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VOL 24 / ISSUE 06 / 17 FEBRUARY 2022 / £4.49

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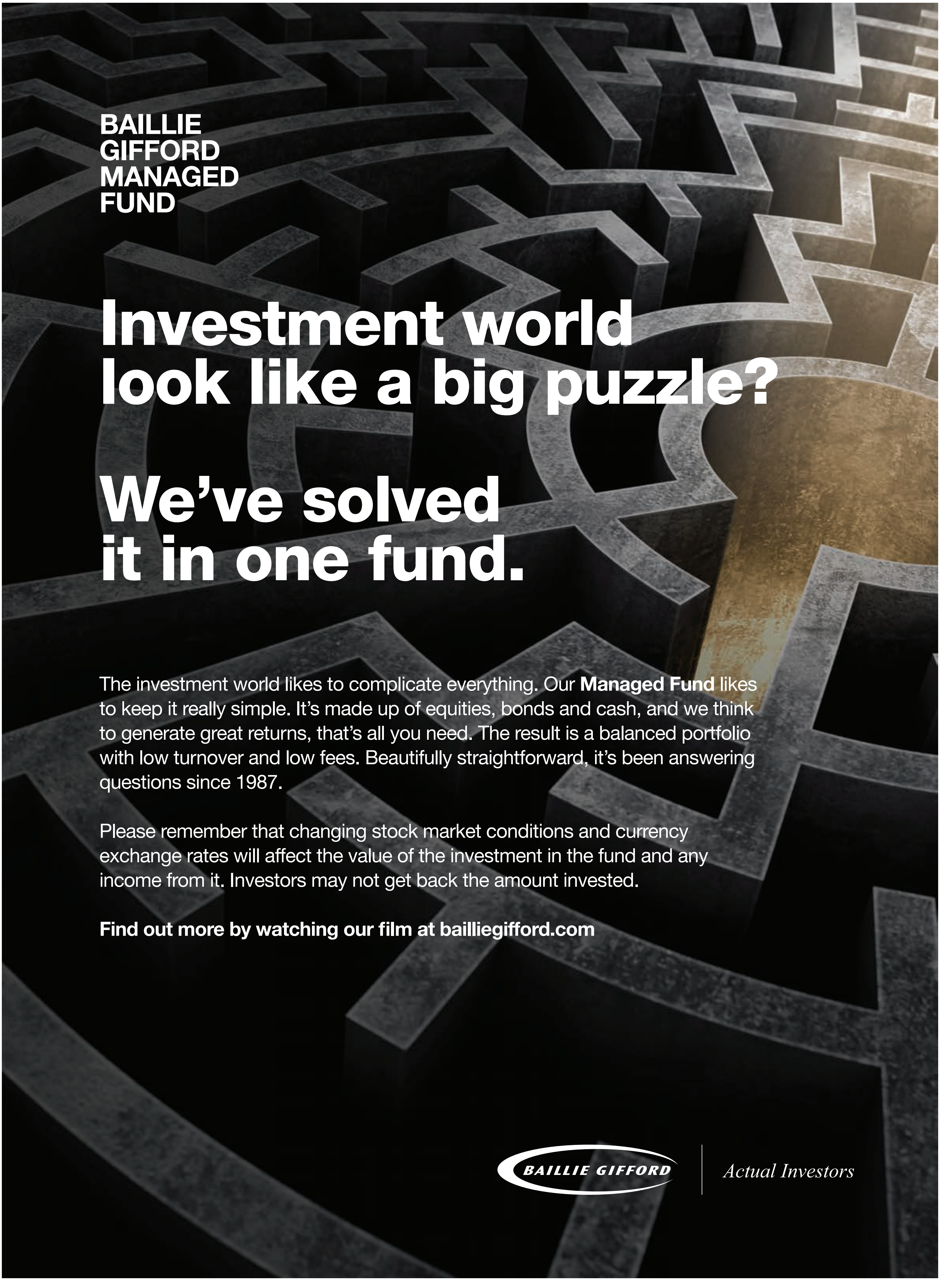
COST OF LIVING CRISIS

The retail sector winners and losers

How to **shelter investments** from an **inflation storm**

The UK income funds which have **topped the charts**

Small caps, big ambitions: 5 AIM stocks to **buy now**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Contents

We see potential in the overlooked and underloved

FIDELITY SPECIAL VALUES PLC

This investment trust seeks out good-quality but unpopular companies, whose long-term growth potential has been overlooked by the market.

Portfolio manager Alex Wright's contrarian approach to the trust thrives on volatile and uncertain markets, when there's more chance of stocks being misjudged and undervalued. Investing mainly in the UK, and supported by Fidelity's extensive research team, Alex looks to invest in out-of-favour companies, having spotted a potential trigger for positive change that he believes has been missed by others.

It's a consistent and disciplined approach that has worked well; the trust has outperformed the FTSE All Share Index over the long term both since Alex took over in September 2012 and from launch 27 years ago.

PAST PERFORMANCE

	Nov 16 – Nov 17	Nov 17 – Nov 18	Nov 18 – Nov 19	Nov 19 – Nov 20	Nov 20 – Nov 21
Net Asset Value	17.2%	-3.8%	10.5%	-11.6%	30.3%
Share Price	15.3%	4.4%	10.4%	-10.9%	29.2%
FTSE All Share Total Return Index	13.4%	-1.5%	11.0%	-10.3%	17.4%

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 30.11.2021, bid-bid, net income reinvested.
©2021 Morningstar Inc. All rights reserved. The FTSE All Share Total Return Index is a comparative index of the investment trust.

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The Trust can use financial derivative instruments for investment purposes, which may expose it to a higher degree of risk and can cause investments to experience larger than average price fluctuations.

The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. The trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies and the securities are often less liquid.

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Daniel **Coatsworth**

EDITOR'S VIEW

Why Unilever, Reckitt and Nestle are under pressure

The big brand owners seem to have weaker pricing power than expected

Big brand owners in the food, drink and household products space are meant to be reliable names that deliver slow but steady growth no matter the economic conditions. So why is it that names like **Unilever (ULVR)**, Nestle and **Reckitt Benckiser (RB.)** are struggling on the stock market this year?

The type of stocks sold off in the market rotation from high growth to value are mainly tech companies where rich equity valuations reflect the potential for future profits years down the line rather than 'jam today'. These tech companies are highly sensitive to rising interest rates which make their future cash flows worth less today.

Unilever, Nestle and Reckitt already generate healthy profits today, yet they have underperformed the global stock market so far in 2022. Unilever is down 5.5%, Reckitt has fallen by 6.9% and Nestle has dropped by 7.7%, versus a 4.4% decline from the MSCI World index, a benchmark for global equities.

One reason behind the underperformance is rising inflation and growing market concern that big brand owners may struggle to raise prices without damaging demand, throwing a bucket of water over the suggestion these companies have robust 'pricing power'.

Earlier this month Unilever warned that its profit margins would fall in the near-term, which suggests it cannot pass on all the inflationary costs to the customer.

Consumers under financial pressure may trade down to cheaper, supermarket own-brand products which would prompt the likes of Unilever and Reckitt to increase their marketing spend to ensure their brands remain front of mind for shoppers. That puts further pressure on profit margins.

Longer-term share price weakness in Unilever and Reckitt is down to strategic mistakes. The former has struggled under the leadership of Alan Jope, with Fundsmith founder Terry Smith implying the CEO has spent too much time on sustainability factors to show Unilever is a good corporate citizen rather than ensuring the business operates efficiently.

In recent weeks, Unilever's £50 billion bid for **GlaxoSmithKline's (GSK)** consumer healthcare arm was poorly received by investors who worried the price was too high.

Reckitt has already suffered from paying too much to buy infant nutrition firm Mead Johnson in 2017 (a deal worth £13 billion). In 2020 it took a £5 billion impairment on the acquisition and last year it started selling bits of Mead Johnson.

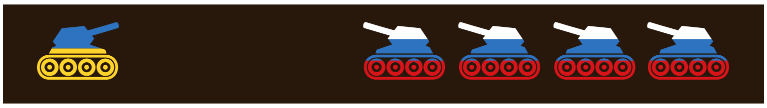
There are rumours Reckitt might exit infant nutrition altogether – look for any comment in its full year results out today (17 February).

Investors might look more favourably on these businesses if they can sharpen their focus. Nestle already seems to be getting its house in order and could be the trailblazer in this regard. Yet near-term headwinds remain for big brand consumer product companies and the sector might not be the shelter from the storm that it once was.

Not everyone is as pessimistic. Speaking at **Finsbury Growth & Income's (FGT)** AGM on 9 February, fund manager Nick Train said: 'Unilever has a wonderful collection of brands that will generate cash for the foreseeable future.

'It is not the most exciting company on the planet, but it is a formidable, durable asset and I promise people that in years when the world is considerably tougher, you'll be grateful that part of your portfolio is invested in a business with Unilever's characteristics.'

What a Russian invasion of Ukraine might mean for markets



Stocks and commodities volatile amid fluctuating tensions on the Ukrainian border

The tensions on the Ukrainian border may have eased slightly as we write but the situation remains highly febrile with Washington and London still warning of an imminent Russian invasion.

Historically war hasn't agreed with the stock market, particularly in the short term. This makes sense given it is difficult for investors to factor in the impact of an armed conflict given the unpredictability over how other parties might react and exactly how the situation might escalate.

There was little love in the air on 14 February as Russian troops massed and the FTSE 100 endured its worst day of what has already been a volatile 2022 to date for the markets.

Oil prices hit seven-year highs and natural gas prices rose amid the tensions. A return of some of Russia's military personnel to base took some of the heat out of the situation on 15 February as energy prices eased and stocks recovered.

However, the danger has not fully passed. InvestmentMetrics' managing director Damian Handzy warns: 'Quantifying the long-term market and economic impact of a full-scale Russian invasion of Ukraine to the geopolitical world order is fraught with uncertainty.

'But it's safe to say that Europe would dramatically increase its military spending, prioritise energy independence from non-NATO countries, and financial markets would take a hit with investors retreating to risk-off mode for the foreseeable future.'

War would likely result in further Russian sanctions which would disrupt trade and the supply of important raw materials. Almost 40% of the European Union's natural gas comes from Russia and the country also exports significant quantities of commodities like palladium and titanium to the bloc. European banks are also major lenders to Russian individuals and corporations.

Big fallers amid mounting Ukrainian tensions

Company	Performance 14 February
Evraz*	-29.1%
Wizz Air	-8.3%
International Consolidated Airlines	-5.6%
Carnival	-4.8%
BP	-4.0%
Ferrexpo	-2.7%
JPMorgan Russian Securities	-2.1%

**traded without rights to special dividend*

Table: Shares Magazine • Source: Sharepad • Created with Datawrapper

Firms like **BP (BP)** and **Shell (SHEL)** have joint ventures in Russia which could be impacted, while other UK-listed resources outfits like steel producer **Evraz (EVR)** and iron ore miner **Ferrexpo (FXPO)** have operations in Ukraine.

Ferrexpo shares fell substantially on 14 February, although this was mainly linked to it trading without the rights to a dividend associated with the demerger of its coal assets.

Russia-focused investment trust **JPMorgan Russian Securities (JRS)** is down 8.1% year-to-date and fell 2.1% on 14 February.

Travel stocks also fell sharply that day amid fears conflict might disrupt a sector just beginning to recover from the pandemic as Covid restrictions are lifted. **Wizz Air (WIZZ)**, which is focused on Eastern Europe, was particularly affected. [TS]

Rising costs may cloud UK banks' results

NatWest kicks off the sector's reporting reason

UK BIG FOUR BANK EARNINGS ESTIMATES

Pre-tax profits	FY2020	FY2021	FY2022
Barclays	£3.1bn	£8.1bn	£6.6bn
HSBC	$8.8bn	$19.1bn	$16.1bn
Lloyds	£1.2bn	£7.2bn	£6.1bn
NatWest	-£351m	£4.1bn	£3.5bn

Table: Shares Magazine • Source: S&P Market Intelligence, Shares magazine • Created with Datawrapper

With the FTSE 350 banks index having doubled in price since hitting a low in September 2020 on value hunting in the first instance and the prospect of higher interest rates more recently, the UK's big four high street banks now need to repay investors' faith.

Their chance to do that comes this month with the release of their full year results, starting with **NatWest (NWG)** on 18 February.

NatWest's shares have almost trebled in price since their September 2020 low as a recovery in the UK economy has allowed it to write back the hefty loan loss provisions it took during the pandemic after the economy suffered its worst slump in decades.

Analysts are expecting the bank to have swung from a pre-tax loss of £351 million in 2020 to a profit of over £4 billion last year, but in addition to the numbers investors will be listening for positive comments on trends in net interest margins and lending growth now that the economy is expanding again. Net interest margins are the difference between what a bank charges on loans and the interest it pays on savings deposits.

Investors will also be expecting a healthy final dividend for NatWest after 2020's famine with the analyst consensus looking for a 5.7p per share ordinary payment topped up with a 0.5p per share special payment, taking the full year return to 9.2p.

NatWest announced a £750 million repurchase scheme with its first half 2021 results: the hope is that rises to £2 billion or more going forward.

Asia-focused **HSBC (HSBA)** announces its results on 22 February, followed a day later by retail and investment bank **Barclays (BARC)**, and **Lloyds (LLOY)** on 24 February.

While UK interest rates and their effect on net interest margins, and by extension return on equity, will be a big focus for investors, most of HSBC's profit comes from its Asian business and in particular its wealth management division.

A slowdown in economic growth in China due to the government's zero-tolerance approach to the Omicron variant, and a slowdown in the property market where many wealthy Chinese have their money, means concerns could linger about the bank's core business.

For Barclays, which has the biggest investment banking business of any of the UK banks, attention may be split between the margin on its retail operations and the size of profits generated from the capital markets.

News about staff salaries and bonuses could sour the reaction to progress on the UK retail side as the firm tries to hang onto its dealmakers and stop them defecting to Wall Street rivals. [IC]

Why British American Tobacco is up more than a quarter in two months

The cigarette maker benefits from market rotation and signs of progress on new categories growth strategy

During the last two months shares in **British American Tobacco (BATS)** are up by 26.5%. There are two very different reasons for this share price surge. The first is the changing macro-economic environment. Rampant inflation has resulted in a succession of UK interest rate rises, and expectations that American will follow suit imminently.

This has caused a rotation out of expensive growth stocks and into value. British American Tobacco, which is a high yield stock and is considered to be defensive in nature, has undoubtedly benefited from this process.

However, on a fundamental basis, investors have acknowledged that British American Tobacco has started to deliver on earlier promises.

Recent results (11 Feb) highlighted how the new categories business witnessed revenue growth of 51%, with the number of consumers of non-combustible products increasing by 4.8 million to 18.3 million.

The group has also initiated a £2 billion share buyback programme in 2022, as net debt to earnings before interest, tax, depreciation and amortisation has come down to below three times. The recently announced full year dividend was covered 1.65 times by free cash flow, the highest level of cover in more than a decade.

The group's transformation strategy has been focused on three categories: vapour, tobacco heating and modern oral. These next generation products now account for 12% of group revenue compared with just 4% five years ago.

Vuse is now the number one global vaping brand with a value share of 34%. In the US it delivered strong revenue and market share growth. In the second half of 2021, Vuse became profitable at the category contribution level for the first time.

Improving dividend cover at British American Tobacco

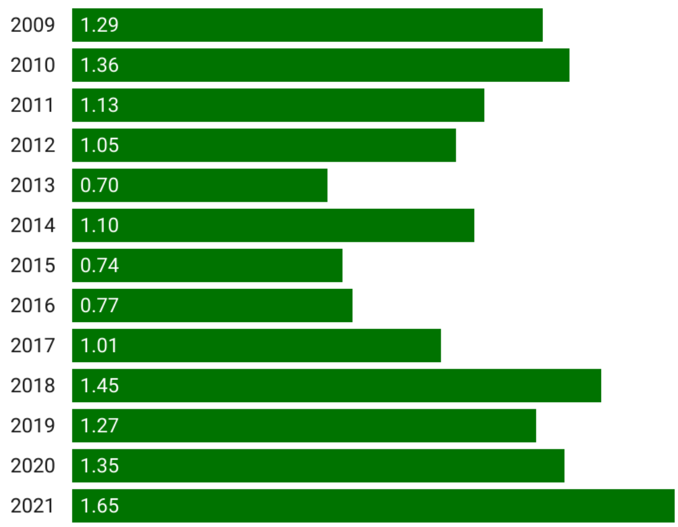


Chart: Shares Magazine • Source: AJ Bell, British American Tobacco accounts • Created with Datawrapper

Glo is the group's flagship tobacco heating product and comprises a battery powered device that heats tobacco sticks to 240 degrees celsius.

Glo has achieved 18% volume share of the tobacco heated product in its key markets.

Management forecast that the positive performance from new categories will continue and emphasised it is on target to reach £5 billion of revenue and maiden profitability for this part of the group by 2025.

Over the next five years British American Tobacco is targeting £40 billion of free cash flow before dividends. The group is committed to growing the dividend, however the improved capital position provides the group with the flexibility to engage in bolt-on acquisitions or make further share buybacks. [MGar]

Burger King UK could be heading to the London stock market

Its private equity owner has lined up investment banks to float the fast food chain, according to reports

Burger King's UK operation is set to join the London stock market, according to reports.

Private equity firm **Bridgepoint (BPT)** has been the master franchisee for Burger King UK since 2018 but is now believed to have appointed advisers with a view to floating the business on the London Stock Exchange with a £600 million valuation during the first half of 2022.

The master franchise for Burger King is owned by US-listed Restaurant Brands. As of the start of last year, it owned or franchised 18,625 Burger King restaurants in more than 100 countries. In 2021, Burger King system sales grew by 15.9% to $23.45 billion.

The exact timing and scale of the UK division stock market listing are still to be settled but a recent report by *Sky News* claimed that a flotation was now 'a likelier outcome' than a sale to another private equity buyer, citing sources close to the deal.

Burger King UK is believed to have hired Peel Hunt alongside Bank of America and Investec to advise on float, said a separate report in *The Times*.

Bridgepoint, which itself floated in London in the summer of 2021 and is now a FTSE 250 constituent, acquired Burger King UK alongside Caspian UK Group, one of Britain's largest franchisees with 74 Burger King sites.

The Caspian acquisition was believed to be worth more than £50 million although details were kept under wraps.

Four years ago, Bridgepoint entered into a 20-year master franchise agreement giving it the right to be the custodian of the Burger King name and control over the brand's proposition in the UK, and the right to rollout new stores across the country.

It now oversees 530 Burger King restaurants, 400 of which are owned by franchisees, although that is dwarfed by US giant McDonald's 1,300-odd outlets in the UK, 1,100 of which are run by franchisees.

Bridgepoint also has a minority stake in the holding company of the French master franchise for Burger King.

A Burger King UK stock market listing would follow the October 2021 London debut of fast food group **Tortilla Mexican Grill (MEX:AIM)** and comes during a period of aggressive expansion in the restaurants industry as the UK reopened following months of stop-start closures because of Covid-19.

For example, **Greggs (GRG)**, Wagamama-owner **Restaurant Group (RTN)**, Pizza Express and Franco Manca and The Real Greek-owner **Fulham Shore (FUL:AIM)** are all planning to expand their estates by exploiting the absence of restaurant chains that failed to survive the pandemic. [SF]

Berkshire Hathaway is a great way to tap into the best companies in the US

Warren Buffett and Charlie Munger have assembled a stable of financially strong companies with leadership positions

We believe Warren Buffett-run Berkshire Hathaway is a great vehicle for achieving a ready-made exposure to a diverse group of some of the best companies in the US and increasingly, elsewhere in the world.

Influence from Berkshire portfolio managers Ted Weschler and Tod Combs has increased the company's exposure to some fast-growing technology companies, such as cloud data platform provider Snowflake and Brazilian payments group StoneCo.

Former hedge fund manager Weschler is often cited as a potential future chief investment officer of Berkshire Hathaway.

Berkshire has used its growing cash pile to repurchase over $51 billion worth of its own shares since 2018, giving a boost to earnings per share growth on top of underlying organic growth.

Despite the share repurchases, the wholly owned businesses continue to throw off cash, and Berkshire has around $70 billion of cash which could be used to buy public companies on the cheap if stock markets stumble, providing a defensive and opportunistic angle to the story.

BERKSHIRE HATHAWAY B
BUY
(BRK.B) $320

Fund size: $713 billion

NOT YOUR AVERAGE CONGLOMERATE

Investors often label Berkshire Hathaway as a conglomerate which is seen as derogatory, implying it is a collection of sprawling, unrelated businesses.

But there are two big differences between traditional conglomerates and Berkshire. Firstly, Berkshire takes both controlling stakes and minority stakes in companies.

Secondly, the businesses targeted are required to have sustainable economic advantages and competent managements.

Buffett said it best in his 2020 shareholder letter: 'It took me a while to wise up. But Charlie – and also my 20-year struggle with the textile operation I inherited at Berkshire – finally convinced me that owning a non-controlling portion of a wonderful business is more profitable, more enjoyable and far less work than struggling with 100% of a marginal enterprise.'

A key characteristic of great businesses is their ability to retain earnings (the portion of profit not paid as dividends) and reinvest them for future growth, creating a virtuous cycle.

THE FAMILY JEWELS

Berkshire is a big operation by any yardstick and employs around 360,000 people across nearly 100 subsidiaries, covering all sectors of the economy including railroads,

Berkshire top stock market holdings

Company	% owned	Cost ($ billion)	Value ($ billion)
AbbVie	1.4%	$2.33	$2.76
American Express	18.8%	$1.28	$18.33
Apple	5.4%	$31.09	$120.4
Bank of America	11.9%	$14.63	$31.3
The Bank of New York Mellon	7.5%	$2.92	$2.87
BYD	8.2%	$0.23	$5.89
Charter Communications	2.7%	$0.91	$3.45
Chevron	2.5%	$4.02	$4.09
The Coca-Cola Co	9.3%	$1.29	$21.93
General Motors	3.7%	$1.62	$2.21
Itochu	5.1%	$1.86	$2.33
Merck & Co	1.1%	$2.39	$2.35
Moody's	13.2%	$0.25	$7.16
U.S Bancorp	9.8%	$5.64	$6.9
Verizon Comm	3.5%	$8.69	$8.62
Others		$29.46	$40.58
Total			**$281.17**

Table: Shares Magazine • Source: Berkshire Hathaway, data as at 31 Dec 2020 • Created with Datawrapper

confectionery, home furnishings, house building, insurance and energy.

But the most valuable assets are three wholly owned operating businesses and one partially owned one, Apple, where Berkshire holds a 5.4% stake, currently valued at $109 billion.

The property and casualty insurance businesses have been the bedrock of the Berkshire empire for 55 years. They are run very prudently and operate with far more capital than any of their competitors.

Key to the business is the concept of float, which simply represents the cash received up front from insurance premiums paid by customers.

If Berkshire writes the same level of business every year, the amount of annual float remains the same or grows in line with the business growth. Over the years the float has grown from a few million to $145 billion at the end of the third quarter 2021.

Even though Berkshire's insurance companies don't legally own the float, they can deploy the cash in whatever way they want, and this has been a good 'cheap' source of funds for the company over many years. Berkshire has used this cash to purchase many of its businesses.

Buffett claims that cumulatively over the years the cost of the float has been zero. That is, the premiums paid, less the costs of claims and expenses has averaged out at close to zero.

The second jewel is the railroad business BNSF (Burlington and Sante Fe railway), the largest railroad in the US measured by freight carried, representing around a 15% market share.

The third jewel is energy company BHE (Berkshire Hathaway Energy) which has grown earnings under Berkshire's ownership by a compound annual growth rate of 17% a year over the last 21 years.

In other words, earnings have grown from $122 million to $3.4 billion. In the third quarter of 2021 BNSF and BHE contributed pre-tax earnings of $2 billion and $1.4 billion respectively.

Berkshire ended the third quarter with shareholders' equity of $472.5 billion, up 6.6% from 31 December 2020, putting the shares on a price to book ratio of 1.5 times.

SUCCESSION AND OTHER RISKS

Buffett turned 91 years of age last year and his long-term business partner Charlie Munger is 99 years old which adds risk to the investment proposition despite decades of succession planning.

The pair have always highlighted the challenge of growth as the company gets larger and that challenge has not receded. Berkshire also has one of the world's largest catastrophe insurance operations which could be impacted by extreme events. [MGam]

Berkshire Hathaway (B)

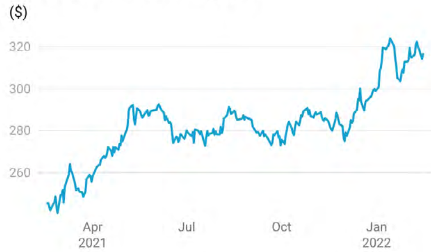


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

B&M could see big customer boost and its shares are cheap

The variety goods value retailer can help cash-strapped shoppers cope with the cost of living crisis

Recent share price weakness in **B&M European Value Retail (BME)** presents a compelling entry point for growth and income investors as the variety goods retailer's value proposition leaves it well positioned for inflationary times.

As household bills rise, the groceries-to-general merchandise seller should benefit from cash-strapped consumers trading down.

Sales surged to an all-time high in a Covid-inflated year to 27 March 2021, though B&M's shares are down 12% year-to-date on concerns the pandemic boost will fade and with investors reading too much into a share sale by CEO Simon Arora.

Liberum Capital says B&M's value proposition means it is up to 15% cheaper than the major grocers on everyday branded items, which should enable it to capture a greater share of existing customers' wallets while attracting new shoppers.

The broker believes B&M's share of a £300 billion total addressable market in the UK alone remains modest at 1%, so the retailer 'does not need to take material share from any particular competitor or in any given space to keep growing'.

Most growth stories in the retail sector are online companies, but B&M's expansion is unusual in that it is all about physical store rollout, says fund manager Ken Wotton who holds the stock in the **LF Gresham House UK Multi Cap Income Fund (BYXVGS7)**.

Wotton also highlights B&M's 'exceptionally strong' management team and an attractive model of 'relatively low capital employed and high returns' when opening new outlets, yielding a swift payback.

'In an environment where the consumer is cost-conscious, B&M is in a good position as it is able to attract new demographics of customers who are looking to trade down to save money, and once they've experienced the business they stick with it,' he adds.

In light of the massive Covid boost, Liberum forecasts a decline in sales for the year to March 2022, though growth should resume thereafter. The broker forecasts pre-tax profits of £521 million (2021: £540 million) this year, ahead of £493 million and then £537 million in 2023 and 2024 respectively.

B&M trades on 13.5 times forecast earnings for 2022 which is way below the peak forward multiple of 27 times, and a historic average 12-month multiple of 19 times since B&M joined the stock market in 2014.

This represents cracking value for a retailer with good growth prospects, strong gross margins thanks to direct sourcing and the cash generation to expand its store estate while paying dividends, with a 3.7% prospective yield. [JC]

B&M EUROPEAN VALUE RETAIL

BUY

(BME) 567p

Market cap: £5.7 billion

B&M European Value Retail

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

CENTRALNIC
(CNIC:AIM) 137.7P

Loss to date: 3.7%
Original entry point:
Buy at 143p, 25 November 2021

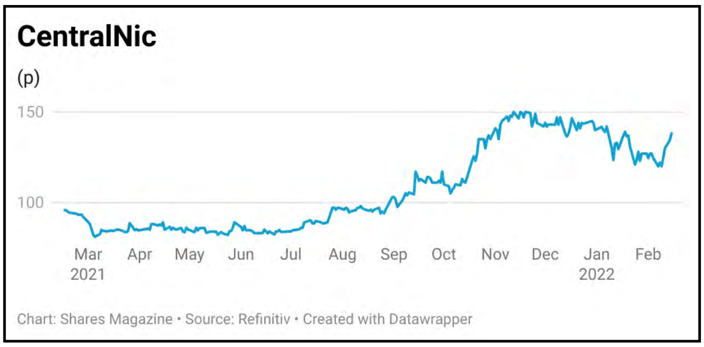
INTERNET EXPERT **CentralNic (CNIC:AIM)** has started 2022 much the same way that it ended 2021, putting up strong growth numbers and continuing its acquisitions push.

That just weeks into its new 2022 financial year CentralNic believes it will beat current forecasts shows just how rampant demand is for online marketing expertise.

Those estimates range between $48 million and $51 million of earnings before interest, tax, depreciation and amortisation on $410 million to $468 million revenue, although Zeus Capital has raised its own estimates by 4% and 15% respectively.

Which makes the shares' relatively slow progress puzzling and frustrating, for investors and management. CentralNic has been using debt funding for acquisitions rather than risk diluting shareholders at what it believes is a discounted valuation.

The small but strategic purchases of Germany domain name .ruhr and Fireball will bolster its domains business and increase its portfolio of privacy-focused solutions for its growing online marketing customer base and generate extra internet traffic revenue.



SHARES SAYS:
Investors should not lose patience and stick with this exciting growth opportunity. [SF]

TATE & LYLE
(TATE) 747.4p

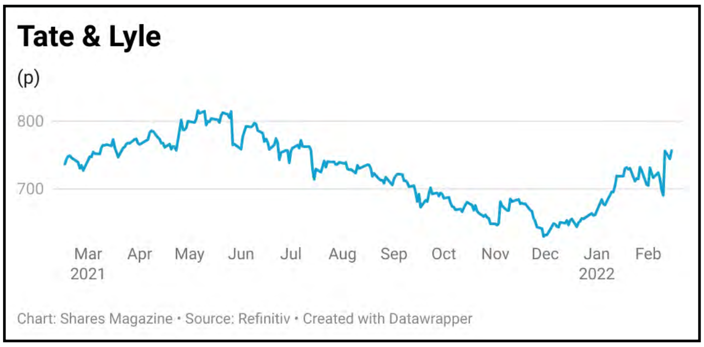
Gain to date: 14.9%
Original entry point:
Buy at 650.6p, 23 December 2021

ONE OF OUR key stock selections for 2022, shares in **Tate & Lyle (TATE)** are up 14.9% since we flagged the global sweeteners group's attractions and they spiked on news (11 Feb) of excellent third quarter trading and reassurance that input and energy cost inflation has been recovered through pricing contracts.

Tate & Lyle confirmed it remains on track to split into two businesses by the end of March. The sale of a controlling stake in its North American Primary Products business will create a higher quality, 'new' Tate & Lyle with superior growth prospects and once completed, it intends to return around £500 million to shareholders through a special dividend.

The food producer reported positive momentum for the continuing Food & Beverage Solutions business ahead of the separation and upgraded full year pre-tax profit growth guidance for the new Tate & Lyle from high single digits to low double digits.

Berenberg expects Tate & Lyle to enjoy 'a material re-rating towards speciality peers, with growth supported by the structural growth enjoyed by the Food & Beverage Solutions unit'.



SHARES SAYS:
We remain sweet on Tate & Lyle as the company serves up broad-based global growth. [JC]

Retail sector winners and losers amid cost of living crisis

Value retailers could thrive while DIY and fast food sellers could come under pressure

Already contending with red hot inflation, consumer-facing businesses are about to be severely buffeted by headwinds from another tick up in energy prices, higher National Insurance tax and rising interest rates putting pressure on family finances.

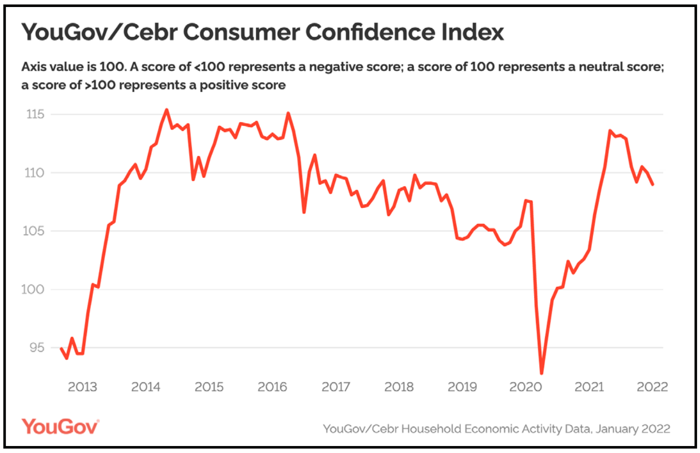
Consumers may pull in their purse strings with further inflation-driven price hikes expected over the months ahead.

Shares believes the cost-of-living crisis will see cash-strapped consumers either buy fewer items, cut back on non-essential spending or trade down to cheaper products, eschewing popular branded goods in favour of supermarket or retail own-label products.

In this inflationary environment, discounters and other value retailers should fare well, while affluent individuals will be able to take rising bills and taxes in their stride, shielding purveyors of premium products from the cost-of-living squeeze.

However, as spending disperses towards value and luxury, we think the near-term outlook for mid-market retailers looks uncertain.

Consumer confidence slips as Britons' household finance concerns increase



COST OF LIVING CRUNCH

The prospect of rising UK energy bills has already had an impact on consumer confidence, according to analysis by YouGov and Cebr (the Centre for Economics and Business Research). While the overall index saw a modest one-point decline in January 2022 from 110 to 109, scores across every metric except home value measures and business activity for the year ahead fell, and dramatically so in some cases.

Cebr senior economist Sam Miley says: 'This month's drop in the YouGov/Cebr Consumer Confidence Index highlights the impact of the rising cost of living on household sentiment. Away from the headline indicator, consumers' assessment of their finances over the coming year provides for a particularly stark reading – reaching a near nine-year low.'

Rising inflation and the planned uplift to National Insurance contributions are two likely factors behind this weaker outlook, explains Miley. 'This sentiment is also mirrored in Cebr's latest forecasts, with real disposable incomes expected to fall year-on-year and the household savings ratio set to narrow significantly.'

While the outlook for consumer income isn't too bad and savings accumulated through the pandemic may provide a cushion, rising tax and more expensive household bills would suggest we could see plenty of profit warnings in the retail sector as the year progresses, particularly after mid-year once April's National Insurance rise and higher energy price cap come into force.

Consumers have paid down debt and grown their savings during the pandemic, but as interest rates rise, the logic for consumers to accumulate via savings or pay down debt will only grow.

THE SQUEEZED MIDDLE

Marmite-to-Magnum ice creams maker **Unilever (ULVR)** warned on 10 February that shoppers face further price increases as it seeks to mitigate surging costs. Two months ago, **Dr Martens (DOCS)** said the price of its boots would go up by £10 a pair in summer 2022. And in January, fashion seller **ASOS (ASC:AIM)** said it had increased prices to offset a rise in costs.

Tesco (TSCO) chairman John Allan says 'the worst is to come' on food inflation in the UK, which could peak at over 5% by the spring. Allan says for the lowest income households rising prices and energy costs are especially regressive. For such households, food could rise to circa 15% of total expenditure, depleting their ability to spend on non-discretionary purchases.

This crisis will only drive low-income families further into the arms of German discounters Aldi and Lidl, while more upmarket supermarkets will either need to absorb price hikes from the big food and household goods product manufacturers including Procter & Gamble and Nestle or pass them on to consumers.

Names that look vulnerable in the current environment to weaker sales growth include **Sainsbury's (SBRY)**. While it has cut food prices to become more competitive, Sainsbury's is still perceived as a supermarket selling premium ranges to the middle classes, though the grocer's ownership of cut-price toys-to-home products retailer Argos may help lure cash-strapped shoppers through the door.

In the consumer discretionary space, we would also be nervous about the earnings outlook for pizza delivery chain **Domino's Pizza (DOM)**. Consumers fretting over their finances are more likely to grab a ready meal from the local convenience store than use their phone to order a £20 pizza, no matter how tasty the topping.

Fast food delivery platforms like **Deliveroo (ROO)** and **Just Eat Takeaway (JET)** could also see their earnings come under pressure if households avoid takeaways in favour of cooking something cheap

and easy at home like spaghetti bolognese.

Over the past two years, people stuck at home for a large amount of time have finally got round to doing those DIY jobs which have been avoided for so long.

With plenty of money now sunk into doing up the home since Covid first struck, families under financial pressure may view further home improvement work as unnecessary spending.

That clouds the earnings outlook for B&Q-to-Screwfix-owner **Kingfisher (KGF)** after a long period of seeing analysts regularly upgrade their sales and profit forecasts. Indeed, the market already appears to be concerned, with Kingfisher's shares having fallen 8% year to date.

In a similar situation is laptops-to-smart TVs seller **Currys (CURY)**. Significant investment by households and businesses in technology during the pandemic mean homes and offices are already kitted out with new equipment. From a consumer perspective, if money is getting tighter, then holding off from buying a new computer or upgrading a phone is an easy way to keep a lid on spending. Currys' share price is down 12% year to date.

COMPANIES WITH THE RIGHT QUALITIES

So which retail stocks should investors buy in the current environment? **Pets at Home (PETS)** and **Dunelm (DNLM)** are two of *Shares*' top picks.

Pets at Home will benefit from non-discretionary spend, namely the fact that consumers will keep spending on their pets no matter the state of the economy. They all need feeding and keeping healthy.

LUXURY GOODS COMPANIES

Higher National Insurance tax, more expensive energy bills and higher borrowing costs are unlikely to trouble wealthy individuals, which suggests that luxury goods companies may not be hurt by the cost-of-living crisis for the public.

LVMH, the conglomerate behind Louis Vuitton, Givenchy and Tiffany, reported record sales and profits for 2021 amid buoyant demand in the US and China with an acceleration in fourth quarter sales growth.

Trench coats-to-scarves seller **Burberry (BRBY)** recently upgraded annual profit guidance after seeing an acceleration in higher margin full price sales for the third quarter to 25 December 2021.

On 10 February, **Watches of Switzerland (WOSG)** upgraded its full year outlook amid continued buoyant demand for high-end timepieces in the UK and US. The Brian Duffy-bossed retailer insisted demand for luxury watches continues to be 'very strong' in both the UK, where it highlighted a 'thriving domestic clientele', and in the US.

Johnnie Walker scotch maker **Diageo (DGE)**, and Pernod Ricard, the French maker of Martell cognac, Mumm champagne and Absolut vodka, both toasted buoyant sales as global hospitality reopens.

They are benefiting as high-end spirits take a greater share of the global alcoholic drinks market and well-heeled consumers trade up to premium brands.

Cynics might argue homewares leader Dunelm is vulnerable because many of its wares are non-essential, but there is always going to be demand for towels, lights, cooking equipment and bedding. The company has also bulked up its value proposition, with more entry-price products and promotional deals, leaving it in a strong position for the straitened times ahead.

Other retailers selling products at low prices include Primark, owned by **Associated British Foods (ABF)**, and **Greggs (GRG)**. **The Works (WRKS)** has a reputation for selling cheap books, art equipment and toys, and **Frasers' (FRAS)** Sports Direct chain is an established name on the high street for people seeking discounted sporting products and athleisure.

Liberum Capital says **B&M European Value Retail's (BME)** value offering 'positions it optimally given the current squeeze on consumers', adding that the retailer will raise prices, but so may competitors. 'We expect B&M to remain up to 15% cheaper,' it comments.

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

Taste test: is Coke or Pepsi best for your share portfolio?

Both brand owners have a solid track record of making investors money

Is Coke or Pepsi the better investment? It's question that investors have grappled with for decades. Celebrity icons like Madonna, Michael Jackson and Prince may have been replaced the likes of David Beckham, Cardi B and Will.i.am but investors will trade cool for cash all day long.

The Coca-Cola Company and PepsiCo share similar market valuations (about $260 billion to $233 billion), trade on similar price to earnings multiples (27 versus 31) and offer similar income credentials.

Their stock prices imply a 2.8% and 2.5% 2022 dividend yield respectively, and both are 'Dividend Aristocrats', meaning they have increased shareholder payouts every year for more than 25 years – PepsiCo for almost 50 years straight, Coca-Cola for nearly 60 years.

Both are supported by big fund groups such as BlackRock and Fidelity, while the fact that investment platform provider Charles Schwab is among the top 10 owners on both share registers suggests heavy backing from retail investors who are its clients and the ultimate shareholders of the beverage companies.

Perhaps Warren Buffett is one useful way of separating the fizzy drinks giants. His investment vehicle Berkshire Hathaway remains Coca-Cola's largest investor as well as the drinks firm being Warren Buffett's longest-held stock position.

Coca-Cola has provided some of Buffett's best returns, with the stock up over 2,000% since he started buying it 33 years ago. Since the end of the global financial crisis Coca-Cola's shares have rallied more than 180% and the shares have averaged a total return of 8.15% a year over the past decade according to Morningstar data.

Yet PepsiCo has been no slouch for investors either, its stock up 199% since the big market crash of 2008/09, and 10-year annualised total returns

running at 12.1%.

Between them the two soft drink giants control 68% of the US carbonated beverages industry, yet Coca-Cola's 43.7% share is nearly double PepsiCo's 24.1%. In terms of perception, Coca-Cola appears to win hands down with roughly two of out of every three people who enjoy fizzy cola seeming to prefer this brand.

WHY PEPSICO HAS OUTPERFORMED

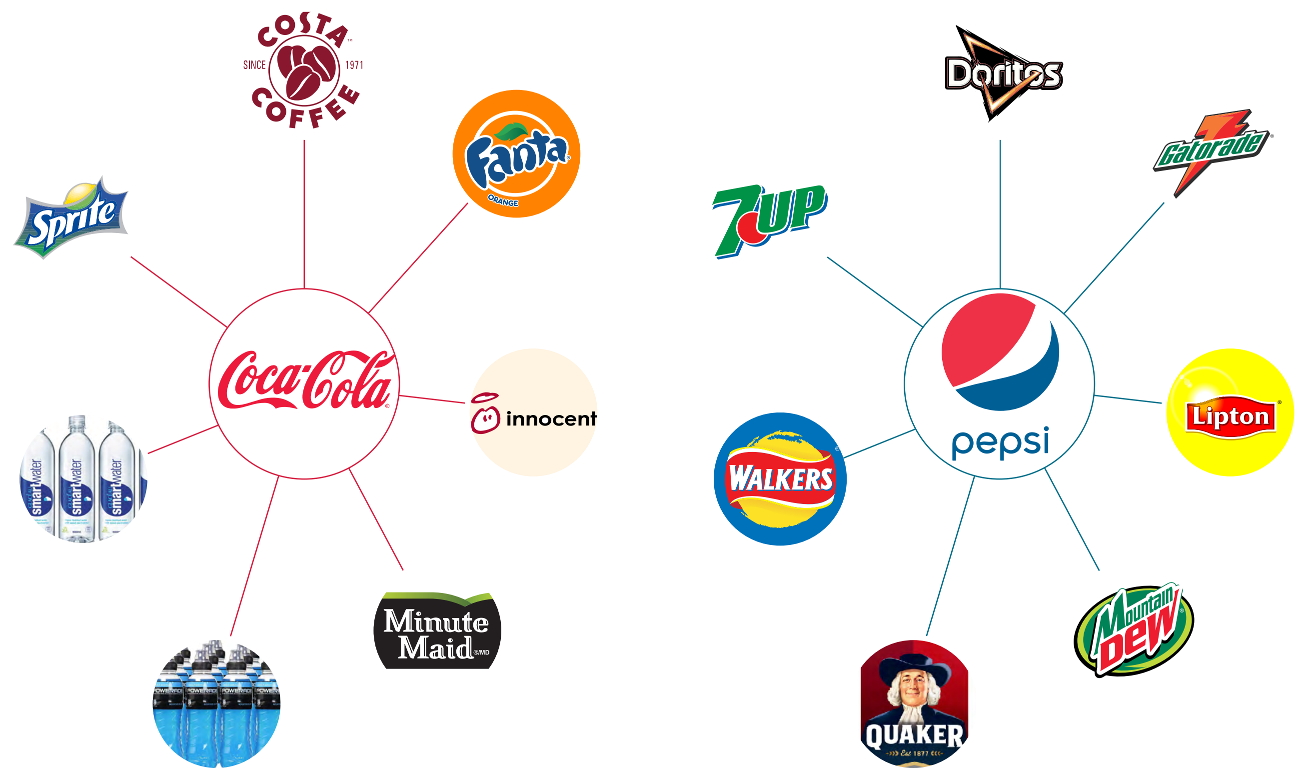
In turbulent markets, many investors have turned to dividend-paying market stalwarts like Coca-Cola and PepsiCo, and the two years since Covid-19 emerged has certainly been rocky.

However, PepsiCo has outperformed in recent years for two reasons:

- **A cheaper valuation.** While this may not be the case in PE (price to earnings) terms now, PepsiCo is still valued at less than half Coca-Cola's price to sales, 2.9-times against 6.6, based on 2021 figures.

- **Better dividend growth.** Over the past five years, PepsiCo has raised its dividend by an average of 9.8% per year. Coca-Cola has raised its dividend by an average of 5.6% a year during that time.

THE COCA-COLA COMPANY AND PEPSICO OWN A WIDE COLLECTION OF BRANDS



As for growth, Coca-Cola's organic revenue increased 9% in the fourth quarter to 31 December 2021, driven by a 10% increase in prices. That's valuable pricing power. Organic revenue at PepsiCo rose 11.9% with a 7% increase in prices. Organic revenue strips out one-offs like acquisitions and asset sales.

However, both are feeling the pinch of rising costs as inflationary pressures squeeze profits. The cost of distribution, agricultural commodities and packaging have all risen, dragging on operating income.

This fell 28% in the last quarter for Coca-Cola, while PepsiCo's operating profit fell 9%. Still, the results published for both companies on 10 February were better than analysts had forecast.

What is also interesting is that both hope to invest their way out of recent profit doldrums. Coca-Cola and PepsiCo are already two of the world's biggest advertisers, yet both ramped up marketing spend during the most recent quarter.

Coca-Cola has gone long on the Winter Olympics, with a big Olympic themed campaign in China. Pepsi boosted marketing in the quarter around the National Football League ahead of the Super Bowl which was held on 13 February.

There is very little to separate Coca-Cola and PepsiCo shares; both look like great buy and hold stocks for investors willing to sit tight for several years.

Warren Buffett backs Coca-Cola, and while it had the better operating margins in 2021 (28.8% versus 14.7%) this is perhaps an area of opportunity for PepsiCo to make its business more cost efficient. PepsiCo also has the better return on investment and equity of 12.4% and 51.7% respectively versus Coca-Cola's 10.4% and 46.2%.

By **Steven Frazer** News 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, Manager of Securities Trust of Scotland

SMALL CAPS, BIG AMBITIONS

5 AIM stocks to buy now

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

There are many interesting businesses on the AIM market which fly under the radar as they do not get the same attention as their counterparts on the Main Market. Research coverage by analysts is thin, AIM stocks aren't discussed much in the media, and only fund managers with a mandate to look at small companies might even be aware of their existence.

This means there is a big opportunity for investors to consider buying shares for their ISAs or SIPPs in the best of these under the radar companies before rapid growth or a breakthrough brings them to the market's attention and lights a fire under the share price.

Successfully picking a small cap winner can be both fun and lucrative, although this is also a high-risk area of the market as there are plenty of companies which fail, so investors should only use money they can afford to lose.

Small cap stocks are often more volatile, meaning they can experience wild share price swings up and down. It can also be harder to buy and sell them at the price you want compared to more liquid large cap stocks such as those in the FTSE 100 index.

Often smaller companies will dilute existing shareholders by issuing new shares to help fund their goals. But these increased risks are balanced out by their greater growth potential.

It is difficult for a FTSE 100 company to double its earnings or market valuation, but it is a lot easier for a smaller business to achieve this feat.

Just look at an outfit like podcast specialist **Audioboom (BOOM:AIM)**. In the last three years its market value has increased nearly eight-fold and its revenue has increased from $22.2 million to $60.2 million, and it notched up its first profit. The company is now reaping the rewards of having positioned itself over several years to benefit from the rapid growth in the podcast medium.

Plenty of AIM firms have a great story to tell yet their ambitions are often thwarted by financial problems, poor management decisions or just plain bad luck.

It is crucial to do thorough research and make sure the company you are interested in, at the very least, has a solid business strategy, is transparent in its dealings with the market and has directors whose interests are aligned with those of ordinary shareholders.

To help with your investment research, *Shares* has looked at the AIM market and identified five stocks which have interesting qualities.

ANPARIO (ANP:AIM) 635p

Specialist feed additive supplier **Anpario (ANP:AIM)** should see a step-change in organic growth as its markets recover from the pandemic and its products penetrate the aquaculture industry.

The £148 million business provides sustainable, plant-based products to livestock farms and aquaculture worldwide.

Key end markets are in dairy, poultry, pork and fish, with Anpario's products including acidifiers, enzymes and essential oils. It is the company behind a natural feed additive/flavour called Orego-Stim.

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

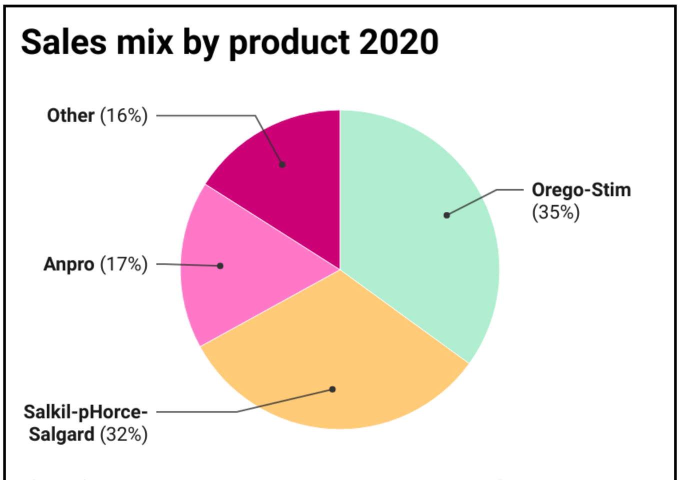


Chart: Shares Magazine • Source: Company report, Canaccord Genuity note • Created with Datawrapper

The company is profiting as food producers around the world transition to natural feed solutions and away from banned feed additives such as antibiotic growth promoters.

Regulation is a tailwind for the business, with antibiotic growth promoters already blocked in China and the EU and other countries likely to follow due to worries over human antibiotic resistance.

Crucially, Anpario's products are essential for customers, enabling the company to pass on cost inflation through price increases.

In January Anpario reported a 'strong operating performance' for 2021 despite pandemic-induced supply chain issues and inflationary pressures, generating growth across Asia, Europe, the Middle East and Africa, and the Americas.

Broker Canaccord Genuity eyes the resumption of double-digit growth and the potential for a substantial, earnings-accretive acquisition.

For the year to December 2022, Shore Capital forecasts pre-tax profit of £5.9 million (2021: £5.7 million) on sales up 4.5% to £34.5 million, and Anpario is forecast to finish the year with the best part of £20 million net cash.

Based on estimated earnings of 22.9p and a 9.9p dividend, Anpario isn't cheap on a forward price to earnings multiple of 27.7 with a 1.6% yield. Yet as investor Chris Hutchinson, manager of the **Unicorn AIM VCT (UAV)**, explains, it is 'an extremely focused provider of niche products in an expanding market', selling science-backed, patented products that competitors struggle to replicate. [JC]

ARTEMIS RESOURCES (ARV:AIM) 4.1p

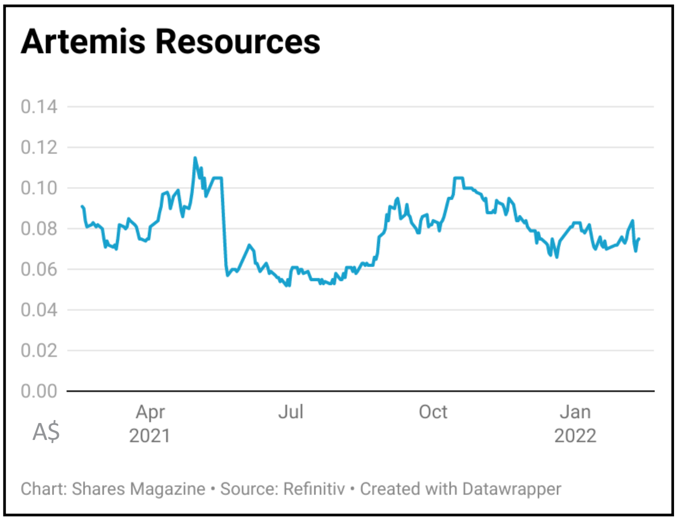
A recent addition to the AIM market, though its shares have traded in Australia for more than a decade, gold mining play **Artemis Resources (ARV:AIM)** is looking to follow in the footsteps of one of AIM's recent big success stories in the resources space.

London-headquartered **Greatland Gold (GGP:AIM)** surged from a share price of around 1.5p in 2019 to more than 37p at its peak in late-2020 off the back of the major Havieron discovery in Western Australia. This is conservatively estimated to contain more than 4 million ounces of gold and has attracted large Aussie miner Newcrest as a partner.

While Greatland's shares have since retraced from their highs its story still illustrates what can happen when a company makes such a significant discovery, particularly in a region with existing infrastructure and in a safe and stable mining district.

The good news for Artemis, which recently kicked off its own exploration effort for 2022, is that it is operating in very close proximity to Havieron with its 100%-owned Paterson gold-copper project.

There are substantial risks and uncertainty with resource exploration, however the fact there



This chart is for the Australian listed shares. Artemis only joined AIM on 7 February 2022

is already a very substantial gold resource next door is encouraging.

Artemis executive director Alastair Clayton told *Shares*: 'Through good luck and good management Artemis has the ground surrounding Havieron and we believe the geology and structures which caused that discovery just a couple of kilometres away continues into our ground.'

The planned 2022 exploration activity is already funded, with the company having raised around £5 million alongside its AIM listing.

It is important to understand that plenty of companies have pegged land next to a big discovery, only to find that the mineralisation hasn't extended into their territory. Therefore, Artemis is not guaranteed to be sitting on a literal gold mine.

As well as Paterson, the £50 million business has the Greater Carlow Castle gold, copper and cobalt deposit which, while seen as being less of a game-changer than Paterson in terms of its potential scale, is more advanced in terms of understanding the geology.

The company should get the latest drill results on Paterson in March, which will show the proportion of metals in the ores it has recovered, and this is the next likely catalyst for the share price.

Artemis is a very high-risk investment as drilling disappointment could have a material negative impact on the shares, however in the event of success the rewards could be significant. Treat this is a highly speculative investment and do not invest any money that is needed for day to day living. [TS]

MADE TECH (MTEC:AIM) 104p

Having enjoyed an initial rally after joining London's junior market in September 2021 at 122p per share, **Made Tech (MTEC:AIM)** has fallen 25% from its 140p peak. That creates a decent entry point into the shares.

Set up in 2012 by chief executive and 28.2% shareholder Rory MacDonald, Made Tech provides a range of technology consulting, implementation and training services to the public sector.

With applications in the cloud, the company helps to catapult central and local government services, healthcare, housing, transport and education into the 21st Century digital age. Its customers include the Ministry of Justice, Hackney Borough Council and NHS Business Services Authority.

Based on estimates from Public.io, investment in these areas will hit £20 billion by 2025 from £3.1 billion in the 2020/21 financial year.

This same market has helped power growth at FTSE 250 group **Kainos (KNOS)** and the smaller **TPXimpact (TPZ:AIM)**, and delivered huge share price gains: 645% over five years for Kainos and 211% for TPXimpact since its December 2018 stock market listing under its previous name of The Panoply Holdings.

Reflecting the scale of the opportunity,

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

Made Tech reported 131% revenue growth in the six months to 30 November 2021 to £11.7 million. Analysts at Berenberg forecast £32 million revenue for the year to 31 May 2022, growing to £84 million by fiscal 2024, implying operating profit of £4 million this year ramping up to £13 million.

As a people business, the chief concern right now is rising staff costs. Yet experienced workers and graduate trainees are being found despite the tight recruitment market. As these pressures ease there is scope to outperform consensus earnings forecasts that already factor in rampant wage growth.

