STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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FREE HALEON SHARES FOR GLAXO INVESTORS

When it happens and what to expect

FEATURE Discover where investors **made money** in the first half of 2022

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PAST PERFORMANCE

	Apr 17 - Apr 18	Apr18 - Apr 19	Apr 19 - Apr 20	Apr 20 - Apr 21	Apr 21 - Apr 22
Net Asset Value	**24.4%**	**-3.4%**	**-0.4%**	**74.4%**	**-39.2%**
Share Price	**26.1%**	**2.0%**	**-4.7%**	**93.5%**	**-41.6%**
MSCI China Index	**27.1%**	**1.3%**	**1.2%**	**24.8%**	**-29.6%**

Past performance is not a reliable indicator of future returns.
Source: Morningstar as at 30.04.2022, bid-bid, net income reinvested.
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Contents

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Daniel **Coatsworth** **EDITOR'S** VIEW

GSK and Haleon: why the spin-off can be the more interesting part of a demerger

Mondi, Indivior, Thungela and South32 are all examples of successful corporate splits

One of the UK market's biggest corporate splits in years is about to happen, with **GSK (GSK)** demerging its consumer healthcare business called Haleon. The latter should become a FTSE 100 company and give investors exposure to some of the best-known brands in toothpaste, painkillers and more.

This article will give you the essential details on Haleon and its prospects. But if you're still unsure what to do, it's worth looking back in history at what happens when a company splits into two. More importantly, the demerged business rather than the original parent is often the more interesting one from an investment perspective.

Demergers happen for various reasons, such as a company under pressure from investors to realise hidden value, or a change in strategy which leads to a tighter focus on a particular area.

A study in 2003 by the Krannert School of Management found that subsidiaries spun out of companies outperformed their former parent by more than 20% over the first three years following the demerger; with most of the excess returns within the first 12 months of trading.

Demerged companies often perform better as standalone entities because management has more freedom to drive strategy rather than having to conform to a parent's demands. This entrepreneurial spirit helps to drive earnings and the share price.

Once separated from the parent, many investors will look at a demerged company and get excited about its prospects, perhaps having failed to realise what was under the bonnet when previously part of a bigger group.

There is also a psychological benefit of being invested in a business undertaking a demerger. Suddenly you'll have two different companies in your portfolio when you only paid for one.

That can work both ways – some people think they've suddenly got something for nothing, so are happy to be patient with the stock to see what returns it might generate.

Others see it as a freebie and immediately sell, which is why the share price can be volatile in the early days of being a demerged company.

Anglo American (AAL) has form when it comes to demergers. Packaging group **Mondi (MNDI)** was spun out of the miner in 2007 and has since done very well on the stock market.

Last year Anglo American undertook another demerger, spinning off its coal assets as **Thungela Resources (TGA)**, whose share price has since increased more than seven-fold in value. At the time of the split, very few people thought it would be a success because coal was so out of favour.

Indivior (INDV) has nearly tripled in price since being separated from **Reckitt (RKT)** in 2014; and **South32 (S32)** is worth more than twice as much as when it was spun out of **BHP (BHP)** in 2015.

Demergers don't always deliver positive returns as investors holding **Wickes (WIX)** since its split from **Travis Perkins (TPK)** have found out.

With Haleon, it's important to note that **Pfizer (PFE:NYSE)** owns a 32% stake which creates an 'overhang', namely something that could act as a drag on the share price until the partner sells this stake, which it intends to do. Despite such an issue, demergers generally look like interesting places to make money.

This is where investors made money in the first six months of 2022

Oil, tobacco, healthcare, defence, pharma and telecoms were all in vogue

The first half of 2022 has been tough for both experienced and novice investors with very few places to hide. However, it was possible to make money if you backed oil and gas producers and defensive stocks, among several other sectors.

Virtually nobody would have predicted that the UK's FTSE 100 would have been the best performing major stock market index in the world, down just under 3% for the period.

In contrast, the domestically driven FTSE 250 was one of the worst performers, losing 20%, although it still fared better than the technology-heavy Nasdaq 100 index which dropped by almost a third.

The FTSE 100 benefited from its big exposure to commodities and energy companies. The oil and gas sector gained almost 30% as energy prices spiraled higher after Russia's invasion of Ukraine.

Brent crude oil gained 39%, while the price of heating oil rocketed 64% and coal prices surged 145% after sanctions were imposed on Russian oil and gas.

Gold prices slipped 1%, leaving investors disappointed at an asset which has a reputation for being a hedge against inflation. Also letting investors down was bitcoin, dropping 59% in the first-half period.

Reflecting its industrial use rather than haven status silver prices fell 17% while copper was down by a fifth, steel prices fell 40% and platinum was down 5%.

Retailers and leisure goods companies came under pressure from concerns over higher living costs dampening consumer expenditures with the two sectors dropping by a third in value.

With central banks pushing up interest rates bond investors also had a tough time with double-digit losses across government and corporate bond prices. This means government bonds have not provided their traditional diversification benefit.

Where have investors made money in 2022?

FTSE 350 sector index	First-half gain
Oil and gas producers	26%
Tobacco	26%
Healthcare providers	25%
Aerospace and defence	17%
Pharmaceuticals	16%
Telecoms	11%
Banks	6%
Waste and disposal services	5%
Industrial metals and mining	3%
Consumer services	2%

Table: Shares magazine • Source: SharePad. Data 1 Jan to 30 June 2022

Despite the carnage brought about by central banks and the war in Ukraine, traditionally defensive sectors performed well. Tobacco was up by 26%, healthcare advanced by 25% and telecoms gained 11%.

Crucially all three sectors have a good degree of pricing power which has become more important to combat rising costs.

The conflict in Ukraine boosted the aerospace and defence sector and propelled **BAE Systems (BA.)** to the top of the FTSE 350 with a gain of 51% over six months.

Performances across investment trusts mirrored sector trends. The technology focused **Baillie Gifford US Growth Trust (USA)** fell 52% while **Scottish Mortgage (SMT)** fell 47%.

Managers focused on protecting against inflation fared well with **JPMorgan Global Core Real Assets (JARA)** and **JLEN Environmental (JLEN)** both up 16%. [MGam]

Sainsbury's celebrates blow-out Jubilee weekend but non-food sales slide

The supermarket chain sticks with its recently-lowered full year profit guidance

Sainsbury's (SBRY) supermarket boss Simon Roberts must have been thanking his lucky stars for the Platinum Jubilee bank holiday weekend, which saw Brits splashing out on scones and clotted cream, washed down with record sales of beer, wine and spirits at street parties up and down the country.

For the 16 weeks to 25 June, the UK's second-largest grocer by market share posted a 4.5% drop in total sales excluding fuel but only a 2.4% drop in grocery sales.

Sainsbury's upmarket Taste the Difference brand saw sales jump 12% over the Jubilee weekend as shoppers went mad for tea, cakes and strawberries, while booze sales during the week were the highest ever outside of Christmas and Easter.

Non-food sales fared less well, with instore

sales down 14.6% and Argos' sales down 10.5%, although the first five weeks of the quarter were lapping an extremely strong period last year.

Sainsbury's repeated its promise to invest £500 million in lower grocery prices over the two years to next March.

Online sales were another bright spot, with revenues over 90% above pre-pandemic levels and the group holding onto customers it gained during lockdown.

Critically, the firm reiterated the profit guidance it gave in April of underlying profits before tax of between £630 million and £690 million, which saw the shares rise 2% to 213p. [IC]

Chrysalis shares slump 63% in six months on investment valuation fears

A big bet on buy now, pay later group Klarna is backfiring

SHARES IN PRIVATE equity investment trust **Chrysalis Investments (CHRY)** continued to fall following reports in the *Wall Street Journal* that investee company Klarna is attempting to raise approximately $650 million from existing investors at a significant discount to previous funding rounds.

Buy now, pay later provider Klarna is the second largest position in Chrysalis' portfolio and accounts for approximately 19% of the trust's net asset value.

Wall Street Journal reported that in its latest funding round Klarna's valuation could decline to $6.5 billion. This compares with a previous funding round in June 2021 that valued the business at $45.6 billion.

Assuming the latest reports are accurate, the new funding round would lead to a reduction of 32p from Chrysalis's March net asset value of 212p.

Over the past month shares in Chrysalis have fallen by nearly 30% and are down by nearly two thirds over six months.

Jupiter (JUP), which manages Chrysalis, is facing growing criticism given that 12 of its funds had invested in the investment trust.

Shares in many private equity trusts have been under pressure this year as investors fear the value of unquoted holdings will be marked down. [MGar]

Investors in US banks could see higher dividends soon

Lenders are in a much stronger position to pay out cash to shareholders

More generous dividends are expected to be a key theme in the forthcoming quarterly reporting season for US banks, which starts on 14 July.

The sector underperformed during the pandemic due to fears of increasing loan losses. Banks took huge provisions in anticipation of a severe downturn. However, the jump in bad debts was a fraction of those witnessed during the great financial crisis.

Lenders have been releasing some of these bad debt provisions and beating earnings expectations. Balance sheets also remain strong.

US banks recently cleared their annual stress test exercise which looked to see if they could cope with a severe economic downturn. Success in the test has already seen several banks declare an intention to pay higher dividends.

For example, **Goldman Sachs (GS:NYSE)** said it would hike its dividend by 25%. However, **Citigroup (C:NYSE)** announced that it wouldn't raise near-term dividends and investors will be eager to find out why at its next update on 15 July.

US banks today have significantly more capital, greater liquidity, generate strong returns, and have a more cautious risk appetite.

The forthcoming results may demonstrate the sector is entering a virtuous cycle. As bond yield and interest rate expectations go up, earnings expectations for the sector will increase. However, bank share prices in general have been weak this year due to fears about recession. [MGar]

AO World shares slide to a record low on cash flow concerns

The firm tries to calm investors by saying it has adequate liquidity

AS IF THE first half of 2022 wasn't tough enough for online electricals retailer **AO World (AO.)**, with a cut to profit guidance, the second half started with a thorough drubbing for the shares.

After reports that one of its credit insurance providers had cut cover for its suppliers, AO shares dropped 18% on 4 July and a further 13% the following day, putting the stock at a new all-time low of 48.66p.

Credit insurance protects suppliers from the risk of retailers going bust between dispatching goods for sale and receiving payment.

Without it, suppliers could ask retailers for payment in advance, which would greatly increase their working capital needs.

While AO recognised one of its credit insurers had 'rebased their cover' from the elevated levels of the pandemic, the firm said there had been no effect on its liquidity.

Moreover, the cash costs of closing its German operations were now seen at the lower end of the original range of zero to £15 million.

On 6 July AO launched a share issue to raise £40 million. It said the money would help strengthen its balance sheet and increase liquidity back to historic levels. [IC]

This trust pays a nice dividend and its share price is up this year

Murray International's qualities look ideal for the current state of the market

Murray International (MYI) offers diversified access to the highest growth regions of the world with an attractive 4.5% yield and proven track record of growing the dividend.

Steered by veteran fund manager Bruce Stout, Murray International is one of the few investment trusts to post a positive return for the year, with the shares up 5.2%, helped by a narrowing discount as investors acknowledge improved performance.

The underlying assets are up 3.6% compared with a 7.7% fall in the MSCI World All Cap index according to data provider Morningstar. This is impressive given the poor returns posted by many global growth funds which have struggled in a rising interest rate environment.

Murray International has a long history of dividend growth and has built up revenue reserves equivalent to almost one year's full dividend payment according to research house Stifel.

Investment trusts can dip into revenue reserves to maintain dividends during difficult times to smooth payments to investors. For example, Murray International maintained the dividend through the pandemic-stricken 2020, a time

when many companies cut or suspended their cash payouts to shareholders.

Stout focuses on parts of the globe offering the best growth prospects. He has over 35 years of investment experience and has worked in Latin America and Asia during his career, gaining local knowledge across various emerging markets.

Unusually for growth investing, Stout allocates money to fixed-income securities which represent around 8% of the portfolio, mainly via investments in emerging market bonds.

The trust's objective is to achieve strong growth in income and capital over time by employing a 'bottom-up' stock picking approach.

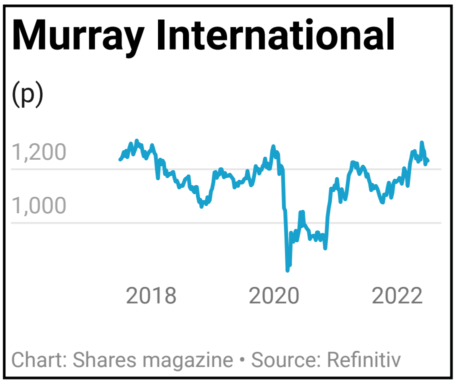
In his latest investor letter Stout said the portfolio remains defensively positioned with a widespread emphasis on real assets.

He views this as appropriate given 'prolonged economic uncertainty and the negative consequence that unchecked inflation has on currencies, wealth and prosperity'.

The trust's largest holding is Mexican airport operator Grupo Aeroportuario del Sureste, which runs nine airports in south-eastern states including Cancun.

Taiwan Semiconductor Manufacturing is the second largest holding in the portfolio. Other investments include tobacco seller **Philip Morris (PM:NYSE)**, semiconductor firm **Broadcom (AVGO:NASDAQ)** and pharma business **Abbvie (ABBV:NYSE)**.

Murray International's shares trade a small premium to net asset value (1.4%) and come with a 0.57% ongoing charge. [MGam]



No-one's interested in On The Beach which means now is perfect time to buy

This is a high-risk but potential high-return investment

Readers will be aware that hundreds of flights out of the UK are being cancelled as staff scarcity puts pressure on airports and the travel industry.

Suggesting that investors buy holidays group **On the Beach (OTB)** in this climate might sound mad, yet Shares believes this is a fundamentally sound and financially robust business with good prospects longer term.

If you're ever likely to invest in this business, now is the time to do it. The company is trading at its lowest valuation since listing seven years ago and customer demand is surging back to pre-pandemic levels.

Before the pandemic, this was a £1 billion business with near-70% gross margins, mid-teens operating margins with a potentially long growth runway ahead of it. According to Statista, UK holidaymakers will spend around £7.3 billion on package holidays this year, rising to £9 billion by 2026.

Numis and Peel Hunt believe the shares could be trading at 400p to 500p within 12 to 18 months. The analyst consensus view is a return to profit at £7.8 million for the year to September 2022, rising to £24.2 million in 2023 and £28.5 million in 2024.

Yes, the holidays market is about as easy to read as ancient Aramaic right now. On The Beach management were cautious about prospects for this summer at half-year results in May, with inflation putting the squeeze on consumer budgets. That said, airport chaos suggests the holiday industry is supply constrained and demand remains robust.

On The Beach says there is no shortage of seats on planes given that airlines are expecting capacity expansion of 10% to 15% this year. Numis says relaxed Spanish restrictions are supportive of deals being snapped up last minute this summer.

While the longer-term growth story looks attractive for investors and the shares are cheap on seven times 2023 forecast earnings, immediate prospects remain laced with uncertainty.

The lack of clarity is likely to make the stock volatile over the next few months. This will not suit all investors, and those of a more cautious nature might choose to avoid the implied risk that comes with investing in On The Beach at present.

For those willing to accept the near-term hazards, On The Beach has real scope of outsized returns if the recovery go well. [SF]

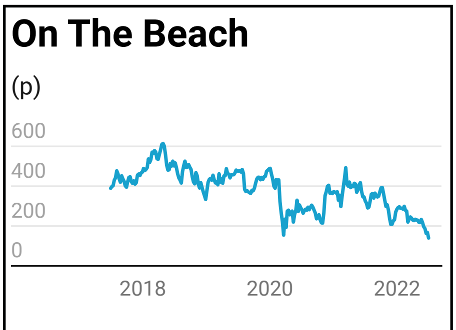


Chart: Shares magazine • Source: Refinitiv

Growth fears and consumer spending crisis dent the performance of our 2022 picks

Some of the holdings have fallen despite reassuring news flow

It's been a challenging first half of the year for investors with so many stocks falling in value. Our annual stock pick selection features a few bright spots, yet the portfolio is still in negative territory. We can only hope for a much better second-half, though the outlook is far from encouraging.

Since we published the portfolio on 23 December 2021, we've seen a 14.5% loss versus a 3.8% decline from the FTSE All-Share index and a 10.5% drop in the sterling-denominated version of the MSCI World index.

CONSUMER SPENDING FEARS

Casual dining group **Loungers (LGRS:AIM)** and dog food-to-vet services provider **Pets at Home (PETS)** have been sold down by investors who fear the cost-of-living crisis will see consumers cut back on spending to cover their household bills. However, that doesn't tally with the messages from both businesses.

In a 26 April update, Loungers said trading had bounced back strongly from a dip around Christmas when the country was struggling with a new wave of Covid. We'll get a better picture of recent trading when Loungers reports full-year results on 13 July.

On 25 May Pets at Home delivered a strong performance for the year to March with revenues and earnings ahead of estimates, a strengthened balance sheet and a hike in the dividend.

The company also talked about pet care being resilient in both good and bad economic conditions and said it expected earnings for its new financial year to be in line with analyst expectations. After all, pets need feeding regardless of the economic environment and most pet owners view animal healthcare as non-discretionary spend.

Nonetheless, the market remains nervous, and it didn't help that broker RBC downgraded its rating on the stock to 'underperform' on 4 July, causing another sell-off in the shares. Pets at Home's next trading update comes out on 5 August.

Both Loungers and Pets at Home are financially healthy and should benefit as weaker players exit their respective markets, but investors are following a top-down playbook for now.

With expectations of more interest rate rises to come and now talk of a recession to follow, sentiment in consumer discretionary stocks is likely to stay poor and there's little we can do for the time being.

The sell-off in sustainable wood company **Accsys Technologies (AXS:AIM)** and French electrical components giant **Schneider Electric (SU:EPA)** is less easy to explain.

Accsys is growing its revenues at a 20% a year thanks to a continued excess of demand versus supply and price hikes.

Despite temporary lockdowns in China which may have affected some of its plants, Schneider Electric is growing its sales in energy efficiency and industrial automation by 10% organically.

The company is still a world-class business, while saving energy and fixing supply chain bottlenecks are top of most firms' agendas.

NO RELIEF FROM OVERSEAS

Our two foreign picks, US internet search and advertising firm **Alphabet (GOOG:NASDAQ)** and Swiss pharmaceutical giant **Roche (ROG:SWX)**, have both seen share price declines since we said to buy.

Alphabet delivered in-line revenues and earnings last quarter and announced a $70 billion buyback, but tech stocks remain out of fashion with investors.

Meanwhile, the news flow on Roche had been uniformly positive until the firm recently suffered various setbacks. In May, trial data showed its cancer drug failed to slow the disease

Shares' 2022 stock portfolio

	Entry price	Latest price	Change
Tate & Lyle	650.6p	763.2p	17.3%
London Stock Exchange	£68.52	£77.30	12.8%
IOG	30.82p	32p	3.8%
Jet2	971.8p	906.4p	−6.7%
Roche	CHF 401.8	CHF 373.80	−7.0%
Alphabet	$2,848	$2,181.62	−23.4%
Schneider Electric	€164.66	€113.10	−31.3%
Loungers	278.5p	181.5p	−34.8%
Accsys	171.75p	110p	−35.8%
Pets at Home	467.6p	280.38p	−40.0%
TOTAL			**−14.5%**
FTSE All-Share	**4,134**	**3,975.6**	**−3.8%**

Table: Shares magazine • Source: Shares, Google Finance. Entry prices taken 21 Dec 2021. Latest prices taken 4 July

in patients with lung cancer, and in June it revealed its Alzheimer's drug failed to slow or prevent cognitive decline.

BEST OF THE BUNCH

Compared with our other discretionary spending picks, airline **Jet2 (JET2:AIM)** has weathered the first-half storm relatively well.

The business recovered quickly from the Omicron variant and the reimposition of travel restrictions at the start of the year, with passenger numbers almost back to seasonal norms in March.

Summer bookings are nearly 20% ahead of pre-pandemic levels with package holidays growing in popularity, which is good for margins.

Elsewhere, shares in gas and infrastructure operator **IOG (IOG:AIM)** are up nearly 4% since we said to buy last December following a tumultuous half-year for gas prices amid the invasion of Ukraine.

On 23 May, FinnCap analyst Jonathan Wright cut his 2022 earnings forecasts after some teething problems with IOG's Saturn Banks development and a record discount for UK versus European gas prices. However, he added: '(We) still see significant upside potential from IOG's exposure to structurally higher long-term gas prices.'

In contrast, it has been plain sailing so far for our only financial pick, **London Stock Exchange (LSEG)**, which is up 12.8% since we said to buy last December.

The firm continues to make strong financial and operational progress with total income growing by mid-single digits in the first quarter helped by the capital markets division.

The star performer in our portfolio has been food and beverage solutions manufacturer **Tate & Lyle (TATE)** which has gained 17.3% this year.

Demand for the firm's ingredients has been robust and its investment in innovation is paying off with a spike in new product revenues.

By **Ian Conway** Companies Editor

M&G Investments

Finding credit income that rises with interest rates

For a full list of terms used on this webpage, please visit here

UK INTEREST RATES EXPECTED TO RISE

UK inflation continues to hit multi-decade highs, with the consumer price index (CPI) reaching 9.1% in May, driven by spiralling food and energy costs . To counter this, the Bank of England has begun to raise interest rates in 0.25% increments, with some Monetary Policy Committee members now calling for more aggressive action. For bond investors, this could present challenges, as bond prices typically fall when interest rates rise – and after a decade of ultra-loose monetary policy, many investment portfolios struggle to generate enough income to buffer inflation.

ALTERNATIVE CREDIT INVESTMENTS CAN OFFER VARIABLE INTEREST PAYMENTS

Although the majority of government and corporate bonds pay fixed interest coupons, other types of credit investment may pay variable levels of income. This means the income rises or falls in line with market interest rates, normally based on the Bank of England's SONIA (Sterling Overnight Index Average) rate or equivalent US and European cash rates.

When interest rates are rising, these credit investments should help to preserve a portfolio's capital value, while also providing investors with higher income. Such deals are often privately negotiated between large lenders and borrowers, or they may require specialist expertise and resources to analyse, which means they are broadly considered 'private debt' or non-standard public debt. Many investors therefore cannot access these deals directly. However, for large, specialist fund managers, they can offer a considerable income premium over corporate bonds with equivalent credit risks.

M&G CREDIT INCOME INVESTMENT TRUST

M&G is one of the UK and Europe's leading private debt investors, with one of the region's largest in-house credit research teams, which gives us access to deals unavailable to other asset managers.

The trust aims to provide an annual dividend of 4% above UK cash rates (SONIA) using a flexible portfolio of public and private debt of overall investment grade credit quality. It is designed for investors who want higher income without the associated increase in volatility in net asset value (NAV) that this may entail, for example, by investing in dividend-paying stocks, real estate or high yield bonds.

With market conditions expected to remain challenging for traditional government and corporate bonds, we believe these variable rate credit investments could offer important diversification for investors seeking regular, rising levels of income in the period ahead.

For more information, please click here.

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The value of investments will fluctuate, which will cause share prices to fall as well as rise and you may not get back the original amount you invested. There is no guarantee that the Company's Investment Objective will be achieved.

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Changes in interest rates may adversely affect the market value of some of the Company's investments.

Debt instruments may be repaid by issuers at short notice: as a result it may be difficult for the Company to reinvest capital at an attractive price or at all, which may affect it adversely.

A variety of factors, such as market conditions, liquidity concerns or Company performance may lead to a reduction in trading volume or shares trading at a discount to their net asset value. Shareholders may also be unable to realise their investment at quoted prices or at all. Please note this is not an exhaustive list, please refer to the risk section in the Prospectus for further details.

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FREE HALEON SHARES FOR GLAXO INVESTORS

When it happens and what to expect

Shareholders in pharmaceutical company **GSK (GSK)** – also known as Glaxo or GlaxoSmithKline – have a big decision to make later in July when potentially 25% to 35% of the value of their investment will be handed back to them in the form of new shares in GSK's consumer healthcare unit, Haleon.

Investors will effectively have three choices; keep their shares in Haleon, sell the shares and reinvest back into GSK, or sell the shares and reinvest elsewhere.

In this feature *Shares* reveals the key facts and investment considerations needed to make an informed decision.

WHY IS IT HAPPENING?

The board of GSK believe both companies will be able to operate more successfully as separate entities.

The product focus and investment requirements of the two businesses are very different. For example, GSK spends around 15% of sales on research and development compared with 3% at Haleon.

The split will allow GSK to focus on biopharmaceuticals, developing innovative vaccines and specialty medicines. Meanwhile, Haleon provides an opportunity to invest in a world-leading focused portfolio of category-leading consumer health brands including Panadol painkillers and Sensodyne toothpaste.

The name Haleon was created from old English words meaning 'in good health' and 'strength' from 'Hale' and 'Leon' respectively.

By **Martin Gamble** Education Editor

WHEN IS THE DEMERGER?

The demerger will happen on 18 July. Eligible GSK shareholders will be given one share in Haleon for each share owned in GSK.

Haleon's ordinary shares will be listed on the premium segment of the London Stock Exchange and should join the FTSE 100 index soon after.

Prior to the demerger, the holding company for Haleon will pay dividends worth more than £7 billion to GSK and joint venture partner **Pfizer (PFE:NYSE)**.

Following the demerger at least 54.5% of Haleon will be held by GSK shareholders, 13.5%

by GSK itself and 32% by Pfizer.

Pfizer is also transforming its business into a more focused global leader in science-based innovative medicines and vaccines. The US company has said it intends to sell down its stake in Haleon in a disciplined manner.

Pfizer's stake could be worth more than £11 billion which might be viewed by some investors as an 'overhang' of stock.

That said, GSK and Pfizer have agreed to a lock-up of their respective holdings until 10 November 2022 at the earliest.

WHAT HAPPENS ON DEMERGER DAY?

Market conditions will determine how the shares trade on the day, but it is likely GSK shares will fall to reflect that it has handed a big chunk of its stake in Haleon to shareholders and so it has fewer assets.

After the market close on 18 July GSK will consolidate its existing shares, returning the share price to around the same level as before the demerger. This will ensure the comparability of earnings per share with prior periods.

EVERYTHING YOU NEED TO KNOW ABOUT HALEON

In 2018 GSK bought **Novartis' (NOVN:SWX)** 36.5% stake in their consumer healthcare joint venture for £9.2 billion. In 2019 GSK merged its consumer healthcare interests with assets from Pfizer under a new joint venture to create what is now Haleon.

Non-core brands have been divested, leaving a more focused business with so-called 'power brands' now representing nearly 60% of revenues.

Haleon has grown its revenues by a compound annual growth rate of 12% a year since 2014 to £9.5 billion and EBITDA (earnings before interest, tax, depreciation and amortisation) by 18% a year to £2.4 billion, expanding the margin from 15.2% to 22.8%.

The number of manufacturing sites has been reduced from 41 in 2015 to 24 in 2021. More than 80% of products sold are locally sourced.

Management anticipates delivering 4% to 6% organic annual revenue growth with a sustainable moderate margin expansion and a high cash conversion.

The growth strategy includes making selective bolt-on acquisitions to supplement organic growth as Haleon aims to consolidate a fragmented consumer healthcare industry.

To give an idea of the extent of market fragmentation, Haleon is the market leader in pain relief through 'power brands' including Panadol, Voltaren and Advil but only commands a market share of 15%.

Haleon market position and growth rates

	Oral Health	Vitamins, Minerals and Supplements	Pain Relief	Respiratory Health	Digestive Health
Position	3	1	1	1	1
Revenues (£bn)	2.7	1.5	2.2	1.1	2
Market Size (£bn)	25	46	15	22	42
Growth	3%-4%	4%-5%	2%-3%	2%-3%	2%-3%
Market Share	11%	3%	15%	5%	5%

Table: Shares magazine • Source: GSK. 2021 data, apart from growth which is 2019 to 2021

THE STRUCTURE OF HALEON

The portfolio of brands is divided into oral health, vitamins, minerals and supplements, pain relief, respiratory health and digestive health.

The global consumer healthcare market is worth around £150 billion, implying Haleon has just over 6% market share. The largest segment is vitamins, minerals and supplements (£46 billion) where Haleon holds the leading position through its Centrum brand.

Haleon is a global business and generates 41% of revenues from Europe, Middle East, Africa and Latin America, 37% from North America and 22% from Asia Pacific. Just over two thirds of sales are generated from developed markets.

HALEON'S COMPETITIVE ADVANTAGE

The company has deep technical and scientific capabilities and employs over 1,400 highly skilled scientists. It has a strong scientific pedigree which has seen 19,000 regulatory applications and approvals made over the last three years.

These capabilities provide insight into consumer health needs and drive sustainable growth through increased penetration of the existing market as well as emerging opportunities.

Haleon has built strong routes to market and possesses effective distribution capabilities. For

Haleon revenues and growth by region

	Revenues (£bn)	2019-2021 Growth (%)
North America	4	3
Asia-Pacific	2	8
EMEA and LATAM	4	4
Market Growth	n/a	2

Table: Shares magazine • Source: GSK

example, it has direct relationships with around 3 million healthcare professionals, and it has developed broad pharmacy coverage.

The relationship with healthcare professionals is important because practitioners exert considerable influence on first time and repeat purchases.

Management claim 85% of pharmacist recommendations lead to a purchase and those healthcare professionals that have close relationships with Haleon recommend its products up to five times more per week in some markets.

WHAT IS THE GROWTH STRATEGY?

Since 2019 Haleon has disposed of businesses which cumulatively had around £1 billion of revenues, of which 90% had experienced negative growth trends.

These actions have mathematically increased the growth potential of the remaining portfolio.

Growth is anticipated to come from increased penetration of the faster growing segments such as oral health and vitamins, minerals and supplements which are expected to grow in mid-to-high single percentage digits.

By 2025 these segments are expected to be generating around half of total revenues.

Emerging markets are expected to grow in high single percentage digits and to grow their share of total revenues from 31% to the high 30s.

The e-commerce channel is expected to be the fastest growing segment, increasing in double digits, and to double its share of total sales to a mid-teen percentage by 2025.

Haleon revenues and growth split by emerging/developed territories

	Revenues (£bn)	2019-2021 Growth (%)
Emerging markets	3	10
Developed markets	7	2

Table: Shares magazine • Source: GSK

HOW MUCH MONEY DOES IT MAKE?

In the past two years Haleon has generated an average £1.6 billion of free cash flow a year. This represents 17% of revenues.

The company has provided clear guidance on how it plans to use future free cash flows. The priorities are to invest to support sustainable growth, pay dividends and reduce debts.

Haleon aims to reduce its net debt to EBITDA ratio (a measure of financial leverage) to below three times by the end of 2024 and to maintain a strong balance sheet.

This implies Haleon will join the stock market with some debt despite historically having operated without any debt while inside GSK.

It is anyone’s guess how much debt it will have, but it will be greater than £7.2 billion. The logic is that if the goal is to reduce leverage to below three times by 2024, it must be greater than three times today (£2.4 billion EBITDA x 3).

Our best guess is that Haleon will list with around £10 billion of debt.

WHAT IS HALEON WORTH?

GSK has already rejected a £50 billion takeover approach from consumer goods giant **Unilever (ULVR)** on the grounds it undervalued the business and its potential.

The Unilever offer was made for the company including net debt. If £10 billion of net debt is in the right ballpark, it suggests Haleon could list with a price tag of at least £40 billion.

We are assuming management doesn't want the embarrassment of listing Haleon at a price below an offer it rejected on valuation grounds.

One 'get out of jail' card that management could use is 'difficult market conditions' but arguably that was also the case in March when Unilever made its move.

A different way to look at the potential listing value is to use peer metrics. US group **Procter & Gamble (PG:NYSE)** trades on an EV (enterprise value) to EBITDA ratio of 17.8 according to Stockopedia data.

Putting a similar rating on Haleon implies an enterprise value of £42.7 billion (£2.4 billion x 17.8). Deducting anticipated net debt implies £32.7 billion of equity value.

The above analysis provides a broad range for the equity value of the business of between £33 billion and £40 billion.

One final consideration for prospective investors is that if Haleon lists at the lower end of the range it may become a takeover target.

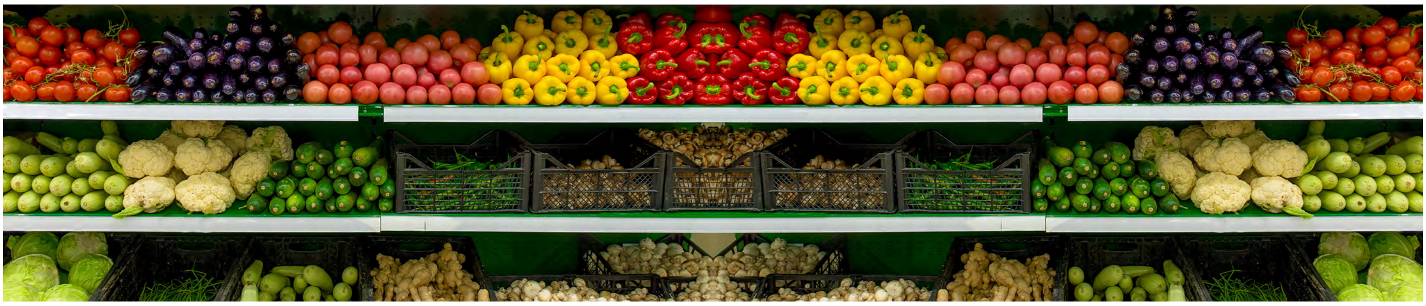
WHAT ABOUT THE SLIMMED-DOWN GSK?

Following the demerger GSK will be a pureplay biopharma and vaccines business. We believe it is an attractive business which offers double-digit profit growth potential over the medium term.

The presence of activist investors will keep management's 'feet to the fire' and ensure further operational improvements. The 2022 PE ratio of 14.8 looks attractive relative to the growth potential and quality of the business.

The relative attractiveness of GSK versus Haleon will become clearer when the valuation of Haleon is known.

Both companies are high quality businesses and offer defensive qualities to a well-diversified investment portfolio during difficult markets.



How trading down could affect supermarkets and consumer goods companies

History shows households typically tighten their purse strings in tough times

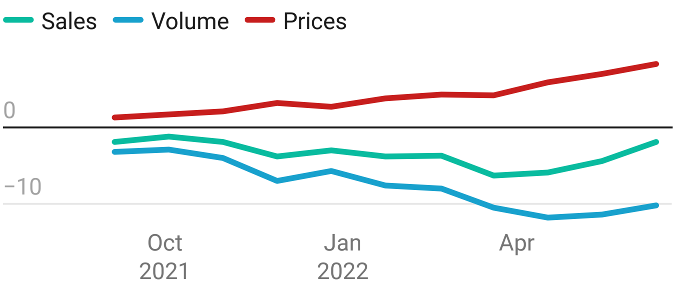
When supermarket giant **Tesco (TSCO)** posted its first quarter trading update, chief executive Ken Murphy made a reference to 'changing customer behaviour as a result of the inflationary environment'.

His comment reverberated through the market, unsettling investors who had come to rely on the grocery sector as dull but dependable – after all, whatever else is happening in the world, we all must eat.

Murphy was essentially describing how the sharp rise in inflation is having a profound effect on how and where we spend our money.

UK grocery sales by volume and grocery prices

12 week preceeding period



Inflation as measured over last 4 weeks of the 12-week period

Chart: Shares magazine • Source: Kantar Worldpanel. Data correct as of 30 June 2022

SMALLER BASKETS

Two things have become apparent since last summer according to the monthly 'till roll' data provided by consultancy Kantar Worldpanel.

The first is that the volume of items we're buying at the supermarket has been falling as prices have been rising.

While the underlying strength of sales has been hard to pin down due to the pandemic – which drove a huge spike in consumption in 2020 and a subsequent fall in 2021 on a comparable basis – the data from Kantar has shown a steady fall in the number of items in the typical family shopping basket.

Since grocery inflation turned positive in the 12 weeks to early September 2021, sales by volume have steadily fallen whereby in the latest period to mid-June they were down over 10%.

They were flat in the same period last year, so we aren't comparing a weak period with a particularly strong period; we are seeing a fundamental change in shoppers' behaviour.

VALUE PROPOSITION

The second obvious change in spending, which pre-dates the pandemic but has accelerated sharply since the economy reopened, is the rise in popularity of the discount retailers Aldi and Lidl.

Frustratingly for investors, you cannot buy shares in these companies as they are privately-

owned businesses.

What makes Aldi and Lidl's success noteworthy is the fact they saw very little benefit whatsoever from the channel shift to online during lockdown because they didn't offer the type of delivery and click and collect services enjoyed by the likes of Tesco, Asda and Morrisons.

Aldi launched click and collect on a very limited basis in late 2020 and it temporarily offered small basket grocery orders via Deliveroo during the pandemic, but the latter was stopped in early 2022. Lidl remains an in-store proposition only.

From being something of a curiosity to most people 10 years ago, the German duo have steadily raised their joint share of the UK grocery market from a little over 11% five years ago to nearly 16% today.

Sainsbury's (SBRY) has a 14.9% market share, Asda is at 13.7% and Morrisons at 9.6%.

With a 27.3% market share, Tesco may still take nearly one pound in three at the tills, but Aldi and Lidl between them are taking another pound in every six that we spend on groceries.

TRADING DOWN

Referring to the 8.3% year-on-year increase in grocery prices in the month to mid-June, which marked the highest level since April 2009, Fraser McKevitt, head of retail and consumer insight at Kantar, said inflation 'makes for difficult reading and shoppers will be watching budgets closely as the cost-of-living crisis takes its toll'.

According to Kantar's own research, the average annual grocery bill is expected to rise by £380 this year, over £100 more than its previous estimate in April, demonstrating just how steep recent price rises have been.

As a result, shoppers are taking steps to manage rising prices, says McKevitt.

'Shoppers have swapped branded items, which have declined by 1%, for own-label products,' he adds. 'Sales of these lines, which are often cheaper, have risen by 2.9%, boosted by Aldi and Lidl's strong performances, both of whom have extensive own-label repertoires.

'We can also see consumers turning to value ranges, such as Asda Smart Price, Co-op Honest Value and Sainsbury's Imperfectly Tasty, to save money and together all value own-label lines grew by 12%.'

Increase in input prices year-to-date compared with 2021 average

In US dollars

Product	Increase
Palm oil	77%
Barley	51%
Wheat	45%
Coffee	37%
Whey powder	34%
Corn	23%
Soybean	23%
Skimmed milk powder	18%
Tissue pulp (Europe)	14%
White sugar	10%
Ethanol	3%

Table: Shares magazine • Source: Berenberg, Datastream. Data correct as of 24 June 2022

There is a certain irony in the surge in popularity of the discounters. Although they would never admit it, the fact their prices are so low to start with means they can raise them by more than the mainstream supermarkets and relatively speaking still appear to offer good value.

That value for money image, reinforced by clever marketing comparing the price of a trolley full of items with the same items at Tesco or Sainsbury's, means Aldi and Lidl continue to attract shoppers looking to make their money go further.

FACING THE CHALLENGE

A survey in March by environmental campaign group Hubbub showed a quarter of shoppers were buying more own-brand products and nearly a fifth were buying more tinned and frozen goods to avoid having to shop so often.

According to Tesco's Murphy, the biggest shift to own-brand sales has been in staples such as pasta, bread and baked beans which have seen some of the biggest price increases.

Not only do the supermarkets need to work out how to beat the discounters, but big branded food, drink and household goods companies need to think about how they are going to keep customers buying their products.

Tesco has the advantage of its Clubcard, which rewards loyal customers with special discounts, so it can push greater volumes through its stores and online.

Retail Gazette cites analyst Bryan Roberts as saying Tesco's Clubcard is 'the best loyalty programme in the world right now'.

Another shift in shopping behaviour is customers setting themselves strict budgets to make sure they only buy the essentials.

Asda chairman Stuart Rose says shoppers are worried about spending. 'They say £30 is one limit and if they get to more than £30 that's it; it's the same with petrol.'

Simon Roberts, chief executive of Sainsbury's, says the chain has noticed an increase in sales of frozen goods, which are cheaper and last longer than fresh produce, as shoppers look to make their money go further.

'People are looking at making sure they don't incur any waste and don't buy products they may not use,' explained Roberts.

WINNERS AND LOSERS

Food and household goods firms are facing sharp

Typical price premium for most popular brand vs supermarket own-label

Product	Premium
Shaving foam	540%
Deodorant	420%
Pain relief	320%
Biscuits	300%
Condiments	210%
Laundry detergent	200%
Shampoo	180%
Breakfast cereal	150%
Ice cream	120%
Household cleaner	100%
Bottled water	100%
Yoghurt	100%

Table: Shares magazine • Source: Berenberg, Tesco. Data correct as of 24 June 2022

increases in their own costs and are planning – or at least hoping – to raise prices themselves in the second half of this year.

Research by investment bank Berenberg showed over half the packaged food and consumer goods companies under its coverage had seen an increase in input prices since March.

The most notable price rises in foodstuffs this year have been in palm oil, barley, wheat, whey powder, corn, soybeans, sugar and skimmed milk powder, according to the bank's research.

It also found manufacturers' branded products tended to sell at an average price premium of 160% to supermarket own-brand products on an equivalent unit basis.

In certain categories, brand loyalty is relatively high and the risk of consumers trading down is low, which means some firms should be able to pass on moderate price increases and protect their margins.

When it comes to buying infant formula, baby food or pet food, for example, we tend to stick to the brands we know and trust, which is good news for Swiss firm **Nestle (NESN:SWX)** which makes all three products.

On the other hand, when it comes to buying staples like pasta and rice, or bottled water, snacks, yoghurts, cooking ingredients and even breakfast cereals, we are much less brand-conscious and are happy to trade down.

That is bad news for French firm **Danone (BN:EPA)**, which owns the Evian and Volvic water brands as well as being one of the world's leading makers of yoghurt. It is much less likely to be able to raise prices if it wants to avoid customers deserting its brands.

In terms of fresh prepared food, **Bakkavor (BAKK)** makes own-brand products for the supermarkets and has been able to pass through price rises without affecting volumes.

In the ingredients market, **Tate & Lyle (TATE)** seems to be insulated as it supplies sweeteners and other solutions to food and drink manufacturers, who without its 'special sauce' wouldn't be able to sell their own products.

Unfortunately, for the makers of household goods such as laundry cleaners, dishwasher tablets, household cleaning products or even personal products such as deodorants, research suggests we are quite happy to seek out a value alternative if we need to save money.

That is obviously bad news for firms like **Unilever (ULVR)** and **Reckitt Benckiser (RKT)**, which have seen sharp rises in the price of commodities such as ethanol used in their personal hygiene and home cleaning products.

In addition to headwinds in personal and home care, Berenberg sees Unilever's large exposure to ice cream as another area of concern as it is particularly vulnerable to consumers trading down.

Given the firm's reliance on raising prices to avoid a decline in the value of its sales, Berenberg says to avoid Unilever's shares for now.

By **Ian Conway** Companies Editor

BuzzFeed and LADbible get plenty of clicks but their shares have been a flop

Investors are worried about a slowdown in advertising

Two companies at the cutting edge of modern media have got hundreds of millions of people devouring their stories. They've become kings of content which goes viral, with users reposting articles and video clips across social media.

Big viewer numbers are music to the ears of advertisers who are eager to push products in front of all these people digesting the viral content.

On this basis, you might expect the owners of media outlets BuzzFeed and LADbible to be interesting investments. The market says otherwise, with shares in both companies having been a disaster.

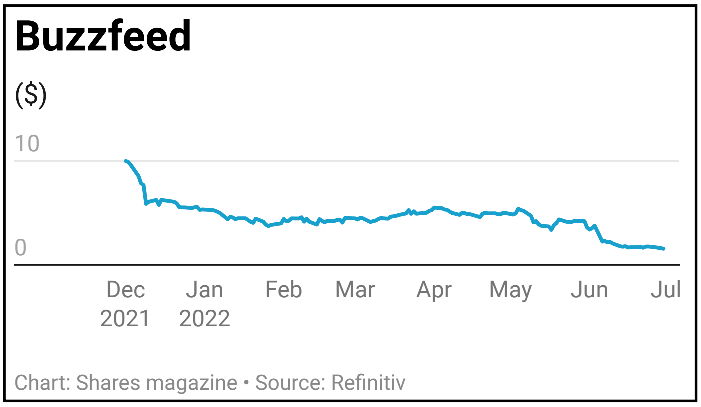
BuzzFeed (BZFD:NASDAQ) went public on 6 December 2021. The shares opened 14% higher on day one at $10.95 but have since fallen by 86% to $1.54. Last month they fell by 41% in a single day after restrictions were lifted on staff and major shareholders being able to sell stock.

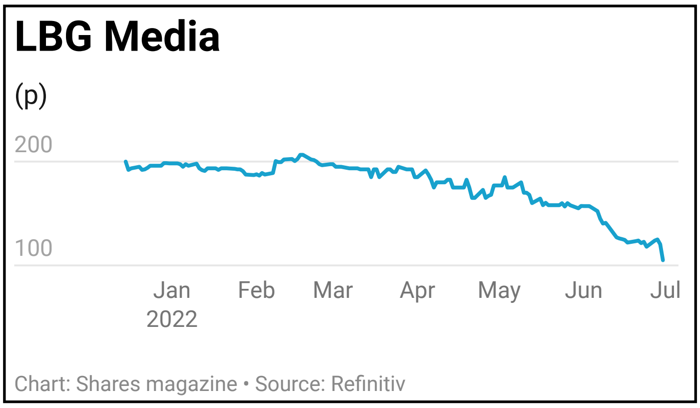
LADBible publisher **LBG Media (LBG:AIM)** joined the UK stock market a week after BuzzFeed, listing at 175p on 15 December 2021. Today those shares trade 39% lower at 106.12p.

WHY HAS BUZZFEED FLOPPED?

BuzzFeed's popularity is dissipating. The time users spent engaging with its content declined by 4% during the first three months of this year compared to 2021.

The group also suffers from having gone public via a special purpose acquisition vehicle, also known as a SPAC.





BuzzFeed's life on the markets was doomed from the start as 94% of the $287.5 million raised by the SPAC was subsequently withdrawn by investors before the media group went public.

Compounding these concerns, the current outlook for BuzzFeed's second quarter anticipates revenue growth in the low 20s in percentage terms. Analysts had previously been forecasting 35% year-on-year revenue growth.

DIVERGRENT TRENDS

BuzzFeed's 2022 first quarter results revealed several areas of weakness. Revenues of $92 million (26% year-on-year growth) were below the analyst consensus forecast of $94.5 million.

Equally disconcerting, the group's net loss quadrupled to $44.6 million, a loss of $0.33 a share. This was significantly worse than the consensus analyst forecast of $0.21 loss per share.

In sharp contrast to its American counterpart, LBG Media reported more upbeat full-year results on 21 April.

Group revenue increased by 80.6% year-on-year and group adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) more than tripled to £16.8 million.

Growth has been broad-based across all divisions and regions, as the group's content continues to resonate with its engaged and valuable youth audience. Put simply, people watched more of its content for longer.

Despite the similarities in the LBG and BuzzFeed business models the former has outlined a more encouraging outlook compared to that articulated by its American counterpart.

In April LBG confirmed current year trading was in line with market expectations. In contrast, BuzzFeed's guidance for the second quarter was considerably below analysts' expectations.

COMPETITIVE MARKET

THERE ARE TWO other key players in the same market as BuzzFeed and LBG.

Vice – This is a print and digital media company focused on arts, culture and news topics. It targets Millennials and possesses circa 55 million followers.

Jungle Creations – This is a social-first publisher, creating and distributing content through its network of media brands. It targets Generation Z and has circa 76 million followers.

HOW DO BUZZFEED AND LBG MAKE MONEY?

BuzzFeed generates income through various means including display advertisements. If a viewer clicks on an advert and subsequently purchases the product being promoted, BuzzFeed receives a commission payment.

It is active on a variety of video-enabled platforms including YouTube, Instagram, Facebook and SnapChat, all of which carry advertisements against its content.

It has accumulated a considerable following with over 20 million subscribers on YouTube and 12 million followers on Facebook.

LBG'S APPROACH TO MONETISING CONTENT

LBG chief financial officer Tim Croston tells *Shares*: 'If you were comparing us to BuzzFeed there are two points I would highlight.

'First, we have a well-balanced and diversified business model. We have a 50/50 split between content marketing, where we have a direct relationship with the client, and indirect marketing.

'With respect to content marketing we are making bespoke content and retain the intellectual property.'

The group's in-house agency provides campaign creation and production, with campaigns subsequently distributed across the group's social media and website platforms. LBG uses these to generate and collect real-time feedback for brands.

Croston adds: 'The second area is indirect, which is more comparable with BuzzFeed which is income coming from web or social video via platforms like Facebook.'

Indirect revenues are created through a revenue-share model with social media platforms for advertisements sold alongside LBG media content, typically on a 50:50 revenue-share basis.

POPULARITY CONTEST

LBG's global audience grew by 13% to more than 264 million during 2021, while content views increased 97% to 62.9 billion. The company's content was viewed for a combined 53 billion minutes, a 14% year-on-year increase.

This contrasts with BuzzFeed where the time users spent engaging with its content declined during the first three months of 2022.

According to the latest estimates from Berenberg, LBG is forecast to grow net profit from £5 million in 2021 to £11 million this year and £13 million in 2023. The investment bank believes LBG will chase opportunities in North America as a key driver of future earnings growth.

BuzzFeed is expected to remain loss-making for at least the next three years, according to market estimates published by Refinitiv.

In the current environment, investors have lost interest in loss-making companies which would suggest that LBG has more going for it than BuzzFeed. Berenberg has a 'buy' rating on LBG, calling it the 'industry-leading youth publisher'.

LBG trades on 6.4 times 2023 enterprise value to EBITDA which is not excessive, neither is a price to earnings multiple of 14.5.

The key risk to earnings estimates is a decline in advertising activity which we're already seeing across platforms like YouTube. Therefore, investors interested in LBG should appreciate there are clear risks to profits and that negative sentiment could weigh on the share price for longer.

By **Mark Gardner** Senior Reporter

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DANNI HEWSON
AJ Bell Financial Analyst

Dark days: have companies got the right leader in place?

We're seeing a lot of change at the top which might make investors nervous

The fact that **Whitbread's (WTB)** share price fell when it said Alison Brittain would step down from her position as CEO implied that investors didn't think now was a good time to rock the boat and bring in a new leader.

Difficult economic conditions call for stability in leadership and a change at the top is a big deal, even if it's been telegraphed, choreographed and planned down to the tiniest detail, as that change heralds a period of volatility.

How long that volatility lasts often depends on the reason behind the departure and the person appointed to step into the breach.

In the case of Whitbread there are questions about the timing coming so soon after shareholders kicked back at remuneration package plans. But there had been hints that retirement could be in the offing before last month's AGM and certainly Brittain has steered the ship through some particularly trying times.

Whitbread's volatile 10 years

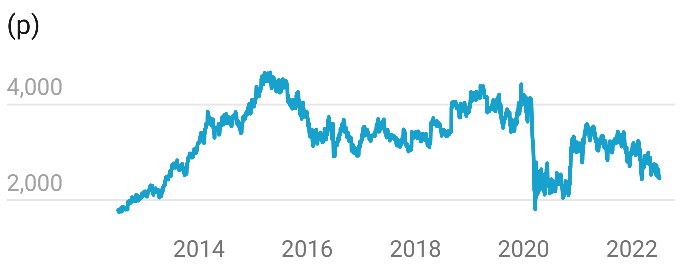


Chart: Shares magazine • Source: Refinitiv

During her reign the business has been streamlined with Costa Coffee sold to **Coca-Cola (KO:NYSE)**, Covid took its own toll and the share price slumped by more 30%. But the last trading update delivered plenty of green shoots with the lucrative Premier Inn operation going from strength to strength, even if Whitbread's pub empire is still trying to battle back to fighting weight.

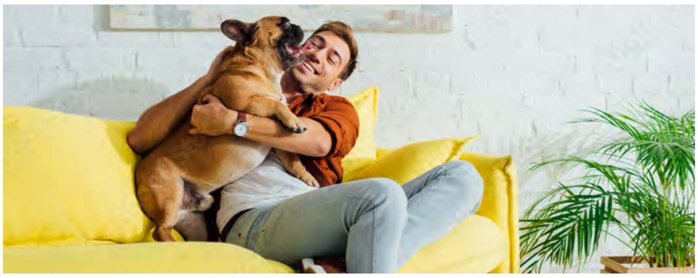
Brittain's replacement seems to have been thoughtfully chosen. Dominic Paul is a former insider with a real understanding of the way Whitbread works. He's somebody who has had the chance to spread his wings, to develop his own style and the confidence to act without looking over his shoulder. It's notable that the share price of his current employer, **Domino's Pizza (DOM)**, also dropped on the news of his forthcoming departure, a nod to his capability in the top job.

INFLATION CHANGING THE GAME

Succession plans can soothe nerves if they're delivered correctly but even with every duck lined up, losing a boss who has made shareholders a lot of money can be hard to get over. Peter Pritchard is such a boss and **Pets at Home's (PETS)** shares jumped in value by more than 200% during his time as CEO.

DANNI HEWSON

AJ Bell Financial Analyst



Pets at Home 10-year surge

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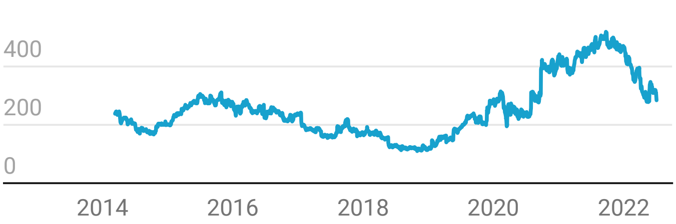

Chart: Shares magazine • Source: Refinitiv

The success enjoyed over the last couple of years can't be ascribed wholly to the man at the top. Pets at Home was undoubtedly a pandemic winner, cashing in on the boom of pet ownership which occurred when people's work/life balance was flipped on its head. But under his leadership the business was able to grab hold of that opportunity, focus on areas of growth like pet clothing and update the online offer to better serve customers during lockdowns.

Pritchard left the business on a high albeit tempered by warnings that inflation was already beginning to bite, and analysts at RBC have recently downgraded the stock arguing the good times are coming to an end.

These choppy waters would be tough for any CEO to navigate but investors are less likely to put their trust into a boss that's untried, and despite Lyssa McGowan's impressive resume she hasn't had the chance to prove herself at the retailer.

The lack of experience in a post is something that's troubling city bosses. The *Financial Times*' City Network, a forum of over 50 senior executives from a range of backgrounds, recently warned that a damaging recession is likely. They worried that many managers haven't had to deal with the kind of severe economic shocks that could well be heading our way.

Investors, already spooked by the volatility gripping global markets, want to know that whatever is coming down the tracks there is some certainty they can grab onto, and continuity at the top could make all the difference to investor sentiment in the short term.

But in the case of **JD Sports (JD.)** the hasty departure of long-term boss Peter Cowgill followed by commitments to radically overhaul the corporate structure leaves investors rather short of certainty and wary of what might still be hiding in the retailer's closet.

The sudden departure of a boss is never pretty and it's even more difficult for investors to stomach when the boss in question has delivered the kind of stratospheric rise in share price seen during Cowgill's tenure.

Where next for JD Sports?

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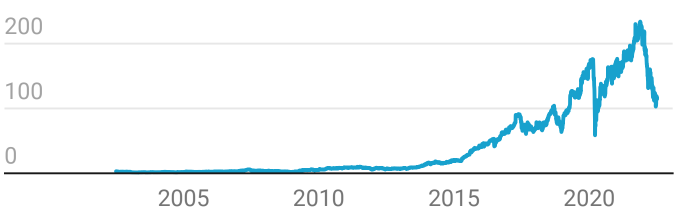

Chart: Shares magazine • Source: Refinitiv

Despite the business enjoying stellar growth, behind the scenes there are questions about how some of that growth came about. The competition watchdog has already issued one fine for breaching takeover rules and another investigation into price fixing is expected to cost the business millions more.

Familiarity and experience are great, but the roll of CEO is complex and exhausting. If the boss is ready to move on, or if change is needed, familiarity can become a detriment. And there's a lot to be said for new blood, new energy and new ideas. Plus, if the corporate structure is sound, if the company culture is set and the ship is a happy one, the CEO you know might not be the CEO you need.

How popular capital preservation funds stand apart

We compare Capital Gearing, Personal Assets, RIT and Ruffer

There are dozens of different investment strategies, but most investors are largely looking to either build wealth for the long run or look after what they already possess. This latter objective is what capital preservation funds are designed to do.

There are a handful of specialist investment trusts which fall under the capital preservation banner, including **Capital Gearing Trust (CGT)**, **Personal Assets Trust (PNL)**, **RIT Capital Partners (RCP)** and **Ruffer Investment Company (RICA)**.

Protecting your wealth is important when approaching or enjoying retirement, since your investments should hopefully provide the cash needed to pay the bills, keep the fridge stocked, cover healthcare costs, and ideally, allow you to go to a restaurant for a nice meal or to the theatre occasionally.

GROWING IN POPULARITY

Hellish global stock markets this year have seen an increasing number of investors drawn to investment opportunities with a blueprint to not lose money.

'The relevance of capital preservation trusts has never been greater,' says Duncan MacInnes, co-manager of Ruffer. 'We've been talking about the return of inflation and cross-asset correlations for two years and people thought we were a bit crazy.'

The topic now gets far less push back because you can see inflation for yourself in daily life, the manager says.

Long-term performance figures show that Capital

Gearing, Personal Assets, RIT and Ruffer have made investors money as well as stopping them from losing it. 'We have an investment objective to protect and increase the value of shareholders' funds over the long-term, in that order,' says Troy Asset Management, which runs Personal Assets Trust.

PRODUCT COMPARISON

There are subtle differences between each trust. One of the most important is investment complexity, believes Ruffer's MacInnes. Capital Gearing and Personal Assets inhabit the simple end of the 'spectrum of complexity', says the manager, in that their strategies are not difficult for most investors to understand.

At the more complex end, there's RIT and **BH Macro (BHMG)**, which tend to invest in higher risk assets using complicated instruments, such as equity hedging, take stakes in less liquid privately-owned businesses, and are happier using gearing, or borrowing money to invest.

Ruffer sits somewhere in the middle, says MacInnes, and a point made clear by its controversial investment in bitcoin at around $48,000 in November 2020. Yes, it sold out within six months at about $65,000, netting a very handsome profit. But for many capital preservation investors, that's not the sort of risk they want their

Popular capital preservation trusts compared

	Ongoing charges	Gearing	Discount to NAV	Income yield
Capital Gearing	0.5%	0%	3.2%	0.9%
Personal Assets	0.7%	0%	1.6%	1.2%
RIT Capital Partners	0.7%	11%	9.3%	1.6%
Ruffer Investment Co	1.1%	0%	1.9%	1.0%

Table: Shares magