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SHARES

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FTSE 100

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- ✓ Commodities exposure
- ✓ Attractive valuations
- ✓ Generous dividends

Inflationary pressures mount amid **war in Ukraine**

Six big mistakes to avoid before the end of the tax year

Is the **60-40 portfolio finished?**

Contents


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Actual Investors

Reasons not to panic as stock markets capitulate

The cost of isolating Russia and disruption to commodity markets take their toll

Investors' initial, measured response to Russia's invasion of Ukraine has gone out of the window.

As commodity prices surge higher the sell-off in global stock markets has intensified. But the last thing you should do is react rashly to this situation.

Essentially people are waking up to the idea that the devastating sanctions imposed on Russia will come at a significant cost to the rest of the world. The disruption to energy, food and metals markets is being reflected in surges higher for these commodities.

Or as George Lagarias, chief economist at global auditor Mazars, adroitly puts it '"Cancelling" Russia will be expensive.'

If the West follows through on an import ban for Russian oil, it wouldn't be a surprise to see a fresh record for oil prices, taking out its previous all-time high of $147 per barrel marked in 2008. As we write the price has touched $139 per barrel just on the suggestion of a ban.

Oil at these levels adds up to a massive tax on growth, given the increased costs it entails for businesses and individuals.

Elsewhere a likely surge in food prices could have implications for geopolitical stability elsewhere in the world, particularly those developing countries where the cost of staying fed is a bigger proportion of household income.

We have had the latest reminder that the FTSE 100 is not representative of the UK economy and is a bit of an outlier relative to other global indices – something we discuss in our main feature this week.

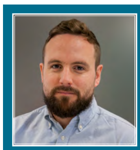
So, while the index is down 8.3% year-to-date, it has been spared the much larger losses seen in other markets thanks to its heavy exposure to the resources sector.

A better indicator of the strain war in Ukraine is putting on the UK economy is the FTSE 250 mid-cap index which is down more than 20% since the start of 2022 and 10% since the eve of Russia's invasion.

The indiscriminate selling may well have created buying opportunities for those brave enough to take them and the *Shares* team will watch this space closely.

However, the best approach is to do as little as possible, assuming you still have time on your side to remain invested and ride out the volatility. While it's hard to see it just now, there will be a recovery for the markets at some point and you don't want to miss it by selling at a time of panic.

Lagarias adds: 'Investors with a high tolerance for risk may choose to roll the dice. But for the critical mass of portfolio holders, those for whom risk is a measurable quantity and financial planning is part of the equation, we think that the best course is to avoid taking significant action before the dust settles and trust in the long-term properties of diversified portfolios.'



By **Tom Sieber** Deputy Editor

Surge in commodity prices threatens to derail the global economy

There is talk of 1970s-style pain as Ukraine conflict supercharges inflationary pressures

Prices of everything from oil and wheat to nickel are surging amid forecasts that supplies from Russia and Ukraine will be disrupted. This threatens to hurt corporate earnings and curb business investment, and at the same time cause consumers to scale back their spending, both leading to economic weakness.

The S&P GSCI Commodity index, made up of a basket of commodities across the spectrum from agricultural products to hydrocarbons, metals and livestock, is up 44.5% year-to-date and 23.8% since Russia invaded Ukraine on 24 February.

S&P GSCI Commodity Index

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

According to estimates from Liberum, Russia exports between 10% and 45% globally of key commodities like oil, gas, platinum group metals, aluminium and nickel, while Russia and Ukraine account for a combined 30% or so of global wheat supply.

Speculation over a ban on Russian oil imports briefly threatened to take oil above its previous 2008 record high of $147 per barrel while nickel, a key component in electric vehicles, hit an all-time high of $100,000 per tonne on 8 March. Gas prices have surged with the Kremlin threatening to cut off Europe's supply.

Wheat prices are also soaring, a development which could have geopolitical consequences given the potential for populations in the developing world to go hungry.

Some of the heat was taken out of these commodities as European leaders cast doubt on an outright ban on Russian gas and oil, after the idea was apparently floated in Washington, presumably on the basis the pain for their economies and populations would be too acute to bear.

The fallout from the invasion is leading to comparisons with the 1970s when cuts by producers' cartel OPEC to oil production shook Western economies. UK think-tank the Resolution Foundation is warning of the biggest decline in UK disposable incomes since the mid-1970s.

Liberum analyst Tom Price makes the same comparison. He says: 'Given the potentially large scale/duration of this conflict, we now believe that the global economy is exposed to an energy-related supply-side shock that resembles those OPEC-led oil production cuts of the 1970s.'

The big risk is that we are headed for an extended period of stagflation or recession accompanied by rising prices. This creates an extremely tricky backdrop for central banks – with the US Federal Reserve expected to introduce the first post-pandemic rate hike on 16 March.

Ordinarily central banks would try to cushion the impact on consumers and businesses by cutting rates or introducing financial stimulus for the economy, but they are constrained thanks to already loose monetary policy and the prospect of inflation running further out of control. [TS]

ITV shares dive 30% on content cost shock

Despite better than expected results investors were spooked by broadcaster's latest streaming strategy

Shares in free-to-air broadcaster **ITV (ITV)**, slumped by nearly 30% on 3 March, despite the group announcing better than expected results.

Investors were shocked by the marked increase in content spend, and questioned the viability of ITV's new streaming platform ITVX.

Despite being in lockdown for the first three months of the year, a resurgence in advertising spend enabled the company to report a 24% increase in revenue to £3.4 billion.

Meanwhile, pre-tax profit improved from £325 million to £408 million, and the board proposed a final dividend of 3.3p, bringing the full year pay-out to 5p a share.

The market took fright though over the viability and associated costs of the group's attempt to supercharge its streaming operations, by launching a new platform ITVX.

ITVX is in essence offering viewers the chance to see some of its programmes before they are broadcast on linear TV, as well as its back catalogue of shows.

The service will be free to watch with ads. However, there will be an optional subscription tier that will offer a premiere each week, and 15,000 hours of content. ITV will replace both ITV Hub and ITV Hub+ when it launches later this year.

Investors have been alarmed by the firm's plans to increase spending on content production. ITV intends to invest £1.23 billion in programmes this year, and a further £1.35 billion next year.

JUSTIFIABLE CONCERNS

There are justifiable investor concerns at the extent of the new investment being made in ITVX, given both the crowded nature of the streaming market, and the negative long-term trends in linear television and the lack of meaningful changes from the existing ITV Hub platform evident in what has

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

so far been announced about ITVX.

In 2021 viewers watched 15.1 billion hours on ITV Hub and its linear channels. This marked a decline of 9% from 2020. Arguably ITV is being forced to invest more in content because it is losing viewers.

Fewer people are sitting down to watch live TV. Increasingly they are switching to the plethora of alternatives including Netflix, Amazon Prime Video, Disney+, Peacock and YouTube.

An additional challenge facing ITV is the vast financial resources of its streaming competitors.

This is likely to further escalate the cost of quality content moving forward. Viewers will always be attracted to companies that can continually provide access to new, innovative and exciting content.

Given the higher content costs, consensus forecasts for operating profit in 2022 have fallen from £800 million to £600 million, or earnings per share of 15.1p.

This places the stock on a forward price earnings multiple of 5.3 times, with a dividend yield of 6%. This valuation may explain why institutional investor Artemis has moved to acquire a 5.1% stake in ITV. [MGar]

The retailers on discount after a New Year rout

Shopkeepers' share prices have slumped amid soaring costs and deteriorating consumer confidence

Consumer sentiment has deteriorated significantly in recent months due to high inflation, with the cost of living at decade highs and latterly, amid concerns over the escalating hostilities in Ukraine. Combined with the earnings impact of inflationary pressures, this has driven the share prices of big retailers sharply lower.

The weakness reflects downgrades already delivered, or negative revisions anticipated by the market.

Even before the invasion of Ukraine, the market expected cash-strapped consumers to begin tightening the purse strings.

Now the fear is war in Eastern Europe could delay and dampen the post-Omicron rebound in consumer spending as Putin's attack triggers a further rise in inflation and rattles consumer confidence.

Shore Capital observed in early March that, depending on the duration of the crisis, 'there will be two very different impacts on demand and supply.

'We feel that demand could be negatively affected with the crisis in the spotlight albeit UK consumers will still seek to "get on with their lives". Supply will undoubtedly be hit by energy-related cost inflation and any new disruptions to production and distribution chains.'

RETAILERS ROUTED

With the help of SharePad, *Shares* has crunched the data to reveal the retailers whose share prices have been hardest hit so far in 2022.

Among the biggest fallers are online fast fashion retailers **ASOS (ASC)** and **Boohoo (BOO:AIM)**, which have both suspended sales to Russia. ASOS' downgrades-driven downtrend has continued into the new year, while Boohoo posted a nasty profit warning just before Christmas.

Share price weakness reflects supply chain pain and muted near-term outlooks for both retailers, with investors pricing in the disproportionate impact of the cost of living

Retail horror show in 2022

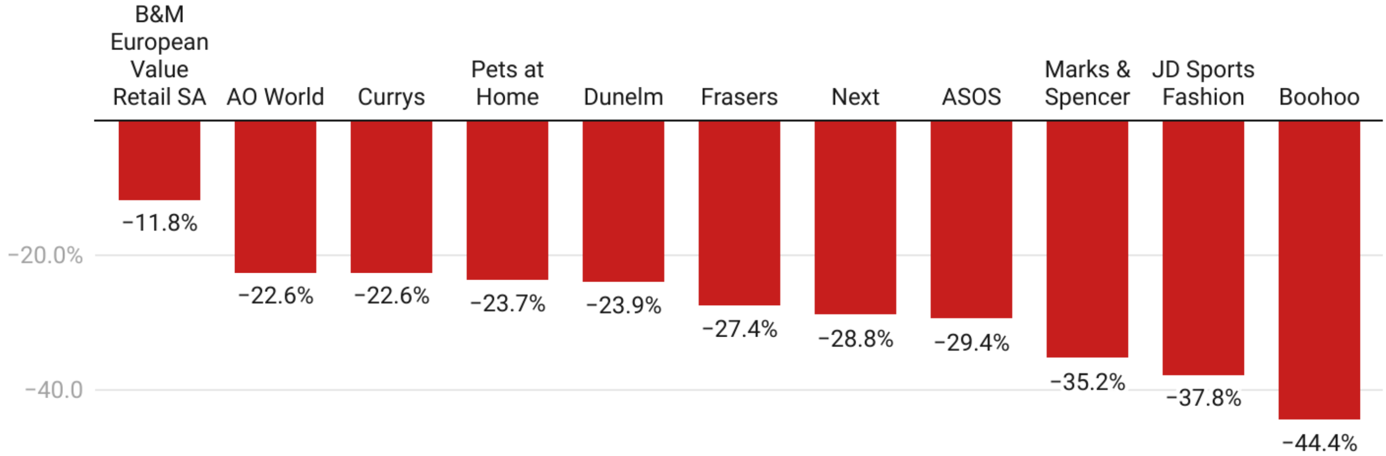


Chart: Shares Magazine • Source: SharePad, data as at 7 March 2022. • Created with Datawrapper squeeze on the purchasing power of their youthful shopper demographic.