Made Tech is still a young business and embryonic in public market terms, so the shares won't suit all investors. But a 2023 price to earnings multiple of 17 makes this a good investment opportunity for those willing to take a long-term view. [SF]

TRISTEL (TSTL:AIM) 452.3p

Tristel's (TSTL:AIM) shares are almost back to where they were before the pandemic despite the medical device contamination prevention specialist being a significantly bigger business today compared with two years ago.

Moreover, the company believes the pandemic has permanently increased global awareness and global demand for its infection prevention and control products.

Arguably the shares got ahead of the fundamentals in the months following the outbreak of Covid-19, but the 52% fall over the past year looks overdone. We think this is a great time to buy the shares.

Tristel is a quality business with hundreds of patents protecting its technologies, unique foams, wipes and sprays used in hospitals to clean small instruments manually instead of using traditional expensive instrument washing machines.

Since listing on the market in 2005, the company has grown revenues at a compound annual growth rate of 17% a year and pre-tax profit at 15.4% year, demonstrating consistent profitable growth.

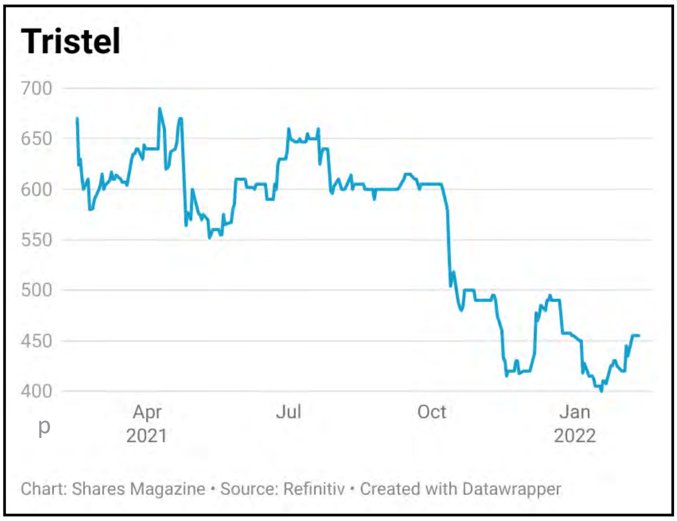
The company has been preparing to enter some of the largest markets in the last couple of years. For example, Tristel is on the cusp of making a breakthrough in the US market and expects to submit the required data to the US regulator in June.

Tristel has already appointed Parker Labs to be the contract manufacturer and marketer for Duo ULT, a high-level disinfectant for ultrasound devices. Parker is registered with the US drug regulator as a manufacturer for medical devices and looks like a great partner for Tristel to penetrate the market. Commercial sales are expected to start in the 2024 fiscal year. Approvals have already been granted for Duo ULT in India and South Korea.

It is further ahead in Canada with the first product sales expected in the current financial year which ends in June. Tristel Duo OPH was recently approved by Health Canada as a medical device used for ophthalmic (eye) instruments.

Tristel has an exciting future and has barely scratched the surface of the global market for infection prevention and control, thought to be worth around $33 billion in 2020.

Investors interested in the stock might want to wait until half year results are published on 21 February before buying to get a clear picture of events in the business. [MGam]



VAN ELLE
(VANL:AIM)
41p

Geotechnical or ground engineering isn't usually seen as a go-go business, but the UK's largest specialist contractor is enjoying a boom in demand as construction activity rebounds from pandemic-related restrictions.

In its latest update for the six months to October 2021 Van Elle posted revenues of £60.1 million, a 57% increase on the previous year but more importantly a 24% increase on the same period in 2019 when trading was 'normal'.

Moreover, profitability improved due to a higher plant utilisation rate which offset supply chain challenges and higher labour costs as well as mobilisation costs as the firm managed higher activity levels.

Demand from the housebuilding sector remains high with the housing division operating at near capacity. Despite the phasing out of the stamp duty holiday in England and Northern Ireland, enquiries from big developers and contract activity levels are still high.

As pleasing, the regional construction division performed well as demand for general piling for large-scale commercial buildings took off last year on the race for space in the logistics sector, helping lift margins thanks to better plant utilisation.

The real kicker was the specialist piling and rail division which saw revenues rise 58% on 2019 levels thanks to the April acquisition of Screwfast and a big improvement in rail activity towards the end of the period, which carried on into this year.

Rail workloads have been more consistent and while the firm is not overly exposed to HS2 chief executive Mark Cutler sees Van Elle becoming more 'embedded' in the project due to its market-leading position.

More importantly, as the UK moves to decarbonise public transport through electrification Van Elle sees potential for significant future long term growth for its rail business.

Meanwhile, a new 10-year contract from the National Highways Agency to support the Smart Motorway Programme is a major feather in the cap of the specialist piling division.

Van Elle raised its full year guidance in January, leading analysts to upgrade this year's earnings forecasts by between 10% and 15% but many have left their outer year estimates unchanged meaning there is scope for further increases to the consensus earnings forecast led by specialist and rail revenues. [IC]

Van Elle

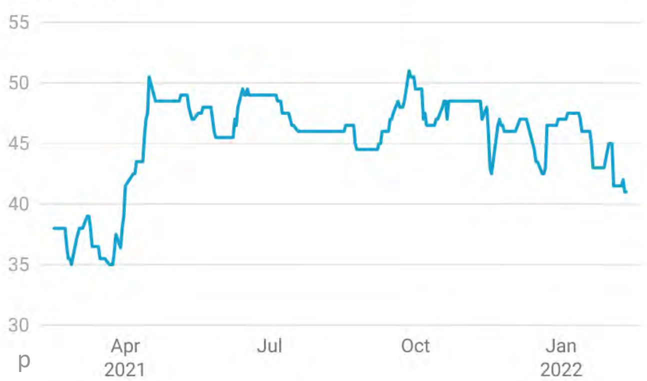
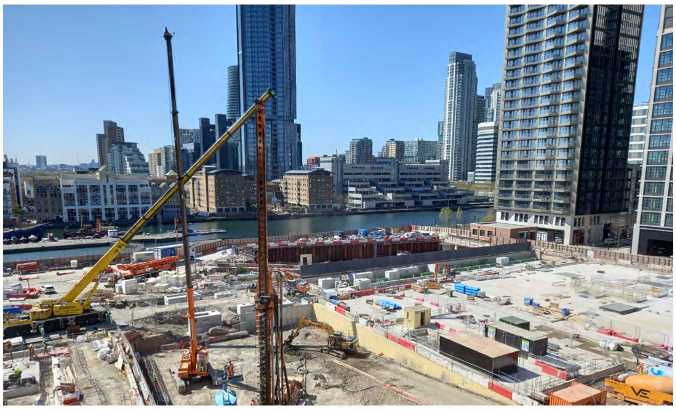


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper



Van Elle outlook

(consensus and company targets)

	FY April 2022	FY April 2023	Company's targets
Revenues	£117m	£119m	5% to 10% annual growth
EBITDA	£8.6m	£10.3m	
Operating Margin	3.3%	4.5%	7-8% Margin
Pre-tax Profit	£3.3m	£5.0m	
Return on Capital	8%	10.6%	15% to 20%

Table: Shares Magazine • Source: Van Elle, S&P Market Inteliigence • Created with Datawrapper

Will the Chinese tiger pounce in 2022?

- ***Investors will be hoping the year of the Tiger brings better times for Chinese stock markets***
- ***The government is taking action to try and boost economic growth and preserve 'common prosperity'***
- ***The stock market has diversified opportunities for active investors***

The year of the Ox did not deliver on its aim of wealth and stability for investors in China. They will be hoping that the Tiger may prove a more auspicious guide in 2022, with its associations of strength and dynamism. There are already tentative signs that the tide is turning.

The Chinese economy has faced a number of headwinds in the past 12 months. The Chinese government took steps to calm the real estate market, which led to high profile difficulties for over-indebted property groups such as Evergrande. It also intervened in the internet and online education sectors, which damaged the business model for many of the country's largest companies. At the same time, the government persisted with its zero Covid policy, which acted as a brake on growth.

These interventions have undoubtedly been painful in the short term but are part of a broader plan that may ultimately help boost the economy. The government's pursuit of 'common prosperity' is designed to create a higher quality economy without the imbalances that have built up in some developed economies. The government hopes to ensure a level playing field for innovation, rather than a number of dominant companies crowding out smaller businesses.

In the real estate market, for example, the government delivered the message that property is for housing and not for speculation. Property is a large sector and the clampdown hurt, but its long-term effect should be positive. The move to tackle the social and privacy concerns on internet stocks is important – and is also being pursued by Western governments – but has come more abruptly than investors might have hoped.

Taking action

Perhaps most importantly, the government is aware of the economic slowdown created by these policies and is taking action to reverse its impact. Common prosperity remains a secondary consideration to the long-term economic advancement of the country. In its most recent set of five-year plans, the government said it wanted to bring per capita GDP to the level of a "moderately developed" economy by 2035. This means delivering average nominal growth of more than 6% in dollar terms each year.

With this in mind, the government has taken action to stimulate the economy through monetary easing. There may also be fiscal spending coming down the road should the recent loss of momentum persist. China is not facing the same inflationary challenges as many developed markets, so has more room to manoeuvre.

2021 may have been a painful year, but the long-term growth story for China remains intact. Its citizens are becoming wealthier and spending more. This year could bring a different style of growth, less reliant on exports but higher in quality, leaving the country more self-sufficient.

What does this mean for markets?

Markets had a tough time last year. The Chinese government hit internet stocks such as Alibaba and TenCent particularly hard. These form a large part of the index (around one-fifth in those two names alone). This meant the performance of indices such as the MSCI China was weak.

Nevertheless, there have been pockets of strength. Active managers in the right space have been able to find opportunities in growing areas. Across our abrdn investment trust portfolios, we have focused on areas such as aspirational spending, digitalisation, going green, health and wealth, where we have seen growth in the past. These areas have been able to transcend economic weakness and many are aligned with significant government initiatives such as energy transition and technological progress.

Market volatility has also seen some opportunities emerge in

unloved areas. The worst may now be over for some of the internet giants, yet share prices have continued to fall. Many strong property companies have been hit along with weaker names. This has seen real value emerge. At the same time, the recent rotation from growth to value has left some high quality companies in areas such as semiconductors trading at more compelling prices.

New opportunities continue to emerge. The Chinese government has committed to increasing research and development (R&D) investment by 7% each year. This is bringing innovation in areas such as artificial intelligence, biotechnology, quantum computing, and robotics. Ultimately, companies in these areas are finding their way onto the stock market and diversifying the opportunity set for investors.

At a time when the rest of the world faces some major challenges from higher interest rates and inflation, to growing social unrest, China exorcised a number of its demons in 2021. This gives it a platform for a stronger outlook in the years ahead. There may still be volatility ahead – tigers are not pussy cats – but for China, the hard decisions have been taken.

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

Nick Train event highlights the benefits of attending AGMs

Shareholders were rewarded with fascinating insights at Finsbury Growth & Income's annual meeting

For most companies on the UK stock market, annual shareholder meetings are not the big glamourous affairs one might assume them to be. Over the years, giants like **BP (BP.)** might have packed out a conference centre, but for most companies these AGM events are sparsely attended.

Shares has heard stories such as a certain listed fast-food company who had laid out more pizzas for people to eat than there were shareholders who turned up for its AGM. And then there are tales of shareholders dumping stock in companies which no longer provide a hot meal at their annual meetings. A decent bit of grub has long been an incentive to get people to attend.

Covid came along and forced AGMs to be held behind closed doors, with some companies deciding to broadcast them online instead. Even though that was convenient for many investors, it's not a perfect situation.

The best thing about in-person AGMs is the ability to put directors on the spot and ask questions. Doing so behind a computer screen runs the risk of these directors being selective with the questions they answer.

It was therefore refreshing to see approximately 75 people turn up for **Finsbury Growth & Income's (FGT)** AGM on 9 February. We're told that number is significantly down on previous years, but a good turnout under the circumstances, with shareholders ranging from their late 20s to 80 years old attending the meeting.

The key draw was the chance to hear from, and

PROS AND CONS OF ATTENDING AGMS IN PERSON

PROS

- ✓ Your chance to ask questions to company directors or fund managers
- ✓ Meet fellow investors and exchange ideas

CONS

- ✗ Location or time isn't always convenient
- ✗ Some meetings are tedious with people just reading out the already-published reports

then grill, Finsbury Growth & Income's fund manager Nick Train and deputy portfolio manager Madeline Wright.

While a pre-recorded version of the presentation is now available online for those who couldn't attend the event, those in the room certainly had the advantage. Train held a lengthy question and answer session (which isn't available to watch online) and Wright and he stuck around afterwards to mingle with investors and chat about all things markets and beyond.

To his credit, Train took time to think about each question from shareholders and, in most cases, give a lengthy answer. 'Candour' was the word of the day, with Train happy to discuss disappointments as well as successes.

Considering that Finsbury Growth & Income lagged the UK market last year (2021 total return of 13% versus 18.3% from the FTSE All-Share), one might have expected a room of angry shareholders demanding answers as to why they paid for active management and the manager didn't outperform.

However, the first question from an investor began: 'I'm not too worried about the performance of the trust, I'm a happy holder.'

REASONS BEHIND UNDERPERFORMANCE

Train might have been given some grace because of the trust's long-term track record. Over the past 20 years it has achieved an annualised return of 10%, nearly double the 5.2% from the FTSE All-Share.

Nonetheless, the fund manager didn't try and brush off last year's outcome, even though the double-digit return was the trust's third best year on an absolute basis since 2013. He was upfront and said: 'Underperforming the benchmark is a disappointment.'

The reasons why it happened were clear. Finsbury Growth & Income has a concentrated portfolio of 20-odd stocks so any laggards can act as a drag on the overall performance.

The three biggest detractors to the trust's performance were **London Stock Exchange (LSE)** with a -23% total return in 2021 as investors thought it might have overpaid for data provider Refinitiv. **Hargreaves Lansdown (HL.)** returned -8% as profits failed to match the previous year's bumper performance, and **Unilever (ULVR)** returned -6.8% amid concerns about sales growth rates and margins.

NEW BITS OF INFORMATION

Train is a highly experienced and clever investor, and there were also some very smart shareholders in the room judging by the quality of their questions.

Two new bits of information were garnered thanks to the inquisitive nature of the attendees of the AGM. First, Train seemed to support Unilever's bold move to look at **GlaxoSmithKline's (GSK)** consumer healthcare arm.

He said: 'We would have been a lot more disappointed with the company if they had not contemplated making that acquisition. That is a rational asset for Unilever to aspire to own. Whether it was practical at this juncture is another matter.'

Train also revealed that Finsbury Growth & Income no longer held a stake in **Pearson (PSON)**, concluding a long period of having to justify why he held on to an underperforming stock. The manager also explained that he decided to sell down a stake in Pearson held in another one of his funds to meet redemptions from investors seeking to withdraw their money.

CANDID VIEWS

Shareholders managed to get Train to give honest answers on some of his other holdings. On Finsbury Growth & Income's stake in Manchester United football club – whose shares are down 13% over the past 12 months – he said: 'In the spirit of candour, I'm disappointed by the return on the investment'.

He added: 'But the incredible value of sport rights remains strong and growing, and you've seen a flurry of change in ownership among top teams. There is an appetite to own these trophy assets and Manchester United is one of the world's most pre-eminent trophy assets.'

Train could have stuck to the script at the AGM and refused to answer stock-specific questions, which is often the case with fund managers. But he was happy to talk about anything, and what's interesting was his ongoing reference to the investment trust being 'your company' when addressing the shareholders in the room.

Some might call him a star manager, but Train knows his place – he is working for the shareholders, and notably during the event he thanked the board of directors for providing support and council over a 'tricky' few years.

'There were a few times we needed the board's wisdom,' he added. This might surprise some investors who think a fund manager is the only one running the show, and that the board is simply there as a formality.

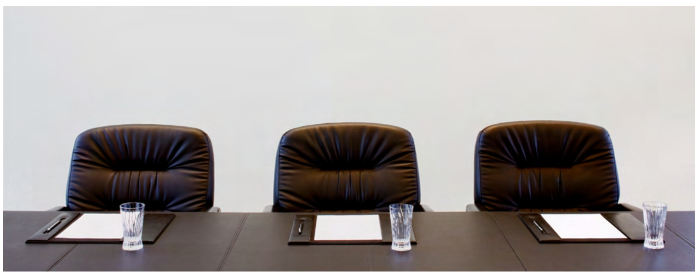
BENEFITS OF AGMS

In-person AGMs can be very important ways to find out about your investments. With actively managed funds, you're paying for an individual or team to beat the market, and it's only right that you're granted an audience with them to ask how it's going, so make the most of it and attend if possible.

Such interaction is also beneficial for those owning individual company shares. After all, as a shareholder you are effectively part owner of the business.

The bonus of attending AGMs is that you'll be in a room with like-minded individuals and sharing thoughts and ideas can be very satisfying and hopefully rewarding.

DISCLAIMER: AJ Bell is the owner of Shares magazine. The author owns shares in AJ Bell



HOW TO SIGN UP FOR AN AGM (ANNUAL GENERAL MEETING)

- If you're a shareholder in a stock, investment trust or fund, you have the right to attend the AGM.

- When you invest via an investment platform your shares or fund units are held in a nominee account, which means you're not classed as the legal owner. The platform is the legal owner, and you are the beneficiary. This means your name and contact details aren't visible to the investee company. To attend an AGM, you need to find out the date of the event yourself and ask your investment platform for a letter to prove you are an investor.

- For example, with AJ Bell Youinvest, customers need to send a secure message to confirm they want to attend a specific AGM, and in return they will be sent a letter of representation.

By **Daniel Coatsworth** Editor

Two low-cost funds for exposure to US value stocks

We compared products from iShares and UBS as investors seek to play the value theme in overseas markets

Many US stocks have become expensive in recent years and these high ratings make them less appealing in the current market environment which now favours cheaper valuations. Investors needn't panic as there are easy ways to get exposure to more value-style stocks in the US.

During the pandemic price to earnings ratios for US growth stocks jumped to 31 times from 22, while those for value rose more modestly to 16 times from 13. This is at a time when inflation in America has climbed to its highest level in 40 years in January, with prices increasing by 7.5% from a year ago.

There is pressure on the US central bank, the Federal Reserve, to now implement a succession of interest rate rises. Highly rated growth stocks are more sensitive to rising interest rates as the value of future cash flows are worth less when discounted to the present day.

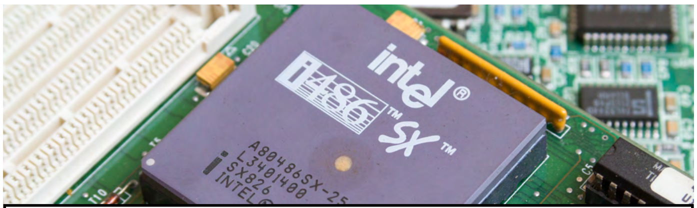
Anyone looking to maintain exposure to the US and switch out of expensive growth stocks into more value-style investment has several options. One is to look at individual stocks trading on low price to earnings or low prices to earnings growth metrics.

Another is to look at exchange-traded funds which have a value tilt and a focus on the US market. Two examples listed on the London Stock Exchange are **iShares Edge MSCI USA Value Factor ETF (IUVF)** and **UBS ETF Factor MSCI USA Prime Value ETF (UPVL)**.

They provide access to the value segment of the US equity market with a single transaction while offering broad diversification across a range of sectors. In addition, they provide a high degree of transparency and are cost efficient.

HOW DO THEY DIFFER?

iShares Edge MSCI USA Value Factor ETF is designed to mirror the performance of the MSCI USA Enhanced Value index, which is composed of US large and mid-cap companies with favourable value characteristics, based on the price to book value, price to forward earnings, and enterprise value to cash flow from operations. The ETF has a 0.2% expense ratio.



TOP HOLDINGS: ISHARES EDGE MSCI USA VALUE FACTOR ETF

AT&T	FORD MOTOR
INTEL	IBM
MICRON TECHNOLOGY	PFIZER
CISCO SYSTEMS	ABBVIE
GENERAL MOTORS	CITIGROUP

Table: Shares Magazine • Source: BlackRock/iShares 11 Feb 2022 • Created with Datawrapper

There are approximately 150 holdings in the index, which as of 31 January had an average price to forward earnings ratio of 10.5 and price to book ratio of 1.9, according to MSCI. That compares with a forward PE of 20.8 and price to book of 4.7 for the MSCI USA index.

From a sector perspective technology has the largest weighting at 30%, followed by healthcare (13.3%), consumer discretionary (11.9%), communication services (10.6%) and financials (10.4%).

Sectors with a relatively small weighting in the index include energy (3%), real estate (2.7%), utilities (2.4%) and materials (2.4%).

CONTRASTING FORTUNES

It is worth comparing the contrasting fortunes of two stocks in the ETF, namely Intel and IBM.

Over the past 12 months Intel's share price has fallen by 24%. Although the company may appear undervalued on various valuation metrics, some might argue it is a value trap. This is because the business faces several structural challenges; once the prominent player within the chip industry, it has fallen behind competitors TSMC and Samsung.

Intel failed to deliver new chips on time which contributed to Apple's decision to sever its relationship with the supplier and build its own chips. Intel also made a major strategic error when it failed to target the mobile chip market.

In marked contrast IBM is an example of how a value stock has commanded a low valuation because the market thought it was stuck it mud yet appears to be proving critics wrong.

IBM has been experiencing negative or low revenue growth for nearly a decade. However, CEO Arvind Krishna, who took control in 2019, has a new vision for the group based around RedHat, the company IBM acquired in 2018 for $34 billion.

RedHat enables customers to manage their hybrid cloud environments regardless of location. Put simply RedHat can be the glue to hold the cloud environment together, where clients are running workloads on multiple different systems including Amazon and Microsoft.

Recent results indicate that Krishna's vision is coming to fruition. Hybrid cloud revenue, the segment where RedHat is based, reported $6.2 billion for the fourth quarter, an 18% year-over-year increase. IBM's share price has risen 16% over the past year.

WHAT ABOUT THE UBS ETF?

UBS ETF Factor MSCI USA Prime Value mirrors the performance of the MSCI USA Prime Value index, which includes large and mid-cap companies based in the US that demonstrate value traits. The ETF has a 0.35% total expense ratio.

Whereas the MSCI USA Enhanced Value index focuses on stocks with higher value characteristics relative to their peers, the MSCI USA Prime Value index combines value with high quality

TOP HOLDINGS: UBS ETF FACTOR MSCI USA PRIME VALUE ETF

INTEL	CIGNA
UNITEDHEALTH	TRUIST FINANCIAL
WALMART	MERCK
PFIZER	US BANCORP
CISCO SYSTEMS	COSTCO WHOLESALE

Table: Shares Magazine • Source: UBS, as of 31 Jan 2022 • Created with Datawrapper

characteristics.

The difference in terms of sector representation is that financials dominate the MSCI USA Prime Value index and therefore the UBS ETF. There is also a much bigger weighting to industrial stocks than in the iShares ETF discussed in this article.

Both ETFs have positions in Intel, Cisco and Pfizer in their top holdings. However, discount retailer Costco only features in the top holdings of the UBS ETF.

Over the past 12 months Costco's shares have risen by 44% as the cash constrained consumer has increasingly seen the company as a source of value for low-cost necessities.

Costco's Kirkland Signature products have been a key factor behind the group's recent success. These are products that Costco can sell at least 20% below named brand competitors. A good example is allergy medication which costs as much as 92% less than named brands.

By **Mark Gardner**, Senior Reporter

Revealed: the UK equity income funds which have topped the charts

The managers have delivered both income and capital growth over the long term

Finding reliable dividend income in the UK equity market remains tricky despite the resumption of dividends by companies emerging from the pandemic and repairing their balance sheets.

In this feature *Shares* puts the spotlight on some of the best performing UK equity income funds and investment trusts which have also displayed consistency over many years.

Topping the trust universe is the **Law Debenture Corporation (LWDB)** which has performed consistently well over five years and ranks highly over the last decade, besting peers and the FTSE All-Share total return index.

The open-ended funds universe is topped by the **Allianz UK Listed Equity Income Fund (FUND:B82ZGC2)** which has delivered an impressive five-year return, almost double the return of the index.

All the figures in this article are total return which includes share price gain/loss and dividends.

A 40-YEAR TRACK RECORD

The £1 billion Law Debenture trust is managed by Janus Henderson's James Henderson and Laura Foll. The trust aims to deliver long-term capital growth in real terms and provide a steadily increasing income.

Impressively, the trust has maintained or grown its dividend consecutively over the last 40 years and the trailing 12-month dividend yield is 3.3%.

The managers are bottom-up stock pickers who spend most their time meeting company managements and conducting detailed analysis of long-term growth prospects.

They are patient investors looking to identify companies with great long-term prospects, but which are trading below fair value due to temporary problems or have just fallen out of favour.

HEAVILY DIVERSIFIED

The portfolio is typically diversified across around 140 different names, two thirds of which are large cap FTSE 100 names and the rest mid-cap and small caps.

Around 77% of the portfolio is invested in UK stocks with 7% in the US and the rest spread across Europe and Asia. There is a cyclical bias to the portfolio with around 70% of the portfolio exposed to sectors such as financial services, industrials and basic materials.

Because the portfolio is so diversified the top 10 holdings only represent around 20% of the assets. Pharmaceutical giant **GlaxoSmithKline (GSK)** is the biggest position at 2.8%, followed by oil majors **Shell (SHEL)** and **BP (BP.)**, and bank **HSBC (HSBC)**.

The trust has an ongoing charge of 0.57%.

Best performing UK equity income funds, ranked by five-year performance

Fund	1yr	3yr	5yr	10yr
Allianz UK Listed Equity Income C	29.1%	46.8%	59.7%	146.3%
Courtiers UK Equity Income Retail	24.8%	38.7%	56.4%	n/a
LF Montanaro UK Income A Acc	9.7%	34.6%	42.8%	163.8%
TB Saracen UK Income B Acc	14.1%	22.3%	39.1%	n/a
Santander Equity Income Unit Trust RI	13.5%	28.3%	34.3%	112.0%
JOHCM UK Equity Income A Acc	27.7%	26.5%	33.9%	143.5%
M&G Charifund A Inc	18.3%	24.5%	33.0%	127.9%
SPW Multi-Manager UK Equity Income B Acc	23.9%	27.3%	31.3%	n/a
RWC Enhanced Income R	26.3%	19.5%	31.2%	77.8%
MI Chelverton UK Equity Income B Acc	14.6%	20.1%	29.3%	179.0%
Lazard Multicap UK Income A Acc	19.3%	22.3%	27.2%	112.5%
Benchmark: FTSE All Share	**18.6%**	**22.9%**	**30.4%**	**101.1%**

Table: Shares Magazine • Source: FE Fundinfo. Total return in GB. Data as of 9 February 2022. • Created with Datawrapper

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

Trust	1 year	3 years	5 years	10 years
Law Debenture	25.0%	60.6%	81.5%	220.6%
Merchants Trust	37.2%	49.2%	68.1%	164.4%
Dunedin Income Growth Investment Trust	12.1%	42.9%	58.3%	129.9%
Shires Income	19.7%	26.6%	55.8%	139.9%
The Diverse Income Trust	14.8%	36.4%	50.9%	230.4%
Murray Income Trust	10.5%	33.3%	49.7%	111.3%
JPMorgan Claverhouse IT	21.3%	22.6%	46.3%	160.7%
Finsbury Growth & Income Trust	2.7%	18.1%	45.7%	211.1%
Schroder Income Growth	17.1%	31.1%	41.6%	140.8%
BMO Capital and Income investment Trust	17.4%	19.2%	37.9%	121.4%

Table: Shares Magazine • Source: FE Fundinfo. Total return in GB. Data as of 9 February 2022. • Created with Datawrapper

BENEFITING FROM EXPERIENCE

The Allianz UK Listed Equity Income Fund has £237 million of assets and is managed by Simon Gergel and Richard Knight. The fund has a trailing dividend yield of 3.5% and income is paid semi-annually.

The fund has been managed with a consistent value-driven approach for many years and benefits from a team which have decades of investment experience gained across multiple investment cycles.

The fund's objective is to generate a greater return than the FTSE-All Share index over a rolling five-year period while delivering an income yield above that of the index.

The portfolio is diversified across 57 holdings and the top 10 represent around 29% of the portfolio.

As might be expected from a value-focused approach, the portfolio is weighted towards cyclical and interest rate sensitive areas of the market and underweight consumer defensives, healthcare and utilities.

That said, the two largest positions are considered defensive, being UK tobacco companies **British American Tobacco (BATS)** and **Imperial Brands (IMB)** which together represent 7.7% of the portfolio.

The fund has an ongoing charge of 0.57% a year.

By **Martin Gamble** Senior Reporter

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DANNI HEWSON
AJ Bell Financial Analyst

Subscription companies face new challenge post-pandemic

Names like Netflix, Peloton and Disney may not have an easy ride

Paying a regular fee for a service is far from a new concept but over the last five years subscription services have mushroomed. Today you can sign up for pretty much everything from TV streaming to meal box deliveries, prescription refills, coffee bean fixes and gym classes.

The pandemic became boom time with people unable to make spontaneous decisions about their free time and shares in companies like Peloton, Disney and Netflix soared to record highs. But investors have been getting nervous and they're looking at rising inflation figures and wondering how consumers will react.

Rising inflation

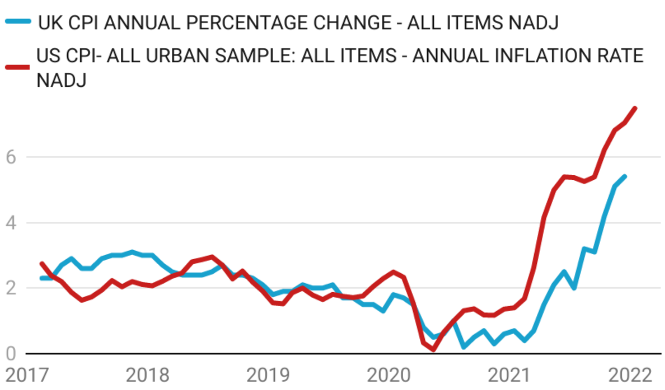


Chart: Shares Magazine • Source: Refinitive • Created with Datawrapper

COST OF LIVING CRUNCH

With inflation now over 7% in the US and expected to head the same way in the UK many people are having to take a long hard look at their outgoings. Do they really need two or even three different streaming services?

Would they rather hit the gym than cycle in their own home and are meal boxes necessary when you can easily pop to the supermarket and pick up fresh ingredients?

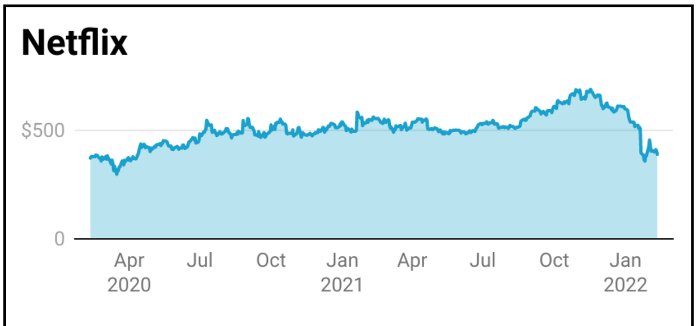
Cost pressures and competition have hit the market in tandem, and the latter has given subscription maestro Netflix a bloody nose when it released its latest figures. Netflix's downbeat growth forecast resulted in its shares losing most of their pandemic gains.

Investors are now wondering if Western markets are simply too saturated, if everyone who wants Netflix already has it and whether some of those might be flirting with cancellation.

Lockdown darling Peloton had to slash the price of its flagship bike but even that wasn't enough to win over consumers who hadn't splashed out when gyms were shut. Slowing demand and a whole host of supply issues have resulted in a spectacular collapse in its market value with the company only worth marginally more than when it first floated in 2019.

But in Peloton's case its subscribers could be its saviour. Those who have jumped on their bikes have remained loyal with very little subscriber churn, possibly because those who could afford the bikes in the first place are relatively cushioned from the current cost of living crunch and there

DANNI HEWSON
AJ Bell Financial Analyst



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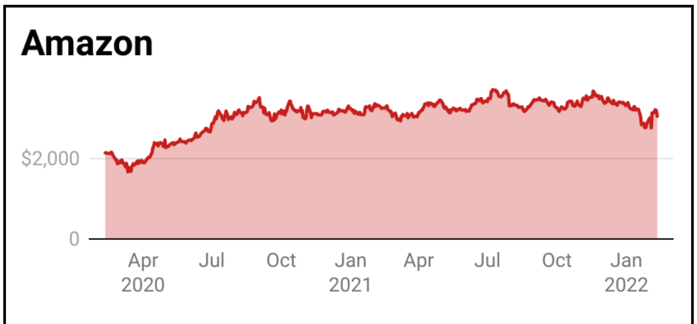


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

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

is mounting speculation that the company and its data might prove a tasty acquisition for a third party like Amazon, Apple or Nike.

VALUE FOR MONEY

Because people want value for money, names like Peloton and Netflix could probably charge more without a significant drop off in demand.

Amazon demonstrated exactly this point when it announced it was going to hike the price for its Prime service by $2 a month for its US customers, and you can bet the rest of the world won't escape either.

Disney's boss Bob Chapek has confirmed Disney+ customers might see a price hike next year as the service inches its way to profitability while at the same time upping spend on content.

The mouse house has confirmed it will shell out $33 billion over the next year as it supercharges its subscriber base, aiming to double the number of eyes currently on the platform by September 2024, though $10 billion of that investment will be on sporting rights.

'Content, content, content' was the message from Disney's CEO. The viewer will most certainly emerge the victor but with these promises locking providers into ever expanding circles what does it mean for shareholders?

THE BUNDLE STRATEGY

That's where bundling might be the key, and not just in terms of the number of channels being tied up in a shiny bow.

Where Amazon combines its retail offer with Prime and Apple hands over free months of its TV offer with new hardware, Netflix is setting its cap towards gaming, and every man and his dog are being suggested as potential buyers of Peloton right now because the subscription space is getting tighter and tighter.

Snapping up a rival's subscribers, even a rival in a different sphere, delivers an easy bounce. And 2022 is already gearing up to be a hotbed of takeover action in this arena with Amazon's huge wallet being linked alongside Spotify as potential suitors for UK podcasting group **Audioboom (BOOM:AIM)**.

The stage is set but there's one more actor waiting in the wings. What will regulators make of such plans? While too much competition leaves the consumer in a quandary, not enough could leave them out of pocket.

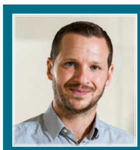
How does flexi-access drawdown work with pensions?

A reader wants to know how they can stagger the 25% tax-free withdrawals from their retirement pot

I plan to access my SIPP soon, probably via flexi-access drawdown. Given the potential volatility of markets and likely valuation degradation, the option of staggering the 25% tax-free entitlement (to avoid significant capital depreciation) over a period of, say, five years seems an increasing likelihood. Please can you outline how this works.

Presumably the 25% tax-free cash entitlement amount is determined at the point you first trigger drawdown? For example, £25,000 would be tax-free on a pot of £100,000.

Could you then take £5,000 in the first year with subsequent £5,000 amounts in each of the following four years?.
Colin



Tom Selby, AJ Bell Head of Retirement Policy says:

Flexi-access drawdown involves taking an income from your retirement pot while keeping the rest of your fund invested. You can do this from age 55, although this 'normal minimum pension age' is set to increase to 57 in 2028.

The two other main options are taking ad-hoc lump sums (with 25% of each lump sum tax-free) – also known as an uncrystallised funds pension lump sum – or buying a guaranteed income from an insurance company known as an annuity. You can also mix and match these options.

One of the primary tax benefits of pensions is the ability to take 25% of your pot tax-free. This involves 'crystallising' part or all of your pension.

If someone had a £100,000 retirement pot, as in your first example, then they could choose to take their entire 25% tax-free cash entitlement of £25,000. Assuming they are going into flexi-access drawdown, this would trigger two 'benefit crystallisation events': Taking £25,000 tax-free cash and committing the remaining £75,000 to flexi-access drawdown.

Both events would trigger a lifetime allowance 'test' and use up a portion of their available lifetime allowance.

While their remaining fund would be crystallised, they wouldn't have to take an income from the fund or change their investments if they didn't want to.

In these circumstances the saver wouldn't be entitled to any more tax-free cash from their pot, even if the remaining fund subsequently grows in value.

Provided they haven't used up their lifetime allowance, they will be able to generate extra tax-free cash entitlement on the fund that grows from any new contributions paid in.

It is also possible to crystallise your pension in chunks. One potential advantage is that your remaining uncrystallised fund, including any associated tax-free cash entitlement, can continue to grow.

Using the example of someone with a £100,000 fund, they could crystallise £20,000 of it, taking £5,000 in tax-free cash and putting £15,000 into flexi-access drawdown. The remaining £80,000 would be uncrystallised. If that uncrystallised fund grew by 5% to £84,000, so too would the tax-free cash entitlement associated with it. So when they crystallise their remaining fund they could take £21,000 tax-free cash (25% of £84,000) instead of £20,000 (25% of £80,000).

Investment growth is not guaranteed and it is possible your fund will go down as well as up, particularly over the short-term.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

How to shelter investments from an inflation storm

Potential options to guard against a rising cost of living

Inflation is now forecast to peak at over 7% in April, which naturally has many people worried about how that will affect their savings and investments. Meanwhile the average Cash ISA is currently paying just 0.34% in interest, so many people will be looking to the stock market to help fend off inflation. That certainly makes a lot of sense, because companies at least have the opportunity to pass price rises onto consumers.

PLAYING THE LONG GAME

Investors need to play a long game when using the stock market to beat inflation. Over the course of one year, there is absolutely no guarantee that an investment in the stock market will beat inflation. But over the longer term, investing in the stock market is one of the key defences savers have against rising prices.

Investors should also consider what kind of companies might prosper in an inflationary environment. Those with pricing power should be well placed to be able to pass their costs onto customers. Consider the fashion brand, **Burberry (BRBY)**, for instance. If you're willing to shell out £2,000 for a Burberry trench coat, chances are you're in a wealth bracket where inflation is a dim and distant problem, so a few extra pounds on the price tag aren't likely to put you off a purchase.

Investors might also think about investing in the key sources of inflation, in particular energy and raw materials. It would be hard to see inflation continuing to be elevated without these prices also increasing, which would be positive for producers like, for example, **Shell (SHEL)**, or **Rio Tinto (RIO)**.

Some inflationary expectations are already baked into share prices in these sectors though, which explains their positive share price performance in the last six months.

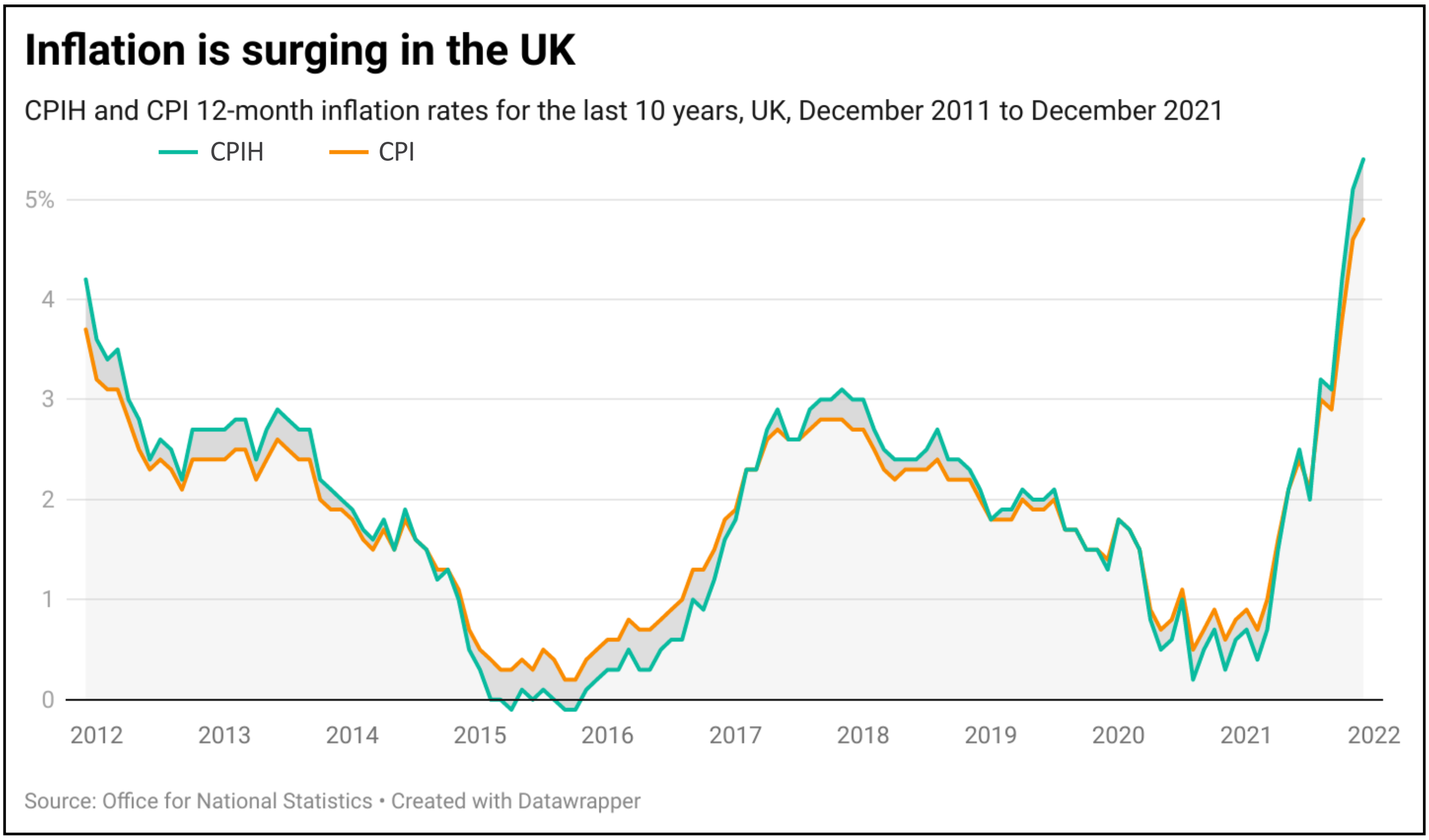
BANKS' PROFITABILITY BOOST

Financials might be another area that could benefit from inflation, albeit indirectly. Banks, for instance, make a return out of taking deposits and lending them out, and the difference between the rates at which they borrow and lend should increase with rising interest rates.

Investors might be tempted to invest in commodities like oil and gas through ETFs (exchanged traded funds), but these funds normally use derivatives to gain exposure, and often come with complex costs which mean that there can be a disconnect between the price movement of the commodity and the return from the ETF. As such, they should only be considered by sophisticated investors who have a very good handle on how these ETFs work.

ALL THAT GLITTERS

Gold often comes to mind whenever inflation raises its head. Unlike barrels of oil and cubic



metres of gas, gold bars are (relatively) easy to store, which means there are some ETFs available which hold physical gold, such as **iShares Physical Gold (SGLN)**, so you don't have to worry about the complexities of derivative pricing. Gold can be volatile however, and it has been trading at around $1,800 an ounce for most of the last year, which suggests the recent inflationary surge isn't hugely impacting pricing. Partly that may come down to the fact higher interest rates aren't good for gold, because it doesn't pay an income, and cash and bonds therefore become relatively more attractive when interest rates are on the up.

As well as thinking where to invest in an inflationary environment, investors should consider where not to put their money too. Cash is necessary for short term spending needs, but clearly it's very exposed to the ravages of inflation, so you should only look to hold an emergency buffer of three to six months expenditure. Government bonds, and in particular long dated government bonds, are also extremely vulnerable to rising interest rates, and so investors should review any exposure they have to this asset class.

EXPENSIVE STOCKS UNDER PRESSURE

We may also see some highly valued areas of the stock market struggle too. There are some stocks, particularly in the tech sector, where their elevated price is built on expectations of future earnings, rather than profits they are making in the here and now. Tesla is a good example. However inflation, and higher interest rates, make distant cash flows in years to come less valuable, and in fact this calendar year we have already seen some frothy areas of the market sell off as a result of this dynamic. Sustained inflation, or fast interest hikes, could see this play out again.

The Bank of England reckons CPI inflation will be back to 2% by 2024. Maybe so, but the Bank's forecasting capabilities haven't exactly won any awards in recent times.

Inflation is extremely unpredictable, and it is entirely possible it will tail off. Investors should therefore take a balanced approach with their finances, which means not betting the entire farm on a continued inflationary environment, while also picking some investments which can do well if inflation proves stickier than the Bank of England expects.

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

Four good habits investors should try to cultivate

Here are some simple tips to hopefully make investing more profitable

Every now and then it's useful to step back and look at your investment process to see what's working and what isn't working. Here are four good habits which we think investors should try to adopt.

1 STAY FOCUSED

One of the most common mistakes investors make is to spread their bets too thinly across too many companies or funds in the belief that they are creating an 'all-weather portfolio'.

Modern portfolio theory says that by diversifying your assets you are reducing your risk. In fact, you reduce risk by buying superior companies and holding onto them. Less is more, and all you are doing by owning more stocks than you need is diluting your returns.

The case for running a concentrated portfolio (such as 20 to 30 stocks, rather than 200 to 300) is obvious from the above-average performance of firms like the Warren Buffett-run Berkshire Hathaway and funds like **Fundsmith Equity (B41YBW7)**.

It is also well documented in modern academic studies. In *Diversification Versus Concentration*, published by the Paul Woolley Centre for the Study of Capital Market Dysfunctionality, Danny Yeung and his colleagues analysed the relative performance of nearly 5,000 US mutual funds and found the funds with concentrated portfolios achieved better returns.

The authors concluded: 'This highlights the potential for investors to diversify across concentrated funds rather than have the funds do the diversification themselves. It also highlights that the stock selection skills of the managers may be lost by their portfolio construction endeavours.'

Another study, *Best Ideas* by Anton, Cohen and Polk, found that the stocks in which active mutual fund or hedge fund managers showed the most conviction, namely their best ideas, beat the market and the other stocks in their portfolios by between 2.8% and 4.5% per year, depending on the benchmark employed.

That level of outperformance or 'alpha generation' is striking, and if compounding were applied over say a 10-year period the gap between the best stocks and the average would be vast.

The authors somewhat provocatively conclude that since most of the other stocks the managers hold don't perform as well, 'the organisation of the money management industry appears to make it optimal for managers to introduce stocks into their portfolio that are not outperformers. We argue that investors would benefit if managers held more concentrated portfolios.'

2 DON'T TRY TO TIME THE MARKET

If the last two years have taught us anything it's that trying to time the market is nigh-on impossible. Not even the highest-paid market professionals could have seen the pandemic coming or predicted the extent of its impact on the market, and even if they could it's not likely they would have predicted the speed or the size of the stock market rebound.

Similarly, this year's sudden repricing of risk caught most investors on the hop. While it was common knowledge the Federal Reserve would tighten monetary conditions, the precise timing of the knee-jerk sell-off was a complete unknown.

However, the long-term performance of stocks beats just about any other asset class, real or financial, and this is helped in large part by dividend reinvestment and compounding.

Investors who understand the importance of time in the market will always beat those who try to time it. Far better to leave your money where it is, look in on it now and again and make sure you are still happy with your choices, and let your investments grow steadily.

Taking money out of the market wholesale risks missing significant upside moves. According to Investing.com, there were over a dozen moves of more than 2% in the FTSE 100 index between the start of March and the middle of April 2020.

If investors had capitulated halfway through March, after the initial fall in the index, they would have missed every one of the up days including a 9% rally on 24 March. Investors who held their nerve and stayed put reaped the gains and the full extent of the rebound.

Biggest 1-day moves in the FTSE 100 in March and April 2020

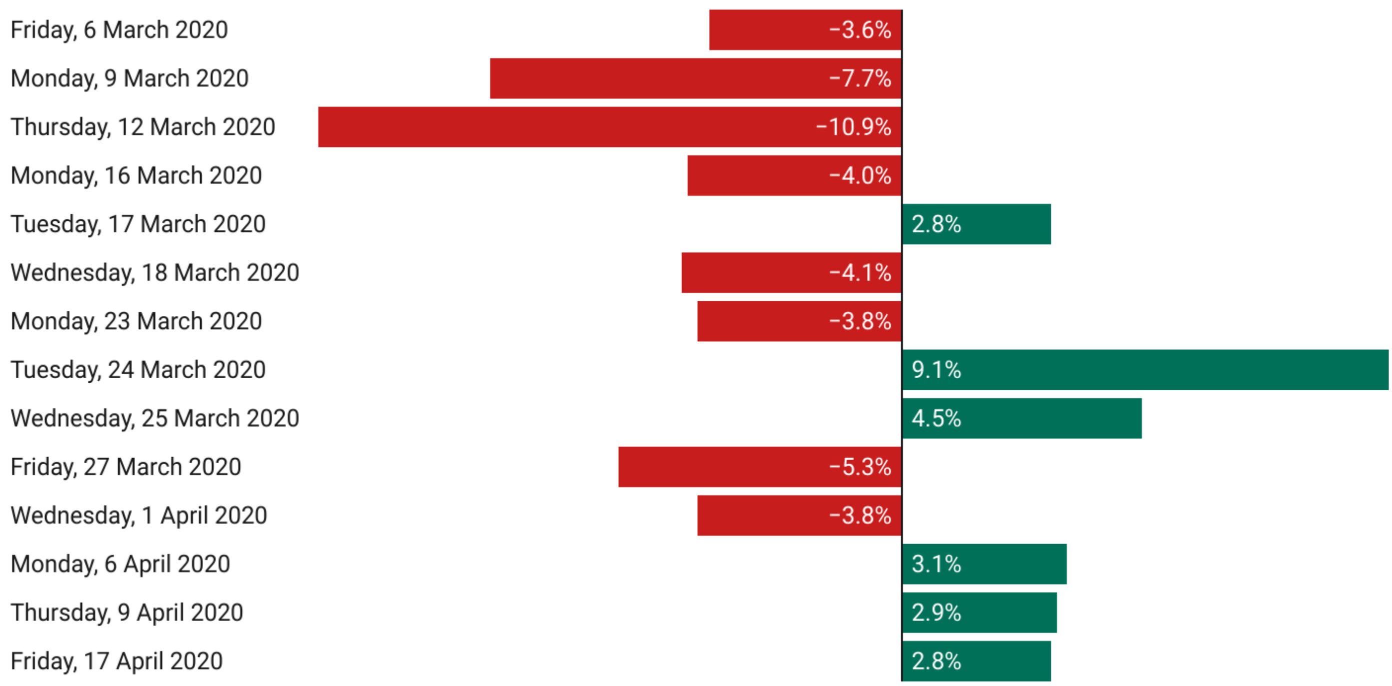


Chart: Shares Magazine • Source: Investing.com, Shares magazine • Created with Datawrapper

3 RUN YOUR WINNERS

It may seem at odds with the current mood given the nervousness in global markets, but investors should resist the temptation to cash in their winners when things get hairy.

Convention wisdom says nobody ever lost money by taking profits. While that's true, it misses the bigger point that nobody ever got seriously rich by cashing in early. Building real wealth takes patience, which means letting winners run.

Lawrence Burns, co-manager of **Scottish Mortgage Investment Trust (SMT)**, makes a crucial point. He says: 'A client is unlikely to be unhappy or indeed notice if a fund manager sells a stock that subsequently goes up significantly. That loss – of forgone upside – isn't captured in performance data, but perhaps it should be.'

Burns turns conventional thinking on its head: 'For the client, equity investing is asymmetric, the upside of not selling is near unlimited, while the downside is naturally capped. It is often not just wrong to take a profit, but it can be the worst possible mistake.'

He gives the example of Masayoshi Son, the founder of Softbank, who in early 2000 invested $20 million in a Chinese e-commerce company. At the same time, US investment bank Goldman Sachs was offered a 50% stake for just $5 million, although it eventually invested just $3 million.

Five years later Goldman sold its stake for $22 million, a seven-fold return, on the basis it's never wrong to take a profit. Today that stake would be worth over $200 billion. Son, who held onto his stake, now has an investment worth over $180 billion.

4 CUT YOUR LOSERS

If running winners can often take nerves of steel, selling loss-making positions is even tougher. All investors find it difficult to face the possibility they may have screwed up, hence the need to fact-check your views now and then and make sure you still have conviction in a stock.

Thanks to evolution we are hard-wired to feel pain more intensely than pleasure. If we put our hand in a roaring fire and it hurts, self-preservation kicks in and we are less likely to do it again.

Most of us research stocks so that we can invest in them for the long term, but as Joachim Klement says in his book *Seven Mistakes Every Investor Makes*, there are risks to performance from being 'the wrong kind of long-term investor'.

Say you buy a stock which on the face of it is uncommonly cheap, with a pessimistic growth outlook and few buyers, on the basis the market is wrong, and you are right.

If the share price fell by 20%, you need the stock to rally 25% just to get back to where you bought it. That's not impossible, but if the share price lost another 20% you need it to rally 50% to get back to breakeven, which is a lot less likely.

'A long-term investment approach is highly recommendable,' says Klement, 'but there comes a point when losses in the interim become so large that it is virtually impossible to ever break even again. If you then still stick to your investment, you are no longer a long-term investor, you are just stubborn.'

There is an old market adage: the first cut is the cheapest. If something you own starts losing you money because the investment case has changed, do something about it. Or as Keynes would say, when the facts change, change your mind.

Disclaimer: The author Ian Conway owns shares in Scottish Mortgage and the editor Daniel Coatsworth has a personal investment in Fundsmith Equity

By **Ian Conway** Companies Editor

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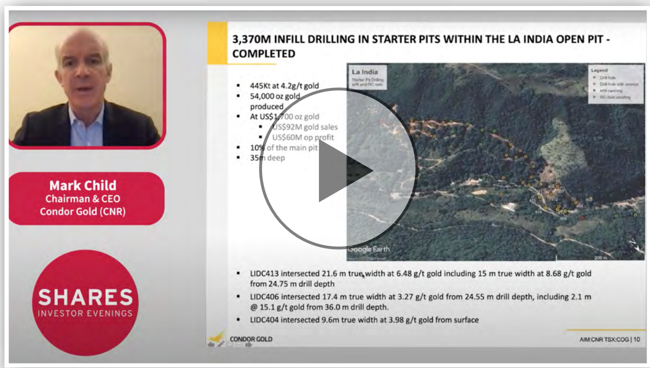

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

18 Feb: Natwest, Pod Point, Segro, The Renewables Infrastructure Group. **22 Feb:** Antofagasta, Bank of Georgia, Coca-Cola HBC, HSBC, InterContinental Hotels, Smith & Nephew, Thungela. **23 Feb:** Barclays, Capital & Counties, Rio Tinto. **24 Feb:** Aston Martin Lagonda, BAE Systems, Centrica, Derwent London, Drax, Howden Joinery, Hikma Pharmaceuticals, Inchcape, Lloyds, Morgan Sindall, Serco, St James's Place, WPP. **25 Feb:** Evraz, Jupiter Fund Management, Pearson, Rightmove

Half-year results:

18 Feb: City of London Investment Trust. **21 Feb:** Dechra Pharmaceuticals, Finsbury Food, Sylvania Platinum, Tristel. **22 Feb:** Bluefield Solar, Hargreaves Lansdown, Petra Diamonds, Springfield Properties. **23 Feb:** Avingtrans. **24 Feb:** Genus, Hays. **25 Feb:** European Opportunities Trust.

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

All chart data sourced by Refinitiv unless otherwise stated