comparatives at the half year stage which, combined with higher shipping and employee costs, resulted in the company failing to beat expectations.

Rumbling customer complaints about Games Workshop's hard-line approach to protecting its intellectual property also played a role in dampening investor sentiment towards the shares.

We believe investors should look beyond the short-term issues and focus on the high quality of the business which has delivered an average return on equity of 66% over the last five years according to Stockopedia. [MGam]

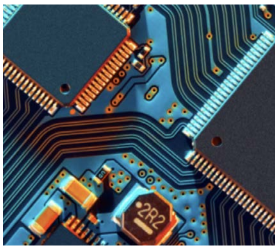


Halma (HLMA) BUY

Price: £23.98

BUY

Market cap: £9.2 billion



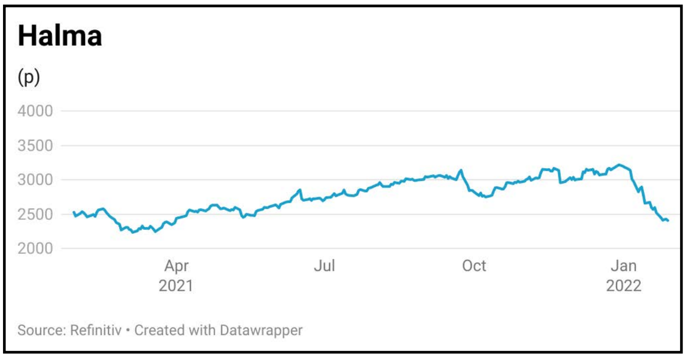
Any time it is caught up in a wider market correction there is a good case for taking a close look at Halma with a view to buying the shares on the dip.

The designer of health, safety and environmental electronics equipment has delivered record annual results and consistent dividend growth for more than a decade, including through the pandemic, benefiting from its exposure to long-term growth markets which often enjoy regulatory drivers. In effect Halma's kit often represents non-discretionary spend for its clients.

As well as investing heavily in research and development, the company has a strong track record of making small bolt-on acquisitions to bolster its market position. As such today it employs some 6,000 people in around 50 small to medium-sized enterprises operating across upwards of 30 countries.

Unsurprisingly these qualities have attracted a high market valuation – currently 37 times 2022 forecast earnings. However, you can buy the shares for 20% less than you could at the start of the year despite no negative news of any note from the company, with the weakness merely reflecting the market rotation out of expensive growth stocks.

History would suggest this is a buying opportunity which you should grasp with both hands, with Halma's ongoing potential likely to be rewarded over time. [TS]



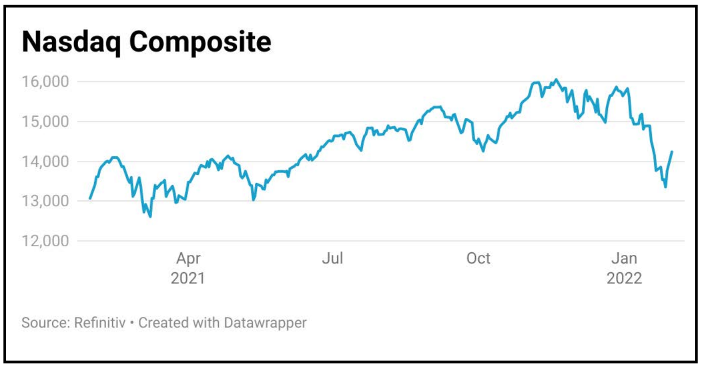
Time to load up after the big tech sell-off

Many profitable technology companies can be picked up at cut-price levels following the recent correction

Is it time to buy the technology sell-off and load up on some of the market's top growth stocks? It is one of the biggest questions currently facing DIY investors and the answer may depend on your own personal circumstances.

However, in our view there is a strong case for buying some of the higher quality tech names caught up in the recent correction. Particularly if they are already generating profit and cash flow.

Steep 2022 share price falls for the likes of Microsoft, Apple, Amazon, Adobe, Netflix, ASML, Nvidia and more could be a golden opportunity to load up on some of the best growth companies around.



Despite a recent fightback, aided by strong earnings reports, so far this year the Nasdaq Composite has lost nearly 10%, and the tech-laden index is down 11.3% since its all-time 16,057.44 record hit in November 2021. That's well into correction territory, when the price falls 10% or more below its recent peak. A full bear market kicks in when falls hit 20%.

THIRD OF STOCKS HALVED

According to Ned Davis Research, as cited by *Bloomberg*, in January 36% of the stocks in the index had plunged at least 50% from their 52-week highs. Historically, when the Nasdaq stands within 10% of its all-time peak, only 12.5% of its stocks

have tumbled that much on average, the Ned Davis study said.

The difference this time around is that the Nasdaq's biggest stocks are holding up reasonably well, and those companies have an outsized impact on the index, given that it's market capitalisation weighted. In other words, the bigger a company's value, the larger its impact on the wider market performance.

For example, Apple has fallen just 4% from its 52-week high (incidentally, chalked-up early in January this year), Alphabet is down 11%, Microsoft 11%, Facebook-owner Meta Platforms 19% and Amazon 21%.

'Microsoft is a bellwether and it is giving a really strong signal of continued demand in the cloud computing space, not just for Microsoft but for suppliers to cloud technology,' said JoAnne Feeney, Advisors Capital Management partner and portfolio manager.

The threat of rising interest rates has hurt all tech stocks but it seems to be hurting less mature, unprofitable companies more than most.

Ark Invest's US-based Innovation ETF – seen by analysts as a proxy for unprofitable and speculative technology companies – has plunged 32% this year and is more than 50% off its 52-week high. Its biggest five holdings – Tesla, Roku, Teladoc, Zoom and Coinbase – are all down substantially on their 52-week peaks.

'I think it's violent and unpleasant repricing, but I don't think it will end up derailing the year,' said Lori Calvasina, head of US equity strategy at RBC.

'For Nasdaq, it's a valuation reset,' she said. 'For the most part, this is a reaction to the monetary backdrop, not a growth scare. To really knock the market down in a significant and lasting way, you need to really have investors question whether the economy is risking recession.'

VALUATIONS RECOVERY

Advisors Capital's Feeney believes that growth this year is likely to slow from the big recovery seen in 2021 but companies like Apple, Microsoft, Broadcom still have strong drivers in place and they should be among the fastest growers in terms of revenue and earnings.

'That's why we believe valuations for companies like these will recover this year,' the fund manager said. 'Some of these technology opportunities have become extremely attractive after recent pullbacks.'

Many retail investors have taken the hint and bought the dips during the savage selling, snapping up shares that funds have shed from their portfolios in light of a more hawkish Federal Reserve, but with a focus on quality stocks as opposed to speculative names.

Craig Richardson, who is involved in running a small private fund, accepts that markets get ahead of themselves with regular pullbacks, but what seems clear to him is that the very largest tech companies continue to develop their products and services, and pile money into R&D (research and development).

Apple, Meta Platforms (aka Facebook), Microsoft, Amazon and Google-owner Alphabet spend around 50% of their operational cash flows on R&D and investment capex compared to approximately 6% on average for non-tech S&P companies.

'That's why I believe they are the cash cow defensive moats of tomorrow – they're proven having traded through many economic cycles,' says Richardson.

Legendary investor Mark Mobius called the tech sell-off a good time to look at FAANG stocks, referring to names mentioned above and including Netflix, although the acronym is increasingly anachronistic.

Big tech's fall, year to date performance

	% off 52-week peak
Netflix	-39%
Nvidia	-29%
Tesla	-25%
Amazon	-21%
Meta Platforms (Facebook)	-19%
Alphabet (Google)	-11%
Microsoft	-11%
Apple	-4%

Table: Shares Magazine • Source: Google Finance, 2 Feb 2022 • Created with Datawrapper

Mobius, a veteran emerging-markets investor and the founder of Mobius Capital Partners, said he was keen on mega tech names like Apple, Amazon, Netflix and Alphabet because they're strong earners.

'Those companies that have been hit as a result of the overall decline in tech stocks, that are making money, that have a good return on capital that are growing… these are great buys right now,' he said.

Billionaire investor Bill Ackman, who built the Pershing Square Capital Management hedge fund business, has built a new stake in Netflix worth more than $1 billion since its stock price tumbled on 20 January 2022 following its subscriber growth warning.

Return on capital, alongside return on equity and free cash flow are three of the most closely watched valuation measurements when assessing high-quality stocks. These measure how effective a company is at getting bang for its investment buck, how hard it sweats the money shareholders invest to create extra value, and how efficient a company is at turning profits into cash.

Microsoft, for example, has earned an average return on equity of 40.3% over the past five years, almost twice the industry average. Its five-year return on investment average was 19.5% versus

Big tech growth markets

	Market value as of 2020 (billion)	CAGR*	Potential value in 2030 (billion)
AI	$10,500	26%	$108,000
Battery Technology	$1,500	35%	$32,000
Blockchain	$1,400	43%	$49,000
Robotics	$168	51%	$10,000
Gene Sequencing	$125	40%	$3,600
Non-Innovation	$94	3%	$126

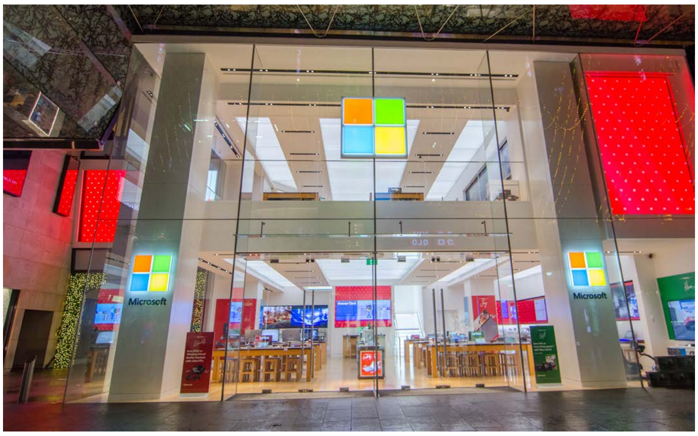
**CAGR = Compound annual growth rate, forecast by Ark.*

Table: Shares Magazine • Source: Ark Innovation ETF. • Created with Datawrapper

the industry's 13.2%.

Other tech firms to score highly on these metrics include craft products marketplace Etsy, graphic design software champion Adobe, and from the UK, **Kainos (KNOS)**, **DotDigital (DOTD:AIM)** and **Quartix Technologies (QTX:AIM)**.

Microsoft is currently the largest single stake of highly successful UK tech funds the **Allianz Technology Trust (ATT)** and **Polar Capital Technology Trust (PCT)**. Other names featuring near the top of their respectively portfolios include cyber security firm Zscaler, microchips maker TSMC (or Taiwan Semiconductor Manufacturing Company) and Micron Technology, a bellwether chips firm. Both funds also own Apple and Alphabet.



LONG-RUN TECH WINNERS

Veteran technology analyst Daniel Ives, of US-based investment firm Wedbush Securities, said that despite rotation and inflation fears compressing high multiple tech stocks, his long-term bullish thesis for the sector remained unchanged.

'We believe this painful sell-off in tech has created the opportunity for investors to own the secular tech winners for the next three to five years,' he observed. 'Cloud and hybrid cloud environments represent one of the most transformational growth opportunities we have seen in our 20-plus years of covering tech stocks,' the analyst said.

'There's nothing wrong with the fundamentals, and their earnings revisions are strong versus other sectors,' concluded RBC's Calvasina. 'I don't think this is the end of tech investing.'

Investors looking to position for the next two to five years, 'there's clearly a buy signal for some of these stocks based on their intrinsic value and their ability to grow and increase profits over time,' agrees Advisors Capital's Feeney.

'It's a clear opportunity for the longer-term investor,' although Feeney accepts that it may be a 'bumpy ride.'

DISCLAIMER: The author (Steven Frazer) owns shares in Allianz Technology Trust and Polar Capital Technology Trust, referenced in this article.

By **Steven Frazer** News Editor

Glencore's stake in crop trader could be worth up to $10 billion

Commodities firm could harvest value in Viterra through IPO or industry sale

Commodities giant **Glencore (GLEN)** could be in line for a multi-billion-dollar windfall if calculations by analysts at UBS are right.

The company is rumoured to be thinking about offloading its near-50% stake in crop trading firm Viterra, which itself recently snapped up US rival Gavilon in a $1.13 billion deal.

Glencore is the world's leading commodities trader as well as being one of the largest global mining firms – with significant exposure to copper, cobalt and nickel. All of which are expected to see higher demand amid a move to electric vehicles and renewable energy.

A GOOD TIME TO EXIT?

Viterra was officially spun out of Glencore as a standalone entity in 2020 after selling a chunk of the business to Canadian investors in 2016.

Supply chain disruption and weather impacts have led to a surge in agriculture prices, suggesting now would be a good time for Glencore to realise value from its remaining holding, whether by floating the business on the stock market or by selling to a third party.

According to a report, UBS has arrived at a $7 billion to $10 billion transaction value for Viterra, encompassing net debt of $2 billion. This is based on other deals in the sector, which have been pitched at around 10 to 14 times EBITDA (earnings before interest, tax, depreciation and amortisation), and Viterra's own $1.6 billion of EBITDA in the 12 months to 30 June 2021 – of which Glencore's effective share is $800 million.

M&A RUMOURS

Divesting its Viterra stake could provide Glencore with a helpful injection of capital. In turn this might be employed to accelerate its repositioning to be aligned with the energy transition.

It may also raise questions about the destiny of its thermal coal assets, which have benefited from recent strong pricing but are seemingly at odds with investors' growing focus on ESG (environmental, social and governance) considerations.

A substantial inflow of cash could also help the company fend off interest from potential predators, with **BHP (BHP)** recently reported to be mulling an approach for the group.

Undermining the credibility of this rumour is Glencore's ongoing exposure to coal, which was swelled by the $294 million acquisition of BHP's stake in the Cerrejon coal mine in Colombia in 2021 as the latter moved away from the polluting fuel source.

Glencore's then CEO Ivan Glasenberg, who has since been replaced by the firm's former head of coal Gary Nagle, took a swipe at BHP at the time suggesting that 'disposing of fossil fuel assets and making them someone else's issue is not the solution and it won't reduce absolute emissions.'

By **Tom Sieber** Deputy Editor

Five charts showing the attractions of Asian equity income

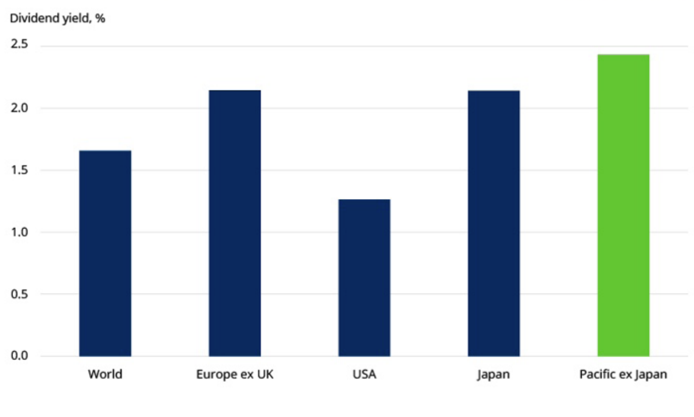
By Richard Sennit, Fund Manager, Schroder AsiaPacific Fund and Schroder Oriental Income Fund

Asian shares offer a compelling proposition when it comes to investing for income.

Interest rates may be on the rise but investors searching for higher income will still want to consider the merits of dividend-paying shares. Income investors often look to UK shares. However, Asian equities also hold significant attractions for income investors, and can help provide diversification.

The chart below shows how dividend yields in the Pacific ex Japan region are above those on offer in other non UK markets, and comfortably ahead of regions like the US. The dividend yield is the dividend per share, divided by the price per share.

Asian dividend yields compare favourably to the rest of the world



Source: FactSet, MSCI, as at 31 December 2021. 603773.

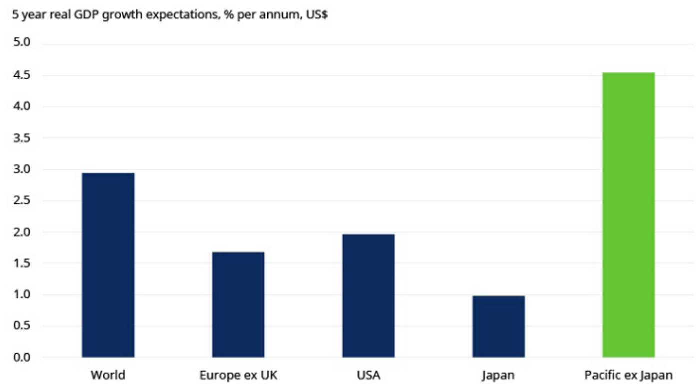
Added to their higher yields, Asian companies are operating in a region that is forecast to enjoy higher economic growth than other parts of the world over the next five years, as the next chart shows.

You may argue that overall GDP growth has little to do with investment returns. But as an income investor I'm looking for companies which are able to grow their income and dividends over time. Given the choice, I'd rather be doing that in an environment of higher economic growth than lower growth.

Then we come onto the opportunity set for income investors in Asia. The chart below shows the percentage of companies in different regions with a dividend yield above 3%.

As we can see, around 50% of companies in

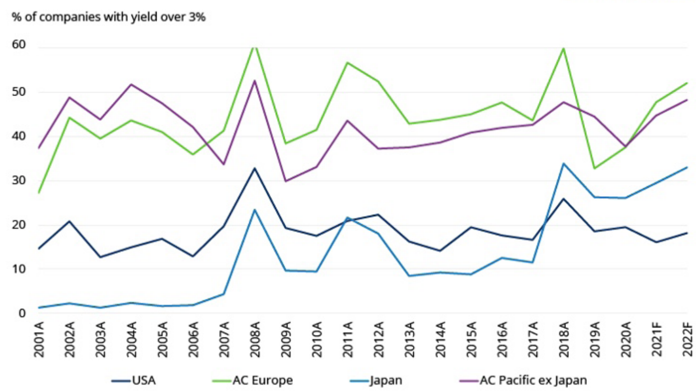
Asian GDP growth forecast to outstrip other regions



Source: IMF, Schroders as January 2022. Pacific ex Japan is based on the countries in MSCI AC Pacific ex Japan. Countries and regions shown are for illustrative purposes only and should not be viewed as a recommendation to buy or sell. 603773.

Pacific ex Japan and in Europe fulfil that criteria. By contrast, the percentages in the US and Japan are much smaller (around 33% and 18% respectively).

Wide opportunity set of high dividend stocks



Source: Jefferies, FactSet, October 2021. 603773.

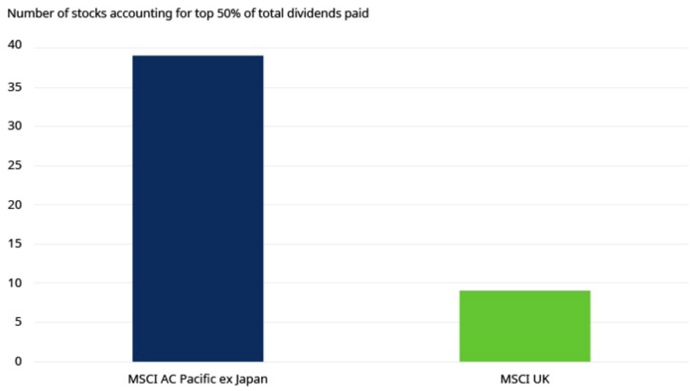
This is a fairly blunt measure but nevertheless demonstrates that income investors in Asia have a broad universe of companies to pick from.

Next, dividends in Asia come from a relatively large number of companies, whereas in the UK they are much more highly concentrated in just a handful of stocks.

The chart on the next page shows how fewer than 10 stocks make up 50% of the income from the MSCI UK index. By contrast, the corresponding figure for Asia is close to 50 stocks.

Again, this highlights the wider opportunity set that Asia offers for investors to choose from. This greater number of income payers making up 50% of the income also potentially makes Asia a more resilient source of income as it means investors are less reliant on any single company than they are in the UK.

Asian dividends are less concentrated than UK

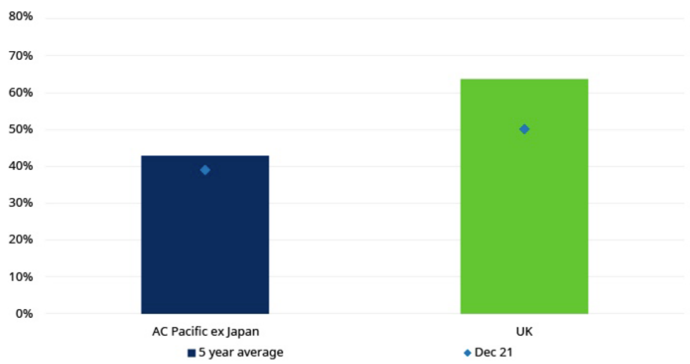


Source: FactSet, MSCI, Schroders. Total dividends paid calculated using dividend yield and market value, as at 31 December 2021. 603773.

The final chart illustrates another key consideration for income investors: the resilience of company dividends. The chart below compares the dividend pay-out ratio of companies in the Asia ex Japan index compared to that of the UK index.

The pay-out ratio is the proportion of earnings paid as dividends, and as we can see this is lower in Asia than in the UK.

Lower pay-out ratio offers flexibility



Source: FactSet, as at 31 December 2021. 603773.

What this means is that if the economy slows and earnings become more volatile, Asian companies on average have a buffer.

We've seen over time in Asia that when earnings come under pressure, companies that have a lower pay-out ratio don't necessarily have to cut their dividends. Instead, this buffer gives them the flexibility to allow pay-out ratios to rise until earnings have recovered.

A lower starting pay-out ratio also offers potential scope for future dividend growth.

Taken together, we think these charts show that Asian shares are an attractive proposition for income investors, offering both higher dividend yields than many other markets in combination with a wide set of opportunities.

To hear more from Schroders Investment Trusts, **sign up to the newsletter**.

Ruffer is top performing capital preservation trust in market shake-up

We look at Ruffer, Capital Gearing, Personal Assets Trusts and RIT Capital as investors seek safety amid volatile market conditions

A global equity markets sell-off at the start of 2022, driven by concerns over hot inflation and rising interest rates, together with growing tensions between Russia and Ukraine, has left many investors nursing significant portfolio losses.

Those with exposure to the technology-rich Nasdaq index across the pond have endured a particularly punishing 2022 so far, as monetary policy tightening, accelerated by inflationary pressures, has driven a market shift away from growth stocks and into value names.

The correction in equities is a salutary reminder for investors to ensure they hold a diverse portfolio of uncorrelated 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 and this is where capital preservation funds can appeal. They position themselves defensively to reduce risk and volatility.

WHAT ARE CAPITAL PRESERVATION FUNDS?

Capital preservation funds are positioned to help investors avoid large losses while growing their wealth too, albeit more slowly than adventurous, more risk-tolerant funds.

The Association of Investment Companies' flexible investment sector is home to a small band of capital preservation specialists that have done a good job at protecting investors' money during tough markets historically, though they haven't always avoided losses entirely.

These trusts can suffer losses during widespread sell offs and there is no guarantee they will always make you money. Yet their whole ethos is to fall

CAPITAL PRESERVATION TRUSTS

10 YEAR PERFORMANCE	Total return (%)
RIT CAPITAL PARTNERS	148.1%
CAPITAL GEARING TRUST	72.4%
RUFFER INVESTMENT COMPANY	67.6%
PERSONAL ASSETS TRUST	65.3%
BENCHMARK: FTSE ALL-SHARE	**100.7%**

Table: Shares Magazine • Source: FE Fundinfo, 27 January 2022 • Created with Datawrapper

YEAR TO DATE PERFORMANCE	Share price change (%)
RUFFER INVESTMENT COMPANY	2.1%
CAPITAL GEARING TRUST	-1.7%
PERSONAL ASSETS TRUST	-2.9%
RIT CAPITAL PARTNERS	-7.9%
BENCHMARK: FTSE ALL-SHARE	**-2.0%**

Table: Shares Magazine • Source: Google Finance, 31 January 2022 • Created with Datawrapper

RUFFER INVESTMENT COMPANY – ASSET ALLOCATION

UK equities	20.2%
Long-dated index-linked gilts	12.7%
Index-linked gilts	11.1%
Cash	9.6%
North America equities	8.7%
Gold exposure and gold equities	7.7%
Japan equities	7.4%
Illiquid strategies and options	6.9%
Europe equities	5.8%
Non-UK index-linked	5.6%
Short-dated bonds	3.1%
Other equities	1.1%
Asia ex-Japan equities	0.3%

Table: Shares Magazine • Source: Ruffer, as of 31 Dec 2021 • Created with Datawrapper

CAPITAL GEARING TRUST – ASSET ALLOCATION

Funds and equities	45.0%
Index-linked government bonds	34.0%
Conventional government bonds	9.0%
Cash	6.0%
Preference shares/corporate debt	5.0%
Gold	1.0%

Table: Shares Magazine • Source: CG Asset Management, as of 31 Dec 2021 • Created with Datawrapper

PERSONAL ASSETS TRUST – ASSET ALLOCATION

Equities	40.6%
US index linked-bonds	28.8%
Cash and UK government bonds	21.8%
Gold bullion	8.6%
Direct property	0.1%

Table: Shares Magazine • Source: Personal Assets Trust, as of 31 Dec 2021 • Created with Datawrapper

RIT CAPITAL – ASSET ALLOCATION

Equities	33.0%
Private investments - funds	25.0%
Absolute return and credit	19.0%
Equities - hedge	12.0%
Private investments - direct	10.0%
Real assets	2.0%
Other investments	−1.0%

Table: Shares Magazine • Source: RIT Capital, as of 31 Dec 2021 • Created with Datawrapper

by less than the market during a downturn, limiting your losses and protecting your hard-earned capital.

It is also important you understand that when equity markets rip-roar ahead, these funds are unlikely to keep pace, since they tend to have a lower exposure to shares than a standard income or growth fund.

PORFOLIO PROTECTION

The main three investment trusts in the capital preservation space are **Ruffer Investment Company (RICA)**, **Capital Gearing Trust (CGT)** and **Personal Assets Trust (PNL)**, each one positioned to cope with the volatile markets, inflationary pressures and interest rate rise increases ahead. **RIT Capital Partners (RCP)** also has a capital preservation slant.

Based on data to 31 January, shares in Ruffer are up 2.1% year-to-date, ahead of the FTSE 100's 0.4% decline but significantly outperforming the FTSE 250's 8.4% slump and the 2% drop in the FTSE All-Share.

Shares in Personal Assets are down 2.9% and Capital Gearing is off 1.7% year-to-date, modest declines which have saved their investors from the sharper falls suffered by the FTSE 250 and from the main US indices.

It is important to note that investments shouldn't be judged on such a short period.

HOW DO RUFFER AND PERSONAL ASSETS DIFFER?

As the asset allocation breakdown tables reveal, 43.5% of Ruffer's portfolio was in equities at last count, which is greater than the 40.6% Personal Assets has in shares in total.

Given the sell-off in equities seen in 2022 thus far, you might have expected the Ruffer's portfolio to have suffered more than Personal Assets, whose investment policy is to protect capital first, with growth second on the priorities list.

After all, Personal Assets is aimed at the cautious investor who is more concerned about not losing money rather than making outstanding returns and it has allocations to companies with pricing power in defensive sectors. It also has the highest gold exposure of the trio and invests in low-risk US and UK government bonds.

However, Personal Asset's top equity holdings include Microsoft and Alphabet, mega-cap growth names marked down during the recent rotation, as well as payments processor Visa. Personal Assets' performance hasn't been helped by the underperformance of consumer goods goliath **Unilever (ULVR)** either.

In contrast, Ruffer's equity holdings were more skewed towards beneficiaries of the rotation towards value, including energy and financials names such as **Shell (RDSB)** and **BP (BP.)** and **Lloyds (LLOY)** and **NatWest (NWG)**. Ruffer also holds **GlaxoSmithKline (GSK)**, in demand after receiving a blockbuster bid for its majority-controlled consumer healthcare unit from Unilever.

WHAT ELSE IS IN RUFFER'S PORTFOLIO?

The core of Ruffer's portfolio is formed of index-linked bonds, gold and equities, and the strategy has the flexibility to use derivatives (credit default swaps, equity put options and interest rate swaptions) to manage risk.

As Peel Hunt points out, Ruffer's managers have been actively hedging the risk of rising rates and are 'particularly concerned by the threat posed to traditional fixed rate bonds. This is reflected in the index-linked bonds within the portfolio (circa 38% of net asset value), and the value bias within the equity book'.

In the six months to December 2021, Ruffer's NAV total return was 2.8% and the share price total return was 2.6%, with the largest performance contributor being index-linked bonds, which added 1.9%.

This return was boosted by some active trading and duration management during a period of rising inflation and interest rates in which the fund's interest rate protection to offset the portfolio duration added 1.3% to performance.

Standout contributors from the equities book included **Marks & Spencer (MKS)** and **Tesco (TSCO)** amid growing private equity interest in the groceries sector.

As Ruffer explained in its latest update: 'We enter 2022 satisfied that our all-weather investment strategy has fared well through a wide range of investment conditions in the last three years. However, for all investors things are likely to get more rather than less difficult from here. In order to protect and grow their savings, investors will need to focus on risk rather than return and adopt a multi-asset approach containing genuinely uncorrelated assets.'

WHICH TRUST HAS THE BEST LONGER-TERM PERFORMANCE?

Over a 10-year view, the best-performing wealth preservation trust is **RIT Capital Partners (RCP)** with a total return of 148.1%, comfortably ahead of the 100.7% haul from the FTSE All-Share.

Over the past decade, Capital Gearing has returned 72.4%, a smidgeon ahead of Ruffer with a 67.6% total return and Personal Assets Trust, which is up 65.3%.

WHAT IS RIT'S STRATEGY?

Like the three pureplay capital preservation specialists, RIT is a multi-asset portfolio that invests in credit, macro strategies and real assets.

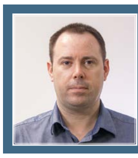
However, it also aims to deliver long-term capital growth through the purchase of risk assets including equities and private companies, both directly and through funds.

Exposure to risk assets explains why it has been so successful during the bull market yet proved more vulnerable to this year's correction than the more dedicated capital preservation plays. It is down 7.9% year to date.

WHAT IS CAPITAL GEARING'S STRATEGY?

Managed by Peter Spiller alongside Alastair Laing and Chris Clothier, Capital Gearing's objective is to 'preserve and over time to grow shareholder's real wealth', i.e. accounting for inflation.

Its portfolio is currently defensively positioned with a focus on inflation protection. It has a 34% allocation to index-linked government bonds, balanced by a 45% allocation to risk assets such as equities, property and alternatives. The remainder is invested in conventional government bonds, corporate debt, cash and gold.



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

SECURITIES TRUST OF SCOTLAND INCOME MATTERS

TROY ASSET MANAGEMENT was established by Lord Weinstock of GEC renown, and Sebastian Lyon in 2000 to protect and grow investors' capital - in that order. Troy, having seen the GEC business destroyed in the technology boom, recognised that times of heightened speculation can be catastrophic to wealth preservation if one loses perspective, patience and discipline.

At the core of this is to invest without reference to benchmarks but with reference to the underlying quality of the businesses in which you invest and have an absolute return mind set. Capital allocation is a function of seeking to balance quality, growth and income while ensuring adequate diversification and no notion of being "overweight" or "underweight" in any particular sector or company. Once a portfolio is established, we believe turnover should be kept low, recognising that the real money is made in the patient compounding in a settled, quality portfolio and not in the continuous buying and selling of shares. Finally this inherently conservative but quality-focussed approach should deliver above average returns with below average volatility over a full market cycle. This is especially important for those with irreplaceable capital and in need of income – two things which often coincide with retirement.

In these disquieting times, this approach is more relevant today than ever. Even before COVID-19 appeared, the backdrop was laden with risk to the unwary investor. After years of structurally declining interest rates and rising asset markets, we are left with an opportunity set across capital markets (bonds, equity, credit, property and so on) that is fully valued by many historical measures which implies low returns. This is at a time when several other underlying factors are also reaching historical extremes. These include levels of indebtedness, declines in working age populations owing to demographics and the pace of technological disruption, which are making economic growth and inflation hard to achieve.

So what are we to do? We believe that investing globally in a portfolio of high quality income bearing equities remains a compelling prospect for investors to meet their needs. But it must be done in a way that recognises and accommodates these distortions and challenges. We are therefore highly selective about the businesses in which we invest , concentrating on those that demonstrate their quality by having a high return on capital employed. This is derived from identifiable and durable competitive advantages and a business model that does not require large amounts of capital to grow and enables companies to both invest adequately in their businesses as well as pay an income. We want businesses that are well financed and sensibly managed. Such a portfolio should generate consistently growing free cash flow which funds both income and capital growth in a predictable way.

In Securities Trust of Scotland, we have constructed a historically resilient portfolio that generates an approximately 5% free cash flow yield funding a current 2.5% income yield which we expect to grow next year and beyond. In this way, we are able to meet the needs of our investors and face the future with confidence despite the uncertain outlook.

James Harries, Manage of Securities Trust of Scotland

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Plotting our position in the market cycle and what comes next

We may have moved past the euphoria stage but investors aren't in full panic mode yet

It is tempting to say the recent tumultuous sell-off in global markets is different to previous pullbacks.

This is on the basis it was triggered by investors reacting to the risk of the US Federal Reserve and other central banks raising interest rates, rather than a global pandemic or fundamental problem in the banking system or the housing market as in previous market downturns.

John Templeton, founder of the asset management group of the same name and a master investor who had the ability to judge market sentiment better than most, would probably argue it's never different.

The fact is the bull market in global asset prices from the post-financial crisis low was already long in the tooth when the pandemic struck, and due to its specific nature the pandemic actually reinforced the upside momentum in a select group of stocks propelling indices such as the Nasdaq into 'bubble' territory.

How the stock market cycle relates to the economic cycle

Both stock markets and the wider economy fluctuate between peaks and troughs. Economies will see periods of both growth in GDP and contraction (recessions). It's a similar story in the stock market but, because investors are forward looking with valuations reflecting expected future earnings, the market cycle is often ahead of the economic cycle. As a consequence stock markets often turn upwards when economies are still mired in recession.

BUBBLE OR SUPERBUBBLE?

In his recent letter to investors, Jeremy Grantham, co-founder of Boston-based asset manager GMO, described US stocks as having entered a 'superbubble' comparable only to those of 1929 and 2000.

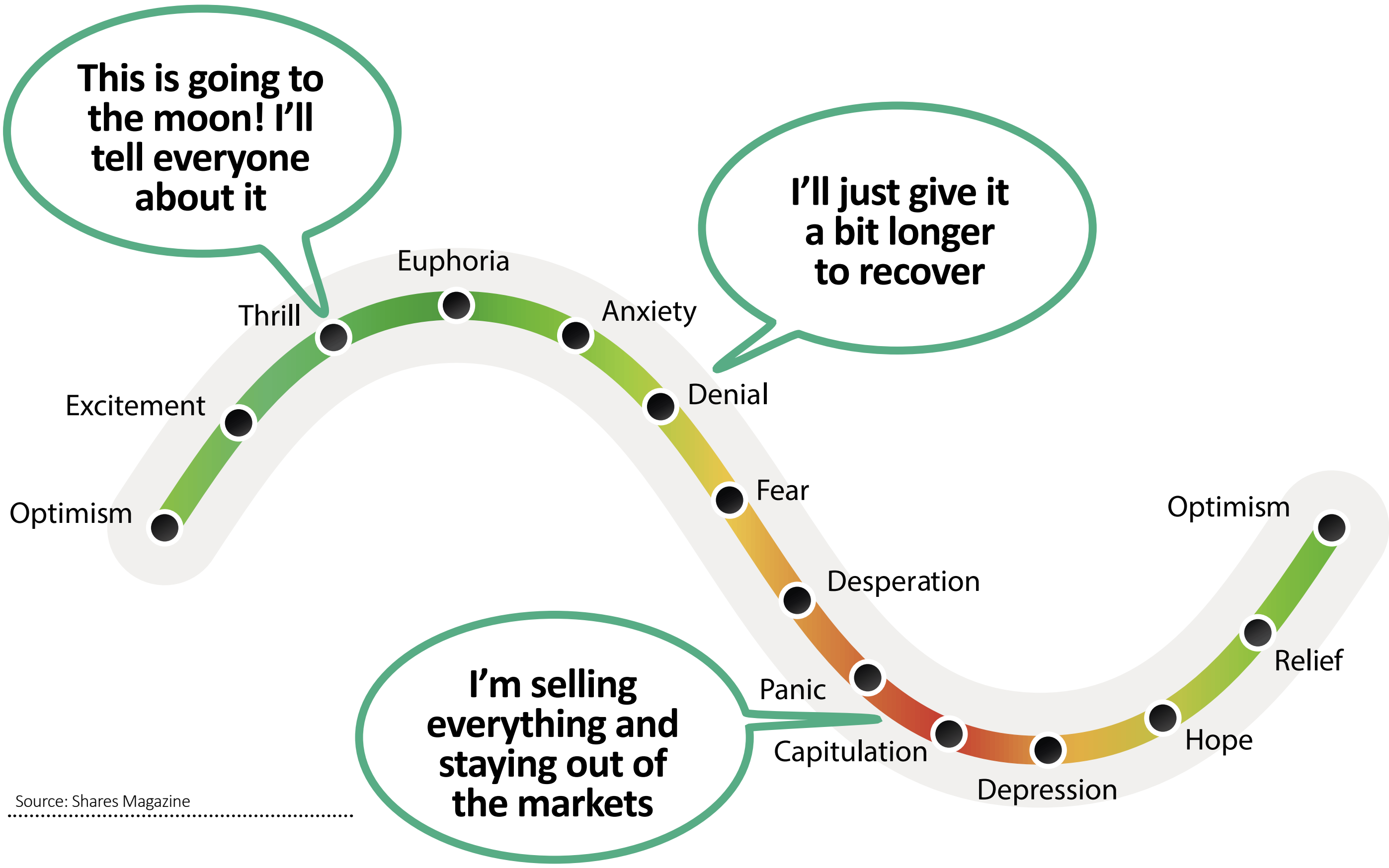
Grantham argues that two of the defining features of superbubbles are an acceleration in the rate of price increases to two or three times the average speed of the preceding bull market, together with a narrowing of market leadership which coincides with big drops in speculative stocks, both of which are consistent with what we have seen of late.

Historically, he concludes, superbubbles eventually correct 'all the way back to trend with much greater and longer pain than average'. GMO is advising its clients to avoid US equities and buy international value stocks with a particular focus on Japan.

THE SENTIMENT CURVE

It was Templeton who famously coined the phrase 'bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria'. We have expanded on Templeton's basic sentiment 'curve' with our own version in this article.

INVESTOR EMOTIONS THROUGH THE CYCLE



Source: Shares Magazine

In attempting to judge where we are in the cycle, it would seem a fair bet that we are past the period of euphoria for stocks or any other risk asset for that matter.

It seems highly unlikely from where we are standing that markets will rush back to their old highs, or even dawdle their way back there over the course of 2022.

However, neither does it feel as though we are anywhere near entering the fear or panic stages. The working assumption seems to be that the Federal Reserve just wants to tame inflation rather than kill it altogether, so markets should be able to live with a brief period of rising rates.

A 'NEW NORMAL'

If the Fed were to tighten monetary conditions too quickly or by too much it would risk a US – and by extension a global – slowdown, which is not its aim.

Moreover, most of the debt built up over the period of easy monetary conditions is in the hands of governments, not individuals or companies, and the Fed, like every other central bank, needs a degree of inflation in order to erode the value of its debt.

Also, central banks don't want to have to pay sky-high interest on any new debt they may need to issue so they need to perform a fine balancing act to convince markets they are being tough on inflation, on the one hand, while on the other hand not being so tough as to derail the economy.

Potentially the best outcome would be for markets to trade in a range until investors have lowered their expectations and the froth has been blown off share prices, dampening speculation and what are sometimes described 'animal spirits'.

This would certainly be preferable to more sharp falls in asset prices, which in turn risk creating a negative feedback loop with consumer confidence and resulting in a pronounced economic downturn.

By **Ian Conway** Companies Editor

DANNI HEWSON
AJ Bell Financial Analyst

Still waiting for the big airline comeback

Demand is expected to pick up but competition for passengers could result in a price war which isn't great for sector margins

There's little doubt that investors see 2022 as being the year that travel gets its mojo back, at least when it comes to Europe.

While US airlines made decent headway in 2021 largely thanks to continued demand for domestic flights, European airlines have been hampered by complex travel restrictions which seemed to chop and change with little rhyme or reason.

Omicron's later arrival to US shores coupled with investors' general yips over impending fiscal tightening have sent US airline stocks into retreat at a time when European Airlines are beginning to look a lot more attractive.

European airline bosses have been falling over themselves to shout about the increase in demand, particularly from UK consumers desperate for a little summer sun to soak away the stress of the last couple of years.

Capacity has been upped for those peak holiday months to those popular destinations that offer cheap and cheerful options for consumers still feeling a little cautious about jetting off anywhere too exotic.

European airlines versus US ones

Airline/Travel Operator	1 year share price change
Ryanair	9.8%
Jet2	8.5%
International Consolidated Airlines	7.6%
TUI	6.6%
Delta Air Lines	0.2%
JetBlue Airways	−4.0%
EasyJet	−4.3%
Southwest Airlines	−4.9%
American Airlines	−7.9%
Wizz Air	−9.8%

Source: Google Finance, 31 Jan 2022 • Created with Datawrapper

Price will be the X-factor and there's uncertainty about exactly how that will play out. In its latest update Ryanair said it expects its pricing power to increase eventually as capacity on sought-after destinations is stretched, but **Wizz Air (WIZZ)** boss József Váradi isn't so sure. He thinks there will be a glut of provision to popular resorts which will force rivals to keep pricing keen.

And that's where the skies look a little less blue. Airlines have high fixed costs and although most have continued to hedge their fuel costs each empty seat weighs on profitability.

It doesn't matter how many bookings are made, how many flights take off or to how many destinations, it matters how full those planes are and how much each passenger was prepared to fork out for their seat.

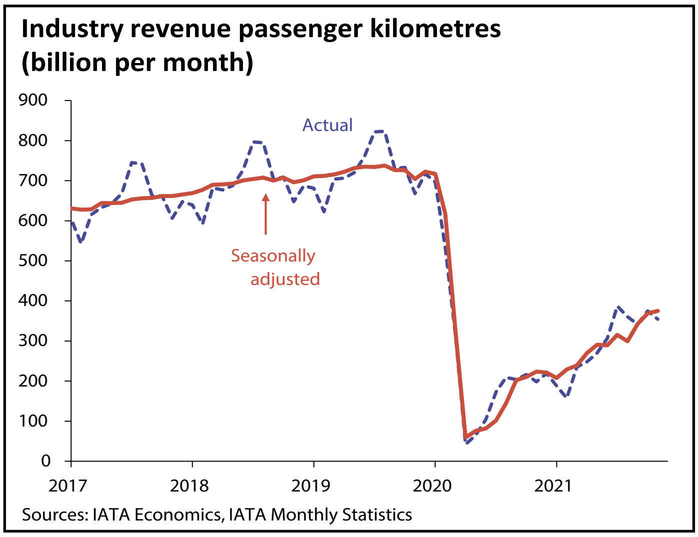
Looking at **EasyJet's (EZJ)** latest trading update the carrier had been making pretty good headway until Omicron dented confidence just as the

Christmas holiday rush should have got underway.

While the load factor (percentage of available seating that has been filled with passengers) had tipped over the 80% mark in both October and November it plummeted to 67% in December. As revenue rose so did costs and the load factor meant the sums still didn't add up to a profit.

Getting bums on seats will be crucial for all carriers and already the ticket offers are circling. With consumers booking later than they habitually would there is a question as to who will blink first. Are the deals now the best they're going to be or will those risking a last-minute break emerge the victor?

Global "flight-back" still miles away



For the low-cost summer sun providers 2022 does look set to deliver some better memories than the last couple of years did, indeed **TUI's (TUI)** UK managing director Andrew Flintham has said that he expects summer bookings to be back to pre-pandemic levels.

Going forward, if variants don't cause any more upset and inflation doesn't keep too tight a grip on the consumer purse then businesses like **Jet2 (JET2:AIM)** and EasyJet are in decent fettle, the latter has just begun hunting for 1,000 new pilots to bolster its roster as normal service is resumed.

But what of those long-haul carriers like British Airways? Globally, air travel is a very long way off the levels seen in 2019 and with many countries still requiring testing, confidence will be slower to return.

Add in the expectation that business travel will never get back to where it was because of environmental targets and the surge in the popularity of video conferencing, and there's a fare bit of turbulence ahead. To that end **International Consolidated Airlines (IAG)** has already begun plotting. Not only is the British Airways owner embarking on a return trip into low-cost territory but it's boosting its transatlantic credentials too.

A tie-up with American Airlines to co-locate at a new, improved JFK Terminal 8 from next December will help create onward opportunities as well as making the Big Apple a more enjoyable stop. Making those premium journeys worth the price tag shows that International Consolidated Airlines understands its true unique selling points but giving everyone a smoother experience through those airport checks will be a big lure.

Planning and development can't be put on hold. It's no accident many carriers have been on an aircraft shopping spree, scenting opportunity to grow. As carriers recover, aircraft manufacturers and the myriad other connected businesses will recover too.

The fact the aviation sector remains one of the few industries still to bounce back from Covid makes it interesting from an investment perspective. At some point, earnings are going to improve. It's a question of when, not if.

Unfortunately, the industry continues to be tested to its limits, and high oil prices and a highly competitive market mean the return to profit is not going to be a smooth ride for the sector.

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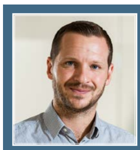
What happens when I turn 75 and I'm over the pension lifetime allowance?

Our resident pensions expert helps with a query about possible tax liabilities for someone approaching a key milestone

I'm 70. I've touched very little of my pension funds. All the untouched funds are in a SIPP. I expect to be 'tested' against the lifetime allowance at 75. Unless there is another crash like 2008 or 2020, I will exceed the standard lifetime allowance. I'm not sure how the tax on my excess will work.

Suppose I'm £120,000 over the limit and I'm hit with a £30,000 lifetime allowance charge. I leave the remaining £90,000 in the SIPP. Does it go back into the general SIPP or does it become a separate fund? Do I still get the 25% tax free when I take out a lump sum?

Paul



Tom Selby,
AJ Bell Senior Analyst says:

For the current tax year (2021/22) the lifetime allowance stands at £1,073,100 and it will remain at this level until 2025/26 after which it is due to be reviewed. Some people may be entitled to a higher figure than this if they have one of the various 'protections' that exist.

You can read more about these protections and the terms that come with them here.

The amount of lifetime allowance used will be tested whenever a 'benefit crystallisation event' occurs.

These events include:

- taking your 25% tax-free cash;
- putting your pension into drawdown;
- taking an ad-hoc lump sum;

- buying an annuity;
- death (if you die before age 75 and have funds in your pension not allocated to drawdown);
- your 75th

The age 75 test is often one that people focus on, in part because it captures any growth in your fund since entering drawdown as well as any untouched funds.

It is therefore possible that someone who hadn't breached the lifetime allowance before age 75 subsequently breaches it at this point in time and is hit with a lifetime allowance charge.

The lifetime allowance is more of a 'check point' than a hard limit that you have to stay under. Pension funds over the value of the lifetime allowance will be subject to a tax charge, and once you have used up your lifetime allowance, you will not be entitled to any tax-free cash on the excess.

So, for example, someone with a lifetime allowance of £1,073,100 and a fund of £1,200,000 could take a maximum of £268,275 in tax-free cash. It is still possible to take tax-free cash after age 75, up to this limit.

When a lifetime allowance test takes place before the age of 75 the level of the charge will be:

- 25% if you leave the excess in the pension (with income tax charged when you subsequently make a withdrawal);
- 55% if you take the excess out of your pension as a lump sum (with no more tax due).

If you reach age 75 with funds in your pension, the lifetime allowance charge on any excess will always be 25% with the remainder of the excess staying in your pension. Once the lifetime allowance charge has been taken you should have a single pension pot with your provider. For those who reach age 75, this will be the final time their pension is tested against the lifetime allowance.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

Please note, we only provide guidance 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.

If you're under 50 do you need to invest in bonds?

Putting money into this part of the market may offer a smoother journey but typically lower returns too

The bond market is under pressure. High inflation and the potential for rising interest rates have led to price falls, which may be the beginning of a tougher period for bonds. That's after a terrific decade in which they have enjoyed abundant returns, thanks to loose monetary policy.

Bonds tend to be viewed as slow and steady investments which find favour with older investors looking to dial down risk.

But should younger investors in their 20s, 30s and 40s consider bonds as part of their portfolio? The answer to that depends on what these investors want from their savings. There are typically two reasons why investors might choose bonds: diversification, and income.

GOVERNMENT BONDS OFFER SAFETY

If you're in the market for safety, government bonds, or gilts as they are known in the UK, might appeal. They're viewed as safe because the chance of the UK Treasury failing to pay back borrowings is very low, though that doesn't apply to every government around the world. Some people therefore invest in government bonds for diversification from a portfolio of stock market investments.

When stock markets are falling, gilts tend to move in the opposite direction, because these are seen as safe havens. Higher yield corporate bonds by contrast tend to have a higher correlation with stock markets, because these are loans to companies rather than the government, so they are also seen as a risky asset like shares.

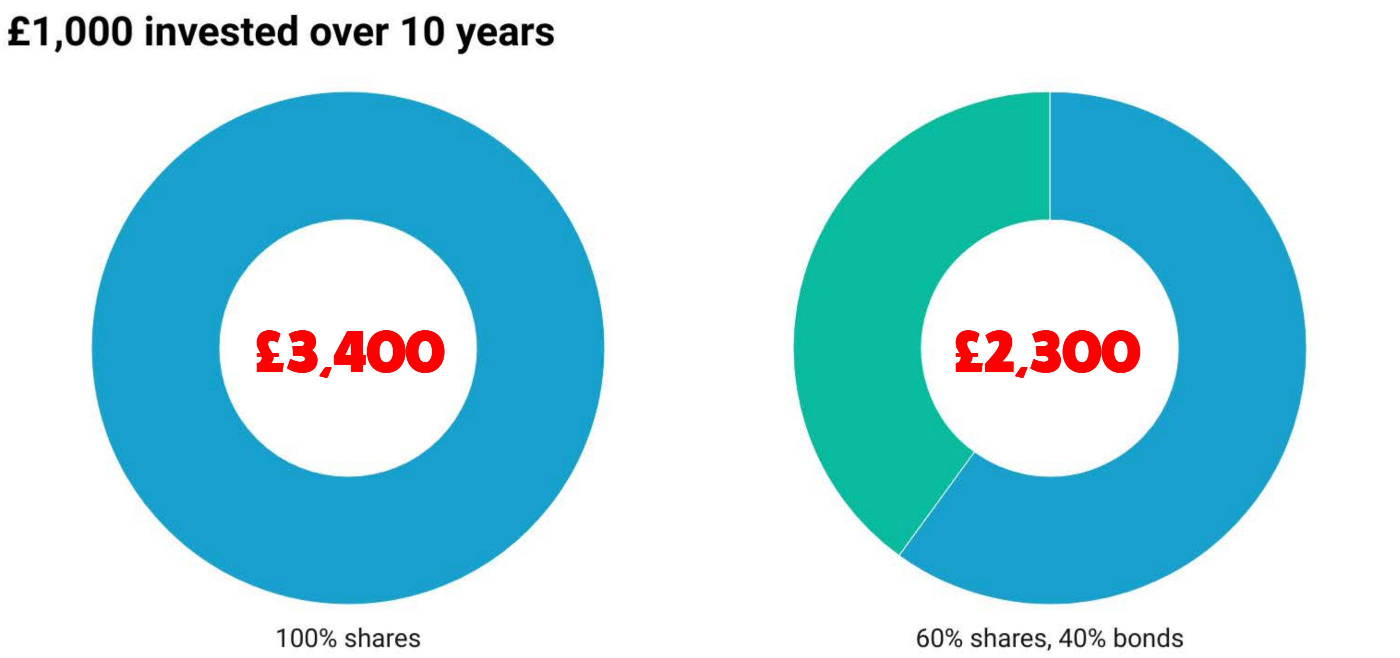
A mixed portfolio of bonds and shares might suit younger investors who are quite cautious, and don't want to see big fluctuations in the value of their portfolio.

BUT RETURNS ARE TYPICALLY LOWER

But there will likely be a price for this caution, in the total returns harvested by lower risk mixed portfolios over the long term. As an example of this, over the last 10 years, a portfolio of 60% stocks and 40% bonds (the Vanguard LifeStrategy 60% Equity fund) has turned a £1,000 investment into £2,300.

A pretty good result, but according to Morningstar a typical passive fund investing in the global stock market would have turned £1,000 into £3,400 given the same timeframe. Over longer periods, such as those enjoyed by younger investors, one would expect this differential to grow.

Nonetheless some more conservative younger investors might choose to invest in a mixed portfolio of shares and bonds, if they really don't want the ups and downs of stocks alone. Likewise younger investors who are saving for a medium-term goal, like a house deposit, or children's university fees, where they may



100% shares is a typical passive fund investing in the global stock market. 60% shares, 40% bonds is Vanguard Life-Strategy 60% Equity fund
Chart: Shares Magazine • Source: Vanguard, Morningstar • Created with Datawrapper

have five to 10 years to invest, rather than 10 to 20.

THINKING ABOUT INCOME

Income is another important consideration which may lead investors to consider bonds. Gilts offer a relatively low income, because the UK government will almost certainly pay you back.

Corporate bonds have a higher yield, because there is a greater risk they will default, so they have to pay more interest to attract lenders.

That's particularly the case with what are called 'high yield bonds', or less generously 'junk bonds', issued by companies which don't have a strong credit rating. Some high yield bond funds are currently offering a yield of 5%, which is pretty attractive compared to cash for example, but the risks are much higher.

However, the vast majority of people in their 20s, 30s or 40s are unlikely to want income from their investments, as they'll most likely have earnings from a job or self-employment. So this aspect of bond investment probably comes into its own when investors hit retirement.

THE MARKET CONTEXT

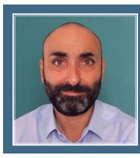
If you're considering investing in bonds, it's also worth considering the market context. Over the last 10 years, gilt prices have been driven up by low interest rates. That means if you buy a gilt maturing in 10 years' time today, your return will be around 1% a year for 10 years, factoring in income and capital returns.

That will leave your money going backwards by 1% a year in real terms, if the Bank of England hits its 2% inflation target. In case you've been living in a bunker, the Bank hasn't been doing that, with expectations that inflation will hit 6% or even 7% this spring.

So that's not a particularly encouraging backdrop for government bonds, which set the tone for the rest of the bond market, leading some commentators to describe gilts as 'return-free risk'.

One of the benefits of being a younger investor is that you usually have a long time until you need to cash in your investments, which allows you to take more risk in search of better performance.

Someone in their 20s, 30s or 40s would therefore only really invest in bonds if they wanted to dial down that risk for a smoother journey, and were happy to accept the likelihood of lower returns in the long run.



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

The global equity funds which have beaten the market

Fundsmith is on the list but products from Baillie Gifford, Malborough and Liontrust have fared better

The global equity fund and investment trust sectors contain some of the most popular vehicles with UK investors – including the likes of **Fundsmith Equity (B41YBW7)** and **Scottish Mortgage (SMT)**.

The big appetite for international exposure should come as little surprise given overseas stocks have comfortably outperformed UK shares for many years, at least until the first month of 2022.

The recent market sell-off has hit some of the highly valued quality names which dominate the portfolios of these global funds. This is reflected in the one-year performance figures and suggests that over the near-term it may be more difficult for global collectives to chalk up the kind of gains experienced in the past decade.

The list of top performers in both the fund and trust categories contains several other big names, alongside Fundsmith and Scottish Mortgage, but it is the presence of passive tracker fund **L&G Global 100 Index Trust (B0CNH05)** which really catches the eye.

TRICKY TO OUTPERFORM

It has been difficult to outperform developed market indices, dominated by a US market which had, until recently, consistently been hitting new record highs. Even in this list of the very top performing global funds, several have fallen behind the MSCI World index, which many investors use as the benchmark for global stocks and shares.

The L&G Global 100 Index Trust, which has a low ongoing charge of 0.14%, has managed to beat the MSCI World benchmark by tracking the return from the S&P Global 100 index. This is a basket of shares which includes some of the leading businesses from around the world. Like the MSCI World there is obvious American bias; the S&P Global 100 index has a 70%-plus weighting to the US.

Despite the L&G tracker fund being one of the top performers in the global sector on a five-year basis, stock picking skills may come to the fore if the current correction in global markets continues. The expertise of top fund managers might become more important and support the case for using actively managed funds even if they come with higher charges.

ESG IN DEMAND

Fundsmith's popularity among many investors is backed up by a strong track record of returns, but it has been beaten on a five-year view by four other funds, three of which tellingly have sustainability built into their investment process.

The importance of ESG (environmental, social and governance) factors – amid mounting investor, regulatory and political pressure – has been reflected in the outperformance of funds which apply such criteria when selecting stocks.

Best performing global equity funds, ranked by five-year performance

Fund	1 year	3 years	5 years	10 years
Baillie Gifford Positive Change B Acc	−17.1%	107.9%	210.3%	n/a
IFSL Marlborough Global Innovation A Acc	−3.1%	78.2%	115.3%	358.6%
Baillie Gifford Global Stewardship B Acc	−20.7%	73.4%	111.8%	n/a
Liontrust Sustainable Future Global Growth Acc	−1.4%	68.5%	105.8%	278.0%
Fundsmith Equity T Acc	8.1%	56.5%	99.5%	398.7%
SVS Aubrey Global Conviction A Acc	−23.5%	47.5%	96.0%	236.2%
Liontrust Global Smaller Companies C Acc	−17.4%	52.0%	94.9%	149.4%
L&G Global 100 Index Trust I Acc	−17.5%	71.7%	94.4%	259.4%
COIF Charities Global Equity Income Acc	8.7%	69.8%	94.4%	237.0%
Rathbone Global Opportunities Fund R Acc	0.8%	59.9%	94.2%	280.6%
Benchmark: MSCI World index	11.7%	52.5%	68.1%	234.9%

Table: Shares magazine.

Source: FE Fundinfo. Total return in GB. Data at of 27 January 2022 • Created with Datawrapper

Top of the global equity fund leaderboard on a five-year basis is **Baillie Gifford Positive Change (BYVGKV5)** which looks for businesses which can have a positive impact on the world while still delivering positive returns.

Managers Kate Fox and Lee Qian, who have been at the helm of the fund since its inception, follow the Baillie Gifford blueprint of taking a patient approach. The portfolio is concentrated, with typically between 30 and 50 holdings, and its larger positions include microchip tech firm ASML, US agriculture kit maker Deere & Co and pharmaceutical firm Moderna.

The focus is on capital growth rather than dividends. An ongoing charge of 0.55% compares favourably with other funds in the sector.

Another product from the same stable with a broadly similar remit, **Baillie Gifford Global Stewardship (BYNK7G9)** also has a strong record and comes with an ongoing charge of 0.5% attached.

TECH BIAS

Liontrust Global Smaller Companies (B29MXF6) is the seventh best performing global fund on a five-year basis. Shares in smaller firms, while typically carrying greater volatility, are often seen as having more growth potential than larger companies.

Best performing global equity investment trusts, ranked by five-year performance

Investment Trust	1 year	3 years	5 years	10 years
Scottish Mortgage	-16.0%	130.2%	224.2%	792.1%
Monks Investment Trust	-17.0%	50.6%	96.7%	281.2%
Lindsell Train Investment Trust	-6.8%	4.9%	94.2%	536.9%
Manchester & London	-19.8%	19.4%	93.0%	116.0%
Brunner Investment Trust	26.2%	61.4%	91.3%	250.2%
Mid Wynd International	5.5%	65.5%	88.8%	292.2%
The Bankers Investment Trust	6.5%	51.2%	80.8%	268.1%
F&C Investment Trust	12.5%	36.2%	72.1%	251.4%
AVI Global Trust	17.7%	52.4%	70.2%	188.5%
Martin Currie Global Portfolio Trust	-4.3%	56.1%	68.3%	233.3%
Alliance Trust	10.5%	43.9%	63.7%	234.2%
JPE Managed Growth	9.4%	41.8%	61.5%	207.5%
Witan Investment Trust	5.9%	28.6%	46.7%	218.0%
The Scottish Investment Trust	26.5%	23.9%	32.8%	145.9%
EP Global Opportunities Trust	3.7%	3.4%	13.4%	109.6%
Benchmark: MSCI World index	11.7%	52.5%	68.1%	234.9%

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Steered by Robin Geffen, the Liontrust fund has a bias towards the technology space and the US. The extra cost and complexity of investing in small caps is reflected in a higher ongoing charge versus some of the other top performing global funds at 0.88%.

In the investment trust space, and despite its recent struggles, Scottish Mortgage is by some distance the standout performer. Trailing in its wake is another Baillie Gifford-managed product, **Monks Investment Trust (MNKS)**. Both have relatively low ongoing charges at 0.34% and 0.43% respectively.

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

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Evy Hambro, Co-Manager

BlackRock World Mining Trust is a British investment trust dedicated to investments in mining and metals. Established in 1993, the trust is listed on the London Stock Exchange and is a constituent of the FTSE 250 Index. It is based in London.

Kavango Resources KAV
Ben Turney, Executive Director

Kavango Resources is an exploration group targeting the discovery of mineral deposits in Botswana. The company's operating segment include Exploration and Corporate. Its projects include Kalahari Suture Zone; Ditau and Kalahari Copper Belt.

World Copper TSX V WCU
Nolan Peterson, CEO

World Copper is an oxide copper focused exploration and development company with two proven resources, one in Chile, and one in Arizona.

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

8 Feb: BP, Micro Focus International, Ocado. **9 Feb:** GlaxoSmithKline, Lancashire, Smurfit Kappa. **10 Feb:** AstraZeneca, RELX, Unilever. **11 Feb:** British American Tobacco.

Half-year results:

8 Feb: Alumasc, Filtronic, Mattioli Woods. **9 Feb:** Barratt Developments, Dunelm, PZ Cussons. **10 Feb:** Ashmore, MJ Gleeson, Redrow.

Trading updates:

4 Feb: Airtel Africa. **8 Feb:** Bellway, BP, DCC. **9 Feb:** Discoverie, Grainger. **10 Feb:** Royal Mail, Watches of Switzerland. **11 Feb:** Tate & Lyle.

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All chart data sourced by Refinitiv unless otherwise stated

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