In the FTSE 250, laptops-to-smart TVs seller Currys' shares have cheapened 22.6% in the new year, with profit and earnings estimates for the 2022 and 2023 financial years negative over both one and three month periods, according to Stockopedia, as analysts factor in the rising costs facing the retailer as well as the significant near-term risks to UK consumer spending.

Many people have spent significant sums on new laptops, smart TVs and smartphones during the pandemic. This kit can comfortably last them for many years without the need to upgrade, which suggests Currys could struggle to deliver meaningful growth in the months ahead.

And Currys recently issued a cautious outlook statement (14 Jan), where it lowered full year pre-tax profit guidance from £160 million to £155 million.

BUY THE DIP

An indiscriminate retail sell-off has however created compelling new entry points in some quality names with very strong balance sheets.

Among FTSE 100 names, **JD Sports Fashion (JD.)** has slumped 37.8%, despite recently upgrading pre-tax profit guidance for the year ended 29 January 2022 to 'at least £900 million' as its positive Christmas trading continued into the new year.

Stockopedia's system shows that consensus earnings estimates for the athleisure purveyor have actually held up well, with JD Sports seeing slightly positive earnings revisions on a three-month basis and a very modest drop on a one-month basis.

Besides wider consumer confidence concerns, JD Sports also sells to younger consumers, many of whom will pull their horns in.

Share price weakness here may reflect a spat with, and penalty imposed by, the Competition and Markets Authority, which is forcing JD Sports to sell Footasylum.

A recent share sale by executive chairman Peter Cowgill also spooked investors, though the correction provides an interesting entry point into the trainers-to-tracksuits seller. It has ceased all trading in Russia, which speaks for less than 0.05% of its annual revenues.

Among other best-in-class retailers, **Next (NXT)** is on a 12-month rolling forward price-to-earnings ratio of 11.1 according to Stockopedia, low relative to recent history.

Admittedly, consensus earnings per share estimates for the year to January 2023 have nudged down slightly over one and three months, yet the pullback should pique the interest of investors prepared to look past near-term uncertainties.

Shares in **B&M European Value Retail (BME)** have held up well, despite a pause for breath in the earnings revisions uptrend, as the variety goods retailer's value proposition leaves it well positioned for inflationary times.

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

In his most recent outlook statement (6 Jan), admittedly before Putin's move on Ukraine, CEO Simon Arora said: 'Despite ongoing supply chain disruption, inflationary pressures and uncertainty surrounding possible Covid-related restrictions, we remain confident in B&M's prospects for 2022.'

Marks & Spencer (MKS), has just suspended shipments to Russia. The shares have been marked down 35.2% as investors weigh an uncertain economic outlook for 2022 which may halt turnaround progress.

Russia and Ukraine account for no more than 0.25% of group sales.

'As such, the steps taken to stop supplying the Russian market are unhelpful to international earnings but do not represent a game changing development', says Shore Capital.

Elsewhere, Mike Ashley's **Frasers (FRAS)**, the Sports Direct-to-House of Fraser owner which has just bought Studio Retail from the administrators, is down 27.4% year-to-date. This is despite a recent positive earnings revisions trend, based on Stockopedia analysis.

Dunelm (DNLM) has also been caught up in the selling, despite positive recent news.

On 9 February the homewares leader reported record first half profits amid continued outperformance of its core markets and assured investors trading in the second half to date 'continued to be encouraging', leaving Dunelm on course to deliver full year pre-tax profit in line with the recently upgraded consensus estimate of £206 million. [JC]

BAE to benefit as global defence spending ramps up

There are long-term reasons to own the shares as countries respond to Ukrainian conflict

The irony of calling a defence company a safe haven while war rages in Ukraine is not lost on *Shares* yet this is what we believe **BAE Systems (BA.)** stock offers investors in these troubling times, and importantly, for the longer-run.

Few reasonable investors would feel comfortable buying a stock based purely on the impact of what is clearly an escalating human tragedy but what the conflict does show is that there are significant long-term opportunities for the UK-listed FTSE 100 company, and that's what investors should focus on.

BAE SYSTEMS

BUY

(BA.) 736p

Market cap: **£22.8 billion**

A LEADING GLOBAL DEFENCE CONTRACTOR

BAE is one of the largest defence contractors in the world, with one of the most substantial portfolios of defence technologies covering land, sea and air.

Latest company data shows a skilled workforce of around 90,000 people in more than 40 countries, developing, engineering, manufacturing and providing support for military capability and national security systems that helps keep critical information, infrastructure and people secure.

There can be little doubt that the world is on the cusp of a significant increase in military and defence spending over the coming years, a direct response to Russia's attack on its neighbour.

Last month Germany announced plans to hike its own military spending to at least 2% of its gross domestic product from an estimated 1.53% in 2021, according to NATO statistics, earmarking an extra €100 billion in its 2022 budget.

Germany is unlikely to be alone. Analysts at Jefferies have calculated that if all NATO members were to raise defence budgets to 2% of GDP it would imply a 25% increase in overall spend, excluding the US, which would trigger significant benefits across the entire industry.

The US already has the world's largest defence budget, with an estimated $750 billion earmarked for 2022. That's more than three times the $237 billion that number two China is expected to spend this year, yet analysts still anticipate substantial US budget growth. Berenberg analysts forecast an 8% increase in 2023 above this year's President's Request and think there is 'growing support to go higher.'

SEA-CHANGE IN SPENDING

This marks a sea-change versus prior expectations for flat or declining military budgets and it bodes well for BAE both in terms of driving future earnings growth

and a higher rating. The shares are now trading on 2022 and 2023 price to earnings multiples of 14.5 and 13.8, based on Berenberg forecasts.

BAE's strategy is comprised of five key long-term prongs centred on maintaining and growing core franchises and securing growth opportunities:

- Sustain and grow its defence and security businesses
- Ongoing growth in adjacent markets
- Develop and expand its international business
- Inspire and develop a diverse workforce to drive success
- Enhance financial performance and deliver sustainable growth in shareholder value

BAE's products and services range from ballistic missile firing systems, armoured vehicles, combat ships, Typhoon and F-35 fighter jets, communication systems and much more, including its growing FAST Labs Cyber Technology digital security and intelligence business. This arm should help future-proof the group as emerging threats in the cybersecurity space become more of an issue.

As a primary contractor for the UK's Ministry of Defence BAE holds a key edge over global competitors when bidding for MoD contracts, while the UK Government owns a golden share in the business, effectively giving it the ability to veto any corporate actions it does not agree with.

UNIQUE RISKS

But there are unique risks. The global defence industry is highly regulated and controlled and BAE must be careful to stay on the right side of regulators to maintain its presence in the market. If it falls foul of these rules, it could be barred from future programmes and cut-off from its existing customers.

It is also a competitive space. There are strict rules about how contracts are bid for and awarded and while it may be among the go-to contractors for the UK, defence departments could favour local suppliers elsewhere, particularly in the important US market.

Maintaining its advantages will require a lot of ongoing research and development spending which could depress future returns. Capital expenditure in 2022 is forecast by Berenberg at £520 million, rising to £560 million by 2024, versus £477 million and £462 million in 2020 and 2021 respectively.

That said, BAE has typically earned returns on capital employed, or ROCE, in the mid-teens, meaning that it has a proven track record of getting value for money for shareholders from what it spends.

A final point worth thinking about is that BAE's improving margins and operational execution are turning the company into an increasingly cash generative one. Berenberg estimates range from £1.68 billion to £1.98 billion of free cash flow in each of the next three years, versus the £689 million earned in 2020, meaning that growth in future dividends looks secure and could be bolstered by share buybacks down the line.

BAE Systems

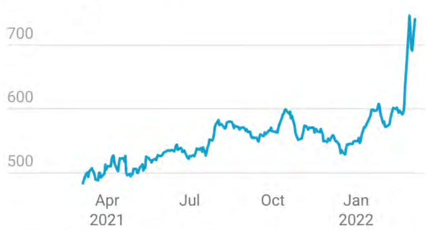


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

Why Drax is a great way to play the tight energy market

A wider implication of the Ukraine invasion could be prolonged higher gas prices

A tight UK energy market and higher prices are providing a tailwind for renewable energy generator **Drax (DRX)** which increased guidance following better than expected full year results (24 Feb).

Drax also benefits from intermittent wind and solar supply and earns ancillary revenue from effectively keeping the lights on and supporting the system.

At a capital markets day presentation (1 Dec) Drax announced £3 billion of investments from 2022 to 2030 to accelerate growth.

The investments are expected to deliver returns significantly above the company's cost of capital, driving shareholder value.

Despite the growth outlook, the shares languish on 11 times 2022 expected earnings, falling to 7.8 times in 2023 according to Stockopedia data.

The rating looks too low compared with expected growth.

DRAX
BUY
(DRX) 667p
Market cap: £2.7 billion

TIGHT ENERGY MARKET

The UK wholesale power market was tight even before the invasion of Ukraine with day ahead electricity prices surging 55% in 2021.

According to analyst Adam Forsyth at Longspur Research, lower average wind speeds in 2021 meant more expensive gas generation was needed to fill the gap.

Gas-fired power is used as back up because renewable sources like wind and power are less reliable and cannot provide energy on demand.

While there are concerns over unusual weather patterns becoming more permanent, accelerated by climate change, work conducted by Imperial College suggest the evidence is inconclusive.

Even assuming a normalisation of wind patterns, Forsyth expects higher carbon prices will keep electricity prices buoyant in the medium term.

DRAX IN A NUTSHELL

Over the last few years Drax has completed Europe's largest transition from fossil fuels to sustainable biomass.

Drax is vertically integrated and sells over 90% of its own energy supply through two business-to-business suppliers, Haven and Opus.

The former targets large industrial and commercial clients while the later focuses on small and medium-sized businesses.

Most of the energy produced by Drax is from biomass burnt at its power station in Selby, Yorkshire near the Humber estuary. In addition, the company has hydro energy plants and a pumped-storage facility.

Drax also has overseas operations. It operates a waste wood and dust business based in Louisiana and owns Canadian wood pellet producer Pinnacle Renewable Energy.

The company is developing BECCS (bioenergy CO2 capture

Drax earnings forecasts

	2022E	2023E
Sales (£ billion)	4.4	4.7
Pre-tax profit (£ million)	259.0	427.0
EPS (p)	61.1	88.6
Dividend per share (p)	19.8	21.3

Table: Shares Magazine • Source: Longspur Research • Created with Datawrapper

and storage) facilities with a long term target of becoming a negative emissions company.

EXCITING GROWTH PLANS

Drax is aiming to become the global leader in sustainable biomass and has targeted a doubling of production capacity for its own use to eight million tonnes a year by 2030.

It is also planning to increase wood pellet sales to third parties to four million tonnes a year from the current two million.

Japan is looking to double the use of biomass while Europe is expected to grow bioenergy use by 70% by 2050, providing long-term demand support from these regions.

As the business increases in scale, it drives down input costs resulting in a higher spread and margin.

For example, the company has reduced the cost per tonne of wood pellets from $166 in 2018 to $141 per tonne and targets $100 per tonne by 2027.

WORLD'S LARGEST CO2 CAPTURE AND STORAGE PROJECT

Drax plans to transform the Selby power station into the world's largest BECCS (bioenergy carbon capture and storage) project aimed at capturing eight million tonnes of CO2 a year by 2030.

It is building transportation facilities to carry the gas into storage facilities under the North Sea, permanently removing it from the atmosphere.

An investment decision will be made in 2024 subject to a supportive regulatory regime with the first unit coming on stream in 2027 and a second in 2030.

In addition, the company is targeting four million tonnes of negative emissions from new build BECCS projects outside the UK.

A LEADER IN UK DISPATCHABLE RENEWABLE ENERGY

Longer term Drax believes 80% of the UK's energy needs could be met by intermittent renewable and inflexible low-carbon energy sources, wind, solar and nuclear.

However, this means the remaining sources need to provide reliable dispatchable energy to maintain security of supply and keep costs low for the consumer.

Drax believes this is a big opportunity for its biomass capability and pumped storage and hydro power facilities.

It plans to build a second pumped storage facility at Cruachan in Scotland, providing 600MW (megawatts) of dispatchable long-duration storage to the power system.

Cruachan is effectively a giant battery produced by two reservoirs which sit between a hanging valley.

The main advantage of pumped storage is its fast response time, taking under 30 seconds to dispatch energy. Additionally, it can store energy for up to 16 hours.

Drax's ambitious plans to become a negative emissions company is aligned with the Government's net zero carbon goals and provides a positive backdrop for the shares.

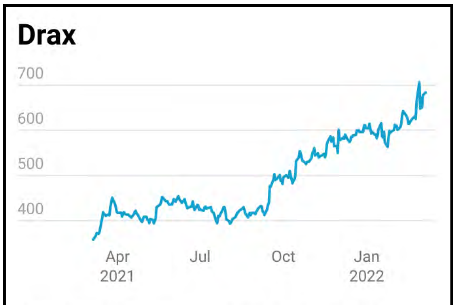
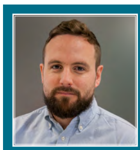


Chart: Shares Magazine • Source: Refinitiv • Created with Datawrapper

FTSE 100

Its time is now



By **Tom Sieber** Deputy Editor

After years in the wilderness the FTSE 100 is finally coming into its own as some of the key features of the index go from being liabilities to advantages.

Our analysis suggests that, in a world of inflation, rising interest rates and surging commodity prices, many of the big names which dominate the index are well placed. As well as domestic investors, this could well increase the appeal of the UK's largest stocks to overseas investors.

DID YOU KNOW?

More than 70% of FTSE 100 constituents' revenue is derived from outside the UK

In this article we will examine the FTSE 100 in some detail and discuss the most cost-effective and efficient ways of gaining exposure to its returns.

FTSE 100 KEY ATTRIBUTES

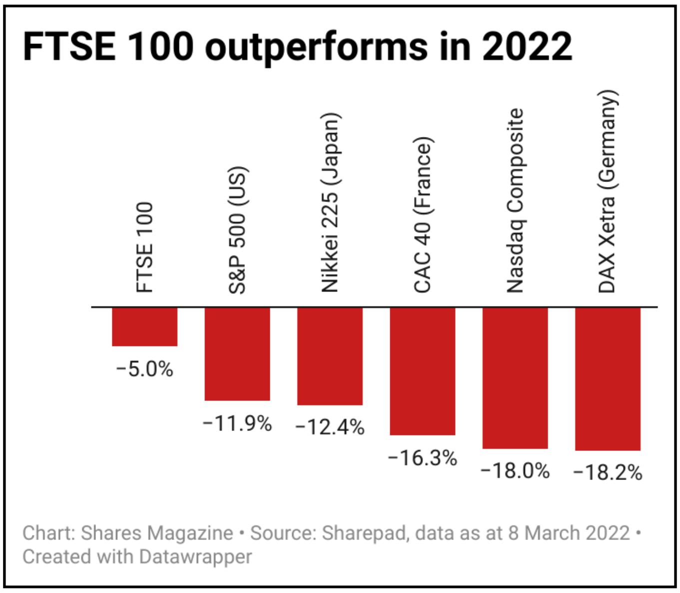
- **Generous dividends**
- **Attractive valuations**
- **Significant commodities exposure**

The relative resilience of the FTSE 100 to the current difficult market conditions is reflected in its year-to-date performance where it has comfortably outshone its global counterparts.

The index has only dipped 5% in 2022 whereas the US S&P 500 benchmark is down 12%, the CAC 40 in Paris is down 16% and Germany's DAX and the US technology-focused Nasdaq index are down around 18%.

This is a direct reversal of the situation in the preceding decade where the FTSE 100 had struggled and lagged other markets in the developed world. There were several factors behind this situation, a key one being political instability.

Arguably since early 2012 when the UK Government agreed to a referendum on Scottish independence and certainly since 2015 when the path was set for the Brexit referendum, investors



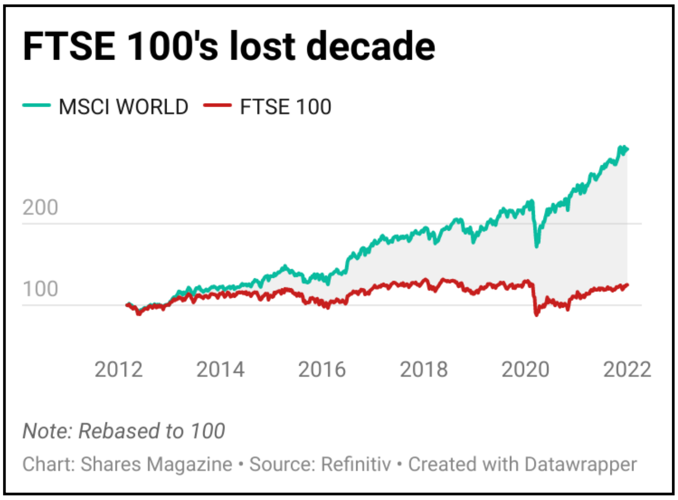
in the UK have had to contend with significant uncertainty over the constitutional direction of the country and its politics.

And just when the decisive victory for the Conservative Party in the 2019 General Election and a subsequent UK-EU Brexit deal seemed to herald a period of stability, the pandemic and the Government's response to it helped upset the apple cart.

The FTSE 100 also suffered from a perception, based at least in part on reality, that it was very much an 'old world' index, under-represented in technology.

As tech valuations surged, a trend accelerated by the pandemic as – by necessity – a lot of activities moved online, the UK's flagship index was left for dust.

Today the situation is different. The current surge in inflation, initially linked to pent-up demand from the pandemic, has changed things. As central banks scramble to respond by hiking interest rates, with the Ukrainian conflict only



adding to inflationary pressures, companies with limited or no cash flow today but offering the potential for lots of cash flow in the future are much less attractive to investors.

In contrast there are lots of more attractively valued FTSE 100 names generating plenty of cash and, in many cases, paying generous dividends too. These are the types of businesses which many investors now favour.

THE TOP 20

Let's look at the top 20 stocks by market value in the FTSE 100. Five are in the resources sector, including **Shell (SHEL)**, the largest name in the index. If you count **London Stock Exchange (LSEG)**, a further five are financials – three of which are banks which all pay generous dividends.

Five stocks are in traditionally defensive sectors like telecoms, utilities, tobacco and healthcare which tend to be less impacted by fluctuations in economic growth.

Even in a downturn people still must eat, which means catering giant **Compass (CPG)** also has some defensiveness built in.

Of the remainder, big brand consumer goods firms **Reckitt (RKT)** and **Unilever (ULVR)** are out of favour as they face rising input costs and pressures on spending implied by a cost-of-living crisis, while alcoholic drinks firm **Diageo (DGE)** and **RELX (REL)** sit in the category of quality stocks.

It is worth noting demand for alcohol tends to hold up well in good and bad economic conditions including recession, and Diageo is focused on the spirits market where brands tend to hold sway with drinkers, more so than in other categories like beer and wine.

More than half of the FTSE 100's top 20 have seen share price gains year-to-date, with the miners and oil and gas firms chalking up an impressive performance. These companies are arguably well placed in an inflationary environment, with commodity prices surging higher.

COMMODITIES STRENGTH

Under-investment in new mines and oil and gas fields in recent years means there is limited supply, while demand for oil and gas is proving durable despite an apparent global commitment

EXPOSURE TO RUSSIA AND UKRAINE

The FTSE 100 does have some exposure to Russia and Ukraine but it is relatively limited. Two of its largest companies – **BP (BP.)** and **Shell (SHEL)** – had very material Russian interests, though both are now taking steps to extricate themselves. Additionally Russian gold miner **Polymetal (POLY)** and steel producer **Evraz (EVR)** both dropped out of the index during the most recent reshuffle. This reflects the massive slump in their share prices since Russia's invasion of Ukraine.

to move away from fossil fuels.

Investment to shift towards renewables for power generation and away from combustion engines to electric vehicles will require lots of metals and minerals, providing long-term demand drivers for the mining sector.

It's not all good news. Banks have been disappointing shares to own for much of the time since the global financial crisis in 2008, and more recently the war in Ukraine has seen expectations for interest rate rises dialled back.

It was hoped higher interest rates would improve banks' profitability, allowing them to charge more for customer loans. Slower than anticipated rate hikes could see earnings forecasts trimmed by analysts. Though to what extent central banks can afford to take their foot off the gas on rates is open to question given the level of inflationary pressures we are currently seeing.

There is also a risk that the cost-of-living crisis and more expensive debt results in more impairments as businesses and individuals struggle to keep on top of their borrowings.

HSBC (HSBA), which despite its UK presence is much more of an Asian business. The bank is the outlier year-to-date as it has delivered a robust share price performance whereas **Lloyds (LLOY)** and **Barclays (BARC)** are nursing share price losses.

ATTRACTIVE VALUATIONS AND GENEROUS INCOME

A common thread running through most of the FTSE 100's largest names are their attractive valuations and generous yields, even for those which have enjoyed decent runs of late.

The average (not weighted by market cap) forecast price to earnings ratio and dividend yield for the top 20 FTSE 100 stocks is 13.4 times and 4.3% respectively. If you focus just on the top 10 it is 11.3 times and 5%.

As a point of comparison, the top 10 US-listed shares by market cap have an average forward PE of 33 times according to SharePad and more than half don't even pay a dividend. For those which do the average yield is a mere 1%.

HOW TO GET EXPOSURE TO THE FTSE 100

The lowest cost, and most straightforward way to get exposure is through an ETF (exchange-traded fund) which tracks the performance of the index.

The largest and most well-established ETF product tracking the FTSE 100 index is **iShares Core FTSE 100 (ISF)** which has ongoing charges of 0.07% and distributes income on a quarterly basis. There is also version which reinvests income – **iShares Core FTSE 100 (CUKX)** – and this carries the same charges.

FTSE 100 TOP 20 RANKED BY SIZE: PERFORMANCE, VALUATION, YIELD

Company	Year-to-date performance (%)	Forward PE	Forward dividend yield (%)
Shell	22.0%	7.2	4.0%
AstraZeneca	1.0%	16.6	2.6%
HSBC	6.0%	9.0	4.4%
Rio Tinto	20.7%	8.0	9.0%
Unilever	−15.7%	16.2	4.2%
Diageo	−16.9%	22.1	2.3%
GlaxoSmithKline	−7.0%	12.5	3.6%
British American Tobacco	8.5%	8.4	7.7%
BP	11.3%	6.0	4.8%
Glencore	25.4%	7.2	6.9%
Anglo American	26.3%	8.8	4.8%
RELX	−10.2%	22.1	2.4%
Reckitt Benckiser	−13.1%	18.4	3.2%
National Grid	5.9%	17.7	4.6%
London Stock Exchange	4.1%	23.4	1.4%
Vodafone	4.7%	14.4	6.2%
Lloyds Banking	−11.0%	6.6	6.0%
Prudential	−17.9%	10.9	1.5%
Compass	−5.7%	27.0	1.8%
Barclays	−17.2%	5.8	5.3%
AVERAGE	**1.1%**	**13.4**	**4.3%**

Forward PEs and yields based on 2022 forecasts unless year end is 30 June or before

Table: Shares Magazine • Source: SharePad, Stockopedia, data as at 8 March 2022 • Created with Datawrapper

More UK stocks have exposure to Russia than you think

Mothercare, Inchcape, AG Barr and EKF Diagnostics are among the London-listed companies doing business in Russia but how exposed are they?

The advent of globalisation has helped to drive considerable earnings growth for companies on the UK stock market thanks to them doing business with an ever-growing number of countries. Unfortunately, widespread geographical expansion means the list of UK stocks with exposure to Russia is bigger than you might think.

Many professional and retail investors have raised a moral objective to having money in Russia-related investments and have been pulling out of various stocks since the country launched a full-scale invasion of Ukraine on 24 February.

Some of the worst hit stocks have had the bulk of their operations and assets in Russia, such as miner **Polymetal (POLY)** and **Raven Property (RAV)**. Others have taken pre-emptive moves to distance themselves from the country, including **BP (BP.)** and **Shell (SHEL)**.

We're now at the stage where investors are looking closer to see which other stocks have exposure to Russia. Selling goods or services in the country, or sourcing product from it, could be viewed negatively by Western investors and therefore weigh on the share price.

Even those who do halt business in Russia still have to contend with likely downgrades to earnings forecasts, something that has historically driven down a share price.

ASOS (ASC) is best known as a seller of clothes in the UK and increasingly the US. Less appreciated is that fact that Russia has been an important sales region for the business. On 2 March the company announced that it had suspended sales in the country, having already done the same in Ukraine where it became 'impossible to serve customers'.

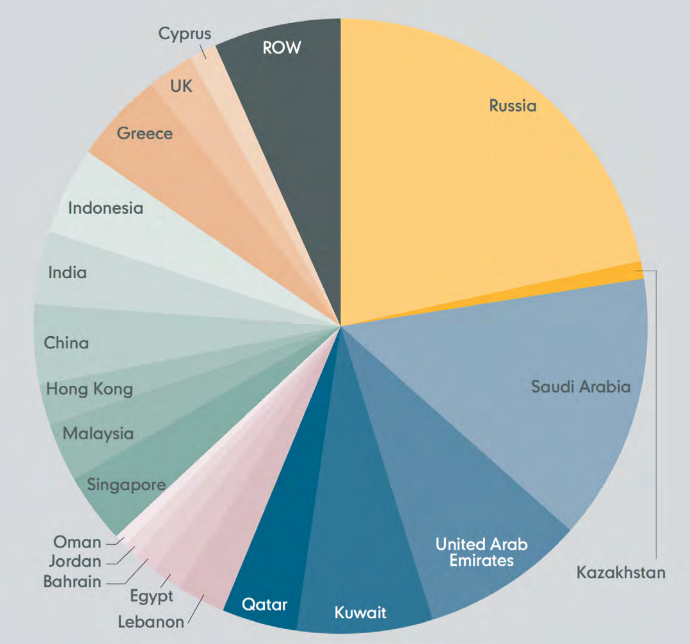
The retailer says Russia and Ukraine represented

4% of group revenue in 2021 and contributed approximately £20 million to group profit. 'The territory has always been relatively profitable (implied contribution margin 13%) given the VAT advantage and very low returns rates,' says Jefferies analyst Andrew Wade about ASOS.

It could miss out on £7 million in profit and £85 million in revenue should the two countries be off limits for sales for the next six months, according to Wade. The key question is whether this is a short-term issue or whether ASOS will decide to stop selling completely to Russia permanently.

Also exposed in the retail sector is **Mothercare (MTC)** which announced on 9 September it had suspended its Russian operations, with an expected hit to annual profit of £6 million. It has changed shape as a business in recent years, with the closure of its UK physical stores and a greater emphasis on overseas operations via franchisees. Russia hasn't been one of its best performing regions of late, but it still accounted for one fifth of the group's global retail sales in its 2021 financial

Russia is a major sales region for Mothercare



Source: Mothercare, for the year to 27 March 2021

year at £77 million, according to stockbroker Numis.

FTSE 100 packaging group **Mondi (MNDI)** says its Russian operations have generated about 20% of the group's underlying earnings over the last three years. Unlike many Western companies which have halted operations in Russia, Mondi says it continues to operate in the country. It has,


Mondi sources raw materials from forests in Russia to make packaging materials

Examples of London-listed stocks with exposure to Russia and/or Ukraine

Aveva	An estimated 2% of group revenues come from Russia
Coca-Cola HBC	It generated 20% of 2021 volumes and earnings before interest and tax from Ukraine and Russia in 2021
Devro	An estimated 2.5% of group revenues are generated from Russia
Ferrexpo	Has mining operations in Ukraine. On 28 February it flagged uncertainty over getting products to European customers by rail
Genus	Has exposure to both Russia and Ukraine and together they account for 10% of adjusted operating profit
Hays	1% of group revenue comes from Russia where it operates two recruitment offices
InterContinental Hotels	IHG has 28 hotels in Russia and two in Ukraine
Next	Between 1% and 1.5% of group revenue is generated in Russia, and the country represents circa 10% of Next's overseas online business
Renishaw	Has offices in Russia and sales to the country account for circa 1% of group revenue
Rotork	Russia accounts for approximately 3% of group sales
Wizz Air	Has operating bases in Ukraine. Flights currently suspended to and from Ukraine and Russia

Table: Shares Magazine • Source: Company announcements, Numis • Created with Datawrapper

however, suspended production at a paper bag plant in Ukraine.

Car distributor **Inchcape (INCH)** derives an estimated 9% of group revenue and 4% of group earnings from Russia, says Numis. 'With revenues

Examples of companies which have suspended sales or limited services in Russia

Apple	Halted all product sales in Russia
Boeing	Suspended parts, maintenance and technical support for Russian airlines
Boohoo	Halted sales in Russia
Canada Goose	Suspended wholesale and e-commerce sales to Russia
Electronic Arts	Removed Russian teams from its FIFA 22 and NHL 22 sports games
Google	Removed Russian state-funded publishers including RT from its features
Harley-Davidson	Suspended business and shipments of bikes to Russia
Maersk	Suspended container shipping to and from the country
Nike	Stopped online orders in Russia

Table: Shares Magazine • Source: Company announcements, BBC, Reuters • Created with Datawrapper

and costs locally denominated, weaker currency would present a headwind to earnings. The weaker currency and any potential trade embargoes are also likely to impact the demand for imported new vehicles which Inchcape over-indexes in and we would estimate new vehicles account for c.35% of Russian gross profits,' adds the broker.

AG Barr (BAG) holds the secret to one of Scotland's most-prized drinks, Irn-Bru. While

Examples of Russia-related stocks suspended from dealing on London Stock Exchange

EN+
Fix Price
Gazprom
Lenta
Lukoil
MD Medical
Norilsk Nickel
Novatek
Phosagro
Polyus
Ros Agro
Rushydro
Sberbank of Russia
Severstal
Tatneft
X5 Retail

Table: Shares Magazine • Source: London Stock Exchange, as of 3 March 2022 • Created with Datawrapper

Russia is not mentioned in its most recent set of half-year and full-year results, the drinks company does sell into this territory. An article published 20 years ago by the BBC said at the time Irn-Bru was the third most popular soft drink in Russia, with its popularity perhaps down to it resembling old Soviet-era drinks.

Russia is one of AG Barr's only export markets for Irn-Bru, where it typically sends syrup to a local bottler and receives a royalty on sales. Numis says this accounts for less than 1% of group revenue, so not meaningful to its finances but there is still a risk of being associated with this sales territory.

There are reports that some people in the US are boycotting drinks brands which they wrongly perceive to be Russian. This includes Smirnoff vodka which is owned by UK drinks group **Diageo (DGE)**.

FUND MANAGERS COULD BE VULNERABLE

Investors are likely to look hard at their portfolios and question if they want to continue with exposure to Russia given its current actions. Several Russia-focused funds have already suspended dealing including **Liontrust Russia (B86WB79)** after the temporary closure of the Moscow Stock Exchange and the temporary ban on foreign investors selling local Russian stocks.

Emerging markets-focused fund manager **Ashmore (ASHM)** is at risk of seeing outflows from some of its funds given that an estimated 4% of assets under management were exposed to Russia and a further 4% to Ukraine as of January.

In other sectors, **EKF Diagnostics (EKF:AIM)** generated 3.6% of its sales and 3% of operating profit in the first six months of 2021 from Russia via its laboratory diagnostics business. Expect more details on any impact to its business when it reports full year results on 29 March.

From an ownership perspective, it is worth noting that **TUI's (TUI)** largest shareholder with a 34% stake is Unifirm, controlled by Russian billionaire Alexei Mordashov. He has been hit by sanctions from the EU and on 2 March resigned from TUI's supervisory board.

Holiday company TUI is one third owned by a Russian billionaire

While the sanctions have no impact on TUI as a business, the company's association with Mordashov might not go down well with other shareholders who have a moral objection to Russia.

By **Daniel Coatsworth** Editor

Janus Henderson INVESTORS

The European Smaller Companies Trust
does what it says on the tin

Ollie Beckett, Portfolio Manager of ***The European Smaller Companies Trust*** *(formerly TR European Growth Trust), provides an update on the Trust highlighting the changes announced by the Board and what they mean for investors. Ollie also touches on why investors should look at European smaller companies for exciting growth opportunities.*

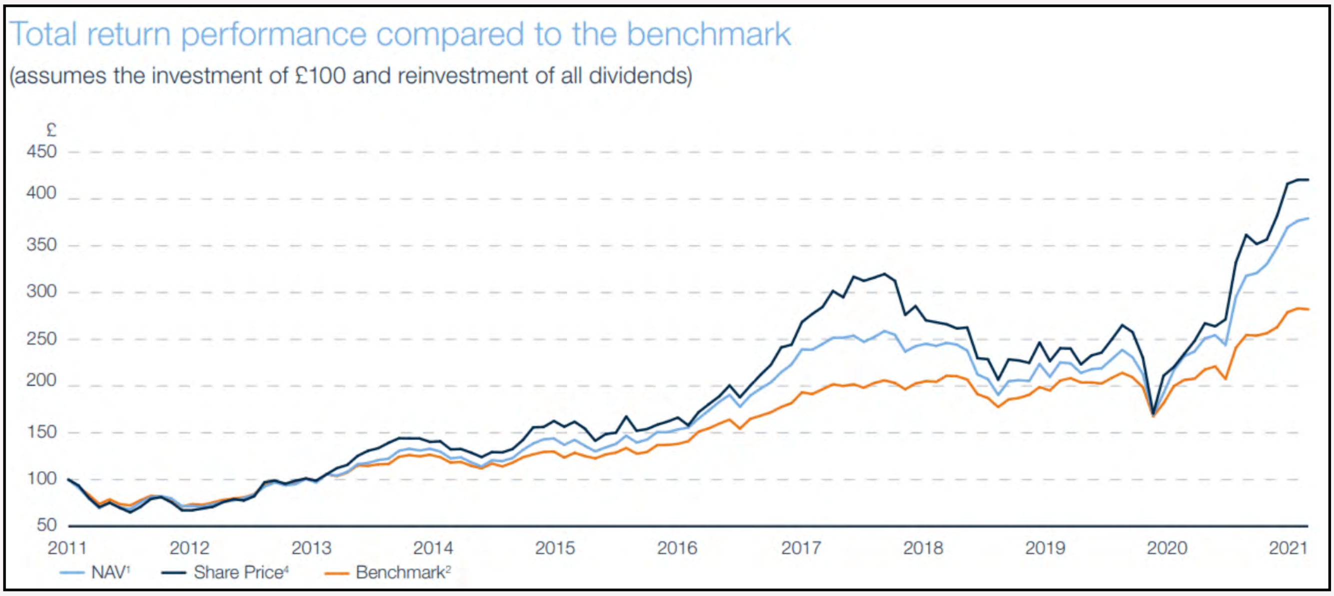
If the last two years have taught us anything, it is that change is not only inevitable but has become increasingly unpredictable. The arrival of the coronavirus changed our way of life, from how we work to the way we conduct business and leisure. Though vaccines have restored some semblance of normal life – dubbed the "new normal" – the fallout has left behind a market riddled with uncertainty.

Variants continue to threaten global growth, global supply chains are faltering, inflation keeps grinding higher, central banks have begun to withdraw monetary support, and some have already started raising interest rates. Amidst all

this, investors have been trying to determine how each factor affects their portfolios and how they can best navigate this testing market environment. With noise and uncertainty now part of the new normal - we believe clarity is more important than ever.

DOES WHAT IT SAYS ON THE TIN

At The European Smaller Companies Trust (ESCT),



Source: TR European Growth Trust 2021 Annual report

1. NAV - Net asset value ('NAV') total return per ordinary share with income reinvested
2. Benchmark - Euromoney Smaller European Companies (ex UK) Index total return and expressed in Sterling
3. Share price - Share price total return including dividends reinvested and using mid-market closing price

our purpose is to deliver long-term sustainable returns to our shareholders from investing in smaller and medium-sized European companies. In seeking to achieve this mandate, sometimes we have to adapt and evolve to the changing market environment. In 2021, the Board conducted a strategic review of the Trust's investment objective, operations, and positioning. Whilst the investment policy and objective remain fit for purpose, the review highlighted that more could be done to improve the Trust's positioning within the market. As a result, several recommendations were made to make the Trusts position clearer to investors. We changed the Trust's name from TR European Growth Trust to The European Smaller Companies Trust. We believe this name change will solve two issues. First, the new name explicitly mentions "smaller companies", thus making our investment focus very clear. This also allows the Trust to do precisely what it says on the tin – invest in European small-cap companies with the potential to be the market leaders of tomorrow. The Trust is the purest small-cap play in its sector, where most peers are skewed more towards mid-caps. Two-thirds of the portfolio is invested in companies with under £1 billion in free float. Our solid long-term performance track record validates our quest to find growing companies across all four life-cycle segments (early, quality growth, mature, turnaround).

Second, the name omits 'growth', an investment style that has become associated with a particular type of investing that does not accurately represent our approach. Yes, we invest in growth companies; however, at our core, we are value-aware investors and therefore retain a "growth-at-a-reasonable-price" mantra. Buying stocks at an attractive price should be every investor's slogan. However, looking back over the last two years, in particular, market sentiment and activity has not reflected this. Valuations in certain segments of the market, notably technology, are extremely stretched, and it is clear that some investors are following a "growth-at-any-price" approach. We believe that valuations still matter and will continue to invest in undervalued companies where we think the market perceptions are wrong.

In addition to the name change, we also announced an 8:1 share split. Improving the liquidity of the Company's shares enhances the ability of a broader range of investors – particularly those within the retail market - to make more efficient regular monthly investments on share dealing platforms. This could also be an important lever in narrowing the Trust's discount, thus benefitting all shareholders. Finally, we will also change the Trust's benchmark from the Euromoney Smaller European Companies (ex UK) Index to the MSCI Europe ex UK Small Cap Index. The change will improve the quality of the benchmark data available to us daily and will also bring us in line with the majority of our peers in the marketplace. The change will become effective from 1 July 2022, the start of the next financial year.

SO WHY INVEST IN EUROPEAN SMALL CAPS NOW?

Europe – particularly the small-cap arena – is seen as a geared play on the global economy, with many young innovative companies helping to provide solutions in manufacturing, health care and technology (including e-commerce). Europe is a stock pickers market, and with a global recovery hopefully slowly underway, this presents an excellent opportunity for us to find businesses with sound businesses models and a plan to grow their business within the next 3-5 years.

European small caps are also at the forefront of sustainability, and therefore, it's no surprise that our portfolio consists of companies with strong environmental, social and governance ('ESG') characteristics. However, smaller companies are often less focused on presenting what they do in these areas and more focused on their business operations. Many of our holdings align with the United Nations Sustainable Development Goal (SDG) of 'affordable and clean energy' – as well as other SGDs such as good health and well-being and sustainable cities and communities. Therefore, we have considerable exposure to companies that could benefit from the premium attached to ESG once companies improve the presentation of their activities and more generally exposed to the direction the world is moving.

Though the arrival of the omicron variant has renewed lockdown concerns in the short term, and inflation remains the wild card (which makes reasonable valuations more relevant) – there is still pent-up global recovery potential to help drive demand for European goods and services. As a result, we believe there are tremendous opportunities with this market and will continue to look for businesses that we believe are undervalued but have the potential to deliver superior returns.

For more insights, research and commentary on the range of Janus Henderson Investment Trusts, visit **the Insights Hub**.

Janus Henderson INVESTORS

GLOSSARY TERMS

Environmental Social and Governance (ESG)
Environmental, social and governance are three key criteria used to evaluate a company's ethical impact and sustainable practices.

Free float
Free float, also known as public float, refers to the shares of a company that can be publicly traded and are not restricted (i.e., held by insiders). In other words, the term is used to describe the number of shares that is available to the public for trading in the secondary market.

Growth stock
A growth stock is any share in a company that is anticipated to grow at a rate significantly above the average growth for the market. These stocks generally do not pay dividends. This is because the issuers of growth stocks are usually companies that want to reinvest any earnings they accrue in order to accelerate growth in the short term.

Liquidity
The ability to buy or sell a particular security or asset in the market. Assets that can be easily traded in the market (without causing a major price move) are referred to as 'liquid'.

Net Asset Value (NAV)
The total value of a fund's assets less its liabilities.

Share split
A stock split is when a company divides the existing shares of its stock into multiple new shares to boost the stock's liquidity. Although the number of shares outstanding increases by a specific multiple, the total dollar value of the shares remains the same compared to pre-split amounts, because the split does not add any real value.

Growth at a reasonable price
Growth at a reasonable price (GARP) is an equity investment strategy that seeks to combine tenets of both growth investing and value investing to select individual stocks.

Valuation
Metrics used to gauge a company's performance, financial health, and expectations for future earnings eg, price to earnings (P/E) ratio and return on equity (ROE).

IMPORTANT INFORMATION

How bond fund managers protect against rising inflation

High yield bonds posted worst ever return in January and now offer value

How can your bond fund manager protect your income from rising inflation?

Most investors have some exposure to bonds through holdings in diversified funds and investment trusts. Traditionally bonds have provided good diversification and a secure income.

A bond is essentially an IOU issued by a government or business which typically pays interest at a specified rate before being repaid or 'maturing' on a specified date.

Investors close to, or in retirement rely on the fixed income that bonds provide, but rising energy and other living costs means that income effectively buys less.

As the name suggests a fixed income doesn't keep pace with variable and rising living costs. You might think the answer is floating rate bonds.

These types of bonds track the prevailing level of interest rates and potentially provide a higher yield. Alas, they are not the answer, explains Phil Milburn, who manages bonds at Liontrust Asset Management.

The reason is because yields on floating rate bonds are based on short-term interest rates which are way below current inflation. UK annual inflation is running at 5.4% while short-term rates are below 0.5%.

BE DEFENSIVE AND BUY HIGHER YIELDING BONDS

Milburn told *Shares* there are two things bond managers can do to fight rising inflation. Firstly, adopt a more defensive approach and try not to lose money.

The easiest way to become more defensive in a rising interest rate environment is to shift into bonds which mature sooner. That's because they are less sensitive to interest rate changes.

Maturity is the end date of the bond when an investor gets their money back.

While helpful, this approach doesn't solve the real problem. Interest rates are at multi-year lows while inflation is at multi-year highs.

According to Milburn the best way of achieving a yield above current inflation is to hold higher yielding corporate bonds. This is debt issued by companies to fund their investments and operations.

High yield bonds have a poor reputation and are sometimes labelled junk bonds. But Milburn says this can be misleading.

He explained there are some good quality, larger companies which fall into this category and provide yields of 6.5%-to-7% at relatively low risk.

In other words, holding a proportion of high yield bonds within a well-diversified fixed income portfolio is a good way to protect against rising inflation.

To boot, high yield bonds have a shorter maturity (one to five years) which makes them more attractive when interest rates are rising.

INFLATION-LINKED BONDS NOT A PERFECT SOLUTION

Index-linked bonds are issued by the UK government and sometimes called linkers. They are designed to pay lenders extra interest to compensate the lender for increases in consumer price inflation.

In the US these are types of bond are called TIPS (Treasury inflation protected securities).

While inflation linked bonds might look like a good way to protect bond investors, they have drawbacks. They were originally created to protect pension funds' liabilities.

These liabilities are a long way off and so they tend to have longer maturities. Milburn told *Shares* the average maturity of an index-linked bond is 17 years.

The problem with bonds maturing a long time in the future is their extra sensitivity to changes in interest rates. After all, the longer you have to wait until the bond matures, the greater the chance interest rates will increase beyond the level paid by the bond.

This maturity risk detracts from the overall attractiveness of linkers to hedge against inflation.

PASSIVE BOND PRODUCTS

There are clearly advantages in employing an active bond fund manager to navigate the risks of higher inflation. Getting similar protection form ETFs (exchange traded funds) is a lot harder to achieve.

That's because going down the passive route introduces asset allocation and interest rate risk, so it is only suitable for experienced investors.

It means the investor must decide on the weightings between different types of bonds and take a view on how interest rates might change in the future.

FACTORS TO CONSIDER

It is important to understand the rules of how each fund chooses bonds to know what is included or excluded.

Investors need to ensure they purchase the appropriate currency hedged version for their needs.

The broad indices such as the Bloomberg Global Bond Aggregate Index do not provide specific inflation protection.

The index is composed of many different bonds, from government bonds, corporate bonds and mortgage backed securities across developed and emerging markets.

However, it only tracks the highest quality bonds, and therefore excludes high yield bonds we discussed earlier.

The good news is there are ETFs designed to track the corporate high yield bond markets and emerging market government bond markets.

These products are more likely to provide a yield above the current rate of inflation.

For example the $6.7 billion **iShares $ High Yield Corp Bond UCITS ETF (IHHG)** has a trailing yield of 5.4% and an annual ongoing charge of 0.5%.

While the $8 billion **iShares J.P. Morgan $ EM Bond UCITS ETF (EMHG)** has a trailing yield of 4.5% and also has an ongoing annual charge of 0.5%.

By **Martin Gamble** Education 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

Does a 60/40 portfolio work in the face of rampant inflation?

Investors might want to look to diversify their portfolios beyond stocks and bonds

For much of the past five decades a conventional balanced portfolio made up of 60% shares and 40% bonds has served its purpose.

The rationale behind this approach has been that bonds cushion volatility and provide income, and act as a counterbalance during a bear market. Conversely stocks provide the capital upside during a bull market.

More recently the two asset classes have become more correlated and the income available from bonds has fallen significantly.

In recent decades the confluence of several drivers including ageing demographics, globalisation and the re-emergence of China as an economic powerhouse have acted as a brake on inflation.

This has circumvented the need for central banks to be concerned about rising consumer prices. Consequently, recent economic history has been characterised by low inflation and declining interest rates. This has benefited bonds.

As yields have fallen bond prices have risen – there is an inverse relationship between interest rates and bond prices, as interest rates decline the price of a bond will rise.

Given the resurgence of rampant inflation within the UK and America, it appears we are entering a new economic regime, where these conditions could reverse.

The Bank of England has already implemented two successive interest rates rises and the Federal Reserve in America looks set to follow suit imminently, notwithstanding the war in Ukraine.

This new economic environment of rising interest rates and high inflation means it is important for investors to re-evaluate the suitability of the 60/40 portfolio model.

WHY 60/40?

Historically on average when equities have fallen the price of bonds has gone up, so holding both asset classes has smoothed out volatility; 60% shares and 40% bonds quickly became accepted as the benchmark for a moderate risk portfolio.

And it has largely done the job, particularly given the strong run for bonds. Look at the performance of the **Vanguard LifeStrategy 60% Equity (B3TYHH9)** fund – which is set up as a classic 60/40 portfolio with exposure to stocks and bonds through a basket of Vanguard funds.

In the past 10 years it has delivered an annualised return of 7.7% compared with 6.1% for the FTSE 100 and FE Fundinfo data shows it has a beta of 0.78 for the last three years. Beta measures how much an investment moves when the overall market rises or falls by 1%, so a beta of 1.5 would see an investment move 1.5% for example.

The beta on this fund shows it has been less volatile than the wider market and therefore lived up to its portfolio protection credentials.

IF IT AIN'T BROKE, WHY FIX IT?

Given its successful track record, investors may naturally ask why not stick with this formula?

Phil Huber, chief investment officer for wealth management firm Savant Capital, provides a clear response in his book, *The Allocator's Edge*.

He says: 'There is a high probability that the 60/40 portfolio that worked tremendously in the past will ultimately fall short in meeting the return targets and objectives of investors in the decades ahead. There are two main culprits to blame here: high valuations of the 60%, and paltry rates on 40%'.

Hubert outlined the potential risks of having a 40% weighting in bonds: 'As of March 2021, the 10-year Treasury rate sits at around 1.5% (a year later it is 1.8%). This is materially higher than the low of 0.52% reached in 2020, but still historically low.

'Assuming realised inflation of 2%, investors are set up for negative expected real returns for an asset class that has historically acted as a ballast against equity volatility and generated mid-single-digit returns in the process.'

Hubert's comments have proved to be prescient, given that the personal consumption expenditure price index which the Federal Reserve uses for its inflation target jumped 6% in January from a year earlier, according to a recent Bloomberg survey of economists.

Charles Hovenden, portfolio manager at Square Mile, echoes Hubert's sentiments regarding the potential overvaluation of bonds, but within a UK context. He suggests the magnitude of this valuation anomaly can be determined by comparing bond yields the last time the economy was in a recession.

Amid the 2007-8 global financial crisis yields on 10-year UK government bonds were closer to 5% than the current 1%.

The answer to what replaces 60/40 is not necessarily a straightforward one. For some it involves increased exposure to stocks and shares, however others have turned to alternative assets like property, commodities and infrastructure, opting for a mix of 45% stocks, 25% bonds and 30% in alternatives. Below we look at some options for investors looking to diversify a traditional 60/40 portfolio.

DIVERSIFICATION OPTIONS

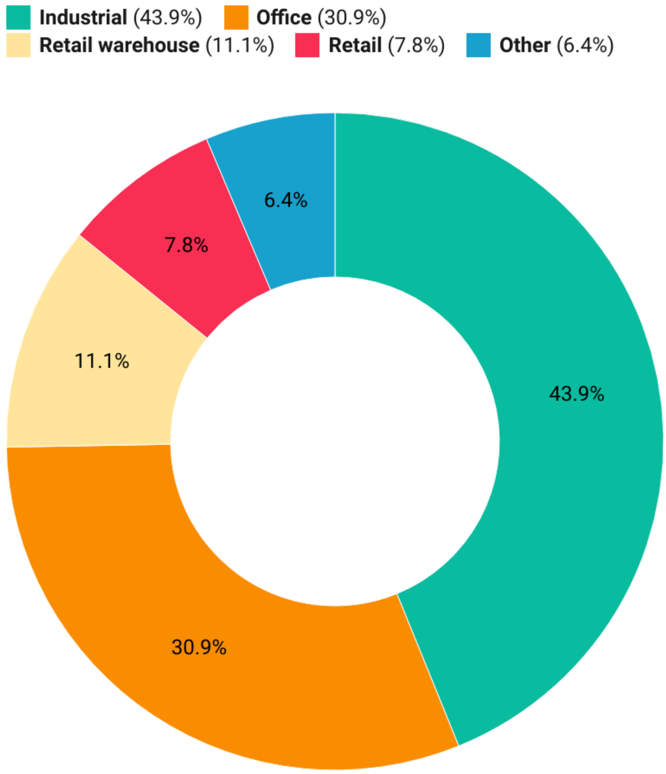
– REAL ESTATE –

Real estate as an asset class warrants a place in a diversified portfolio. The case for strategic allocation to property is strong given the benefits of capital appreciation potential, coupled with inflation protection and an income stream.

As well as helping you to achieve diversification, a fund or listed property firm can provide access to a wide variety of different types of property including shops, offices, warehouses, homes and alternative assets like healthcare facilities and student accommodation.

For example, **Schroder's Real Estate Investment Trust (SREI)** has 73% of its portfolio in industrial and office assets and its retail holdings include almost zero exposure to structurally challenged shopping centres.

Schroder Real Estate Investment Trust



Includes post-period end industrial portfolio acquisitions.

Chart: Shares Magazine • Source: Schroders, November 2021. Percentage of total real estate portfolio value • Created with Datawrapper

The real estate investment trust is trading at a 21.7% discount to net asset value, and offers a 4.3%

dividend yield.

Nick Montgomery, Schroders' head of UK real estate investment, is focused on so-called 'Winning Cities' – urban areas with characteristics that will make them attractive places to live and work in the long term.

– INFRASTRUCTURE –

Infrastructure assets are another way to diversify a traditional 60/40 equity/bond portfolio. They offer high barriers to entry, relatively inelastic demand and are typically resilient to economic cycles. They also generate relatively stable and predictable cash flows and have a positive correlation to inflation.

Pantheon Infrastructure Investment Trust (PINT), which came to the market in November 2021, targets an 8% to 10% annual return. It is diversified across different types of infrastructure assets. In comparison, many other infrastructure trusts listed on the London Stock Exchange specialise in either government-backed projects or renewables.

Pantheon's focus is on investments in infrastructure businesses that provide essential services to the public including assets such as mobile phone towers. The asset manager is an established global investor with long standing relationships with leading private market infrastructure investors.

It invests alongside these partners to construct a diversified portfolio of direct co-investments in five different categories. These are utilities, transportation, social infrastructure, digital infrastructure and renewable energy.

The trust currently trades at a 7.65% premium to net asset value, which reflects the current demand for infrastructure assets.

– MULTI-ASSET FUNDS –

If bonds will no longer cut it in an inflationary world, investors need to transition into an array of alternatives which include inflation-linked bonds or gold, as well as property, infrastructure, carbon credits and commodities. Multi-asset funds are an option for investors who want exposure to these types of investments under a single roof.

In September 2021, Ruffer launched the **LF Ruffer Diversified Return Fund (BMWLQT5)**, aiming to generate positive returns in all market conditions. It states: 'We try to first protect, then grow the value of the fund. If we can do this, we should outpace inflation, protecting and increasing the real value of our investors' income and capital.'

LF Ruffer Diversified Return Fund

Top 10 holdings

Stock	% of fund
BP	2.7%
Royal Dutch Shell	2.7%
iShares Physical Gold	2.6%
Barclays	1.9%
NatWest Group	1.9%
GlaxoSmithKline	1.6%
Cigna	1.3%
Kinross Gold	1.3%
Bristol-Myers Squibb	1.0%
Mitsubishi UFJ Financial Group	1.0%

Table: Shares Magazine • Source: www.ruffer.co.uk • Created with Datawrapper

Co-manager Duncan MacInnes believes we are entering a world in which bond and equity prices look poised to fall in tandem. He says: 'In this environment true diversification and a lack of correlation to other asset classes or strategies will be absolutely vital to portfolio construction.'

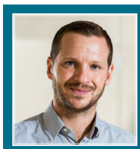
From an asset allocation perspective index-linked gilts feature prominently in its portfolio, as do gold and shares in gold miners. The largest equity holdings include **Shell (SHEL)**, **NatWest (NWG)**, **BP (BP)** and **GlaxoSmithKline (GSK)**.

By **Mark Gardner** Senior Reporter

Does invasion of Ukraine mean I should reduce risk in my pension?

Our expert discusses what impact the conflict might have on retirement pots

Can you explain what the crisis in Russia could mean for people's pensions? Is now the time to take some investment risk off the table given all the uncertainty we're seeing? I'm 43, have a workplace pension and a SIPP and I'm planning to retire when I'm 65.
Owain



Tom Selby, AJ Bell Head of Retirement Policy says:

What's happening in Ukraine is, of course, first-and-foremost a humanitarian crisis. But given Russia's role in the global economy – in particular the supply of oil and gas – the ramifications are being felt by companies and individuals in lots of different ways.

Pension investors might understandably be nervous the conflict and resulting political uncertainty across Europe might hit their retirement plans. However, for a number of reasons investors should keep their finger well away from the panic button.

First, short-term volatility is part-and-parcel of long-term investing. It is possible the value of your retirement pot will drop if your investments hit the skids, but provided you are comfortable with the risks you are taking this should not mean you need to make any portfolio changes.

In fact, tinkering in this way risks layering on extra costs for no clear benefit, and could result in a drift away from your original strategy. While the situation in Ukraine may be unique, knocks to the stock market are not.

Second, the vast majority of pension savers – be they invested via their automatic enrolment workplace scheme, in a SIPP or elsewhere – will hold a diverse selection of assets in different sectors and different countries, either directly or through a fund manager, aimed at delivering returns over the long term.

As a result, direct exposure to a single country such as Russia will be tiny for the average person.

Take, for example, the National Employment Savings Trust (NEST), the workplace pension scheme established by the Government to support automatic enrolment. If you have been automatically enrolled into a pension, there's a decent chance your money will be with NEST.

The pension scheme's chief investment officer Mark Fawcett confirmed this week it will divest from Russian companies and bonds – and that this would involve selling just 0.2% of its assets.

Of course, the ripple effect of what's happening in Ukraine will be felt more widely, with the impact on your pension depending on the assets you hold.

At most investors might want to double-check they are comfortable with their portfolio in light of what we've seen in the past week or so – both in terms of the risks they are taking and the companies or funds they are invested in. But in the majority cases there will be no need to do anything at all.

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.

Six big mistakes to avoid ahead of the end of the tax year

We explore some common pitfalls and what you can do to steer clear of them

MISSING OUT ON FREE MONEY

Whether it's your pension, your Lifetime ISA or ensuring you claim tax breaks that you are eligible for, you want to make the most of any free government cash that you're entitled to. Pensions benefit from tax relief at 20% for basic-rate taxpayers, but higher and additional rate payers can reclaim an additional 20% or 25% tax relief respectively through their tax return. That means for a higher-rate taxpayer every £1 in your pension only costs you 60p

Anyone using a Lifetime ISA can also get up to £1,000 of free money from the government each year, if you put in the maximum £4,000 subscription. So, if you have some spare cash you were planning to put into your Lifetime ISA and still have some of this year's allowance left, make sure you do it before the tax year end and claim that free cash.

Just be aware that you can withdraw Lifetime ISA money once you've reached age 60 or earlier to buy your first property, but if you take the money for any other reason (apart from severe ill health) you'll pay an exit penalty of 25%.

You should also check that you're claiming any government tax-breaks that you're eligible for, such as the marriage allowance or claiming tax-free childcare, which gives a 20% top-up to money you use for childcare.

NOT SHELTERING MORE OF YOUR INVESTMENTS FROM TAX

If you've got investments outside of your ISA you can use something called 'Bed and ISA' to funnel them into an ISA and protect them from tax. You need to check you've got some of your £20,000 ISA allowance left and that the investments can be held in your ISA.

You can then use your investment platform's Bed and ISA service, which means the investment outside of the ISA is sold, the proceeds moved into an ISA and used immediately to purchase the same investment within the ISA.

You just need to be aware that if you've made any gains on the investment outside an ISA you may have to pay tax on them when you sell them as part of this process. For this reason lots of people sell enough of the investment to take them up to their CGT (capital gains tax) allowance of £12,300.

NOT USING ALL YOUR TAX-FREE ALLOWANCES

Any investments held outside an ISA or pension will be subject to capital gains tax, which means the annual tax-free allowance is very valuable. Investors can make investment gains of up to £12,300 in 2021/22 without paying any tax.

Gains over that amount are added to income and if they fall in the basic-rate tax band are taxed at 10% and if they fall in the higher-rate tax band are taxed at 20%. An additional 8% is added to the tax rate if the gains are from a second property.

The annual capital gains tax allowance cannot be carried forward into future years so if you don't use it, you lose it. If you have investments with gains outside of an ISA or pension you should consider whether to realise some of that gain before the end the tax year to make the most of your tax-free allowance.

If you're in a couple you can get double this allowance as you can transfer investments to your spouse or civil partner in order to use their annual CGT allowance too. This means that for the current tax year you can lock-in up to £24,600 of gains before you face any tax.

PAYING INTO MORE THAN ONE OF THE SAME TYPE OF ISA IN A YEAR

You're only allowed to pay into one of each type of ISA each tax year. This means that you can pay into a Cash ISA and a Stocks and Shares ISA in one year, but not into two different Cash ISAs (and a Help to Buy ISA is a Cash ISA so you can't pay into both).

It's tricky though, as you're allowed to have more than one open, you just can't pay into two in the same tax year. With the rise of investing apps and people using multiple providers for different types of ISA, it's harder for people to keep track of what they've paid into in each tax year.

If you accidentally pay into more than one ISA in a year, don't attempt to fix it yourself, as you may close the wrong ISA. Instead, call HMRC's ISA helpline on 0300 200 3300 to get advice on what to do.

PAYING MORE THAN YOUR ALLOWANCE INTO YOUR ISA

Every adult has a £20,000 annual limit for their ISAs each year, but within that there are different limits.

For example, a Lifetime ISA has a £4,000 annual limit, which counts as part of your overall £20,000 limit. And a Help to Buy ISA has a limit of £200 a month, which also counts towards the £20,000 limit. If you have different ISAs with different providers it can be easy to accidentally pay in too much.

If you realise you've done this then you shouldn't attempt to just withdraw money from one ISA yourself. Instead you should call HMRC's ISA helpline on 0300 200 3300 to explain the situation. HMRC will work out which ISA had the payment into it that breached the limit and will reclaim the money. They will also charge you for any tax owed.

NOT BEATING THE DIVIDEND TAX RISE

People with lots of income-producing investments outside of an ISA or pension will face a higher tax rate from April if they earn more than £2,000 in dividends in a tax year. That's because the dividend tax is rising, with an extra 1.25 percentage points being added to all the tax rates.

That means any dividend income you get above the tax-free allowance is taxed at 8.75% for a basic-rate taxpayer, 33.75% for a higher-rate taxpayer or 39.35% for additional-rate taxpayers. Assuming a 4% income on your investments, anyone who has more than £50,000 invested in dividend-producing assets outside an ISA is likely to be hit by this rise.

For example, someone with £10,000 of dividends outside an ISA will pay an extra £100 a year in tax as a result, taking their tax bill to £700 if they're a basic-rate taxpayer, £2,700 at the higher rate and £3,148 at the additional rate. (This assumes someone hasn't already used their £2,000 tax-free dividend allowance but has used their personal allowance).

This means that it's more beneficial than ever to put your income-producing investments inside an ISA, to protect them from tax. You can use the same Bed and ISA process mentioned above to move assets into an ISA. By using this year's ISA allowance and immediately using next year's at the start of the new tax year in April, you can shelter £40,000 from the taxman before the dividend hike bites. If you're a couple and both haven't used your allowances you can move £80,000 in before the tax rise comes in.

But rather than moving just any assets into the ISA, investors should prioritise the highest income-paying investments as they are the ones that will be hit hardest by the dividend tax. So investors should rank their investments from the highest dividend paying to the lowest, in pounds and pence, rather than percentage terms. They should then work through the list, shifting the highest yielding investments into the ISA first to cut their tax bill.

By **Laura Suter**
AJ Bell Personal Finance Analyst

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RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues

Why junk bonds suggest the global economy is in a mess

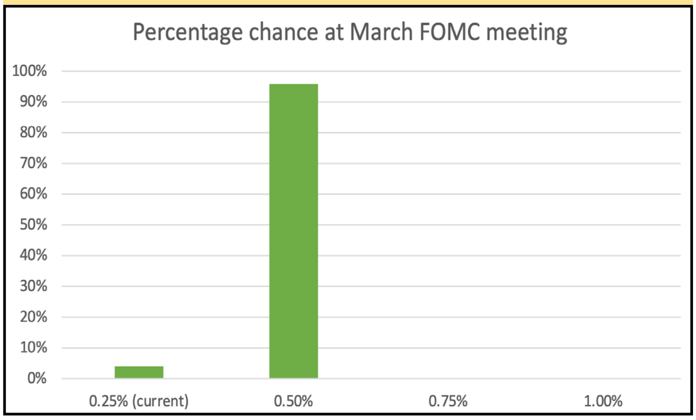
High yielding corporate debt is under pressure which could be bad news for stocks

No-one, but no-one, knows what the ultimate ramifications of Russia's invasion of Ukraine will be, looked at from the broad perspective of international politics or the much narrower – and less important – one of investments.

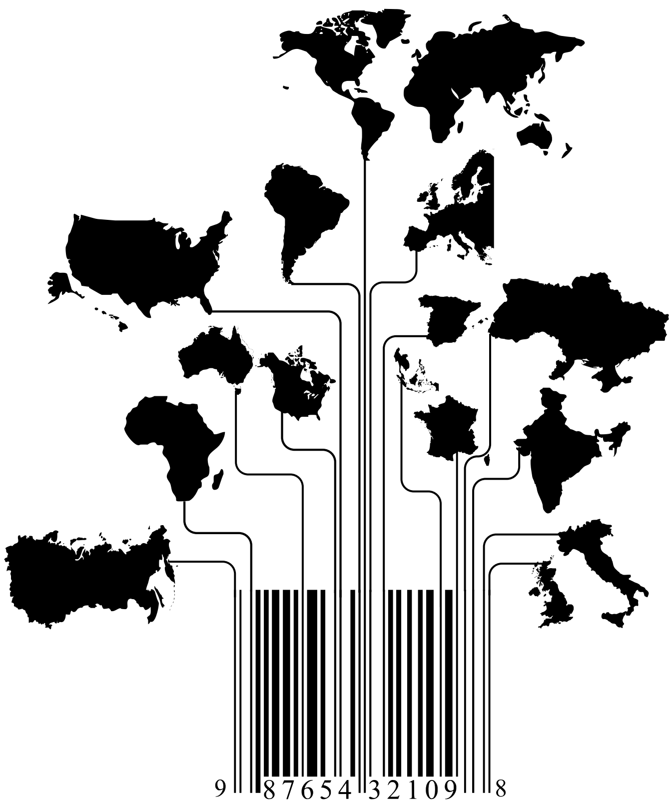
Commodity markets are in foment but stock and bond markets are so far keeping relatively cool, perhaps because they just do not know what to make of it, perhaps because they think a diplomatic solution is still possible and perhaps because they still feel (or hope) Western central banks have their back.

Why that would be when central banks cannot print oil or copper or wheat is an interesting question (and is itself an explanation for why those commodities are soaring). But markets are beginning to reduce their expectations for the number of interest rates that the US Federal Reserve may push through in 2022.

Markets are pricing in a quarter-point hike from the Fed on 16 March



Source: CME Fedwatch, Friday 4 March 2022 and Friday 25 February 2022



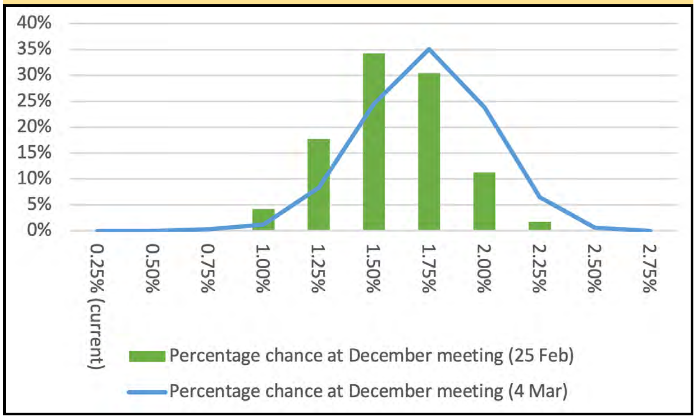
Fed chair Jay Powell last week (3 Mar) seemed to confirm that the meeting on 16 March will see a quarter-point increase, no more. A month ago, markets were putting a 50%-plus chance on a half-point rise whereas now some even think there is a small chance that the US central bank will do nothing.

The view seems to be that higher energy and commodity prices will bump up inflation and in turn hit consumers' (and corporations') ability and willingness to spend. That will slow the economy and take out some of the heat from inflation, with

RUSS MOULD
AJ Bell Investment Director

the result that rates will not need to go up as far or quickly as expected. Markets are now pricing in five rate hikes from the Fed, down from seven, according to the CME Fedwatch service.

US rate rise expectations have ratcheted back



Source: CME Fedwatch, Friday 4 March 2022 and Friday 25 February 2022

An end to the fiscal stimulus so liberally applied during the pandemic and the withdrawal of monetary stimulus surely makes some kind of slowdown inevitable anyway, after the sharp bounce back as lockdowns ended. The question now may be how abrupt that slowdown becomes – with the Russian invasion getting the blame. The Atlanta Fed's GDP Now forecast suggests potentially very, as the service's estimate for Q1 GDP growth in the US is precisely zero.

That may leave central banks with a dilemma, as they face a choice of letting their economies take a hit from inflation or a hit from higher interest costs. One way in which stock market investors can assess the potential implications of this tricky choice is to look at high yield (or 'junk') bonds.

JUNKYARD DOGS

High yield is the technical term is non or sub-investment grade debt and this is tradeable debt (bonds) issued by companies that carry a rating of BB or lower from agencies Standard & Poor and Fitch or Ba or lower from Moody's.

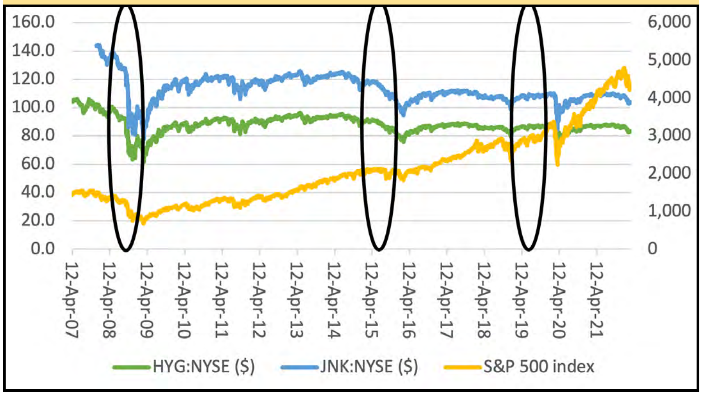
Generally, these are firms with a lot of debt and potentially troubled operating models where there is a higher risk of default, either through the non-payment of a coupon at the pre-agreed time in the pre-agreed size or the failure to return the investor's principal (or initial investment) in full.

Owing to this risk, 'junk' debt tends to come with a higher coupon than investment grade corporate debt or sovereign (government) debt, as potential buyers demand higher rewards to compensate themselves for the greater dangers.

High yield debt also tends to trade more like equity, since an economic upturn will be good news, in the shape of more profits, improved cash flow and a reduced risk of default. A recession is usually bad news indeed for high yield debt prices, as investors flee, thanks to the prospect of lower profits, less cash flow and the increased risk of default.

As a result of that, high yield is often seen as a lead indicator for stocks and shares. The asset class can be followed quickly and easily by checking out the prices of two US-listed exchange-traded funds, the SPDR Bloomberg High Yield ETF and the iShares iBoxx High Yield Corporate Bond ETF.

Junk bond prices are sagging



Source: Refinitiv

The good news neither is collapsing. The bad is news is that the price of both high-yield ETFs peaked last autumn and they now stand some 5% to 6% down from their highs. The HYG product trades at $83.3 at the time of writing. If history is any guide – and there are admittedly no guarantees on that front – there could be trouble ahead for the economy and share prices if it goes below $80, either in the form of a recession or even stagflation – where inflation is accompanied by a downturn in the economy.

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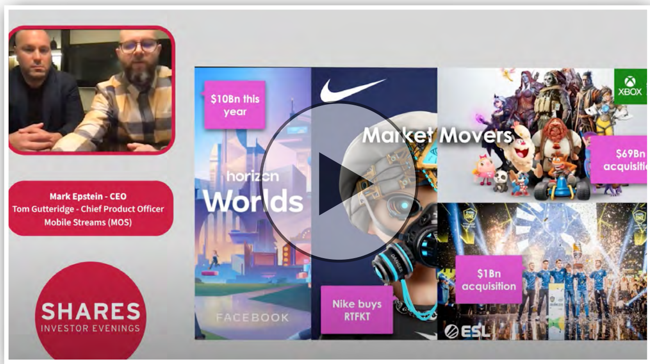

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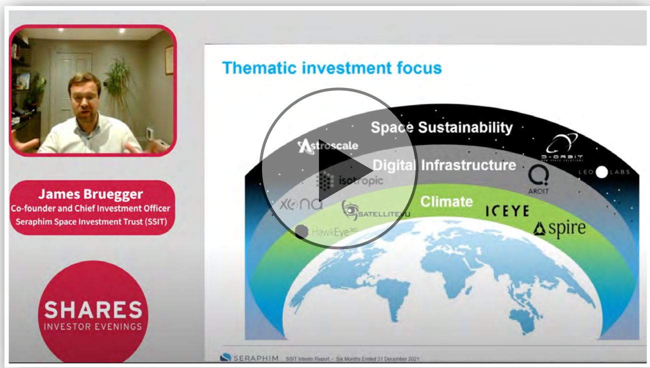

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Main Market

ETFs

AIM

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Funds

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

11 Mar: SIG. **14 Mar:** Hostmore, Phoenix, Stelrad. **15 Mar:** Aptitude Software, Genel Energy, Genuit, Old Mutual, Petrofac, Smart Metering Systems, TI Fluid Systems, Tissue Regenix. **16 Mar:** 4imprint, Advanced Medical Solutions, Centaur Media, CLS, Computacenter, Ferrexpo, IP Group, Pharos Energy, Restaurant Group, RPS, Science in Sport. **17 Mar:** Ceres Power, Cineworld, Deliveroo, EMIS, Empresaria, Harbour Energy, Helios Towers, Marshalls, PensionBee, Portmeirion, TransGlobe Energy, Tribal. **18 Mar:** Contour Global, Eurocell.

Half-year results:

14 Mar: Craneware, Fonix Mobile, Nightcap. **15 Mar:** Close Brothers, DFS Furniture, Ferguson, Litigation Capital, Virgin Wines. **18 Mar:** JD Wetherspoon.

Trading announcements:

11 Mar: Berkeley. **17 Mar:** Ocado. **18 Mar:** Investec.

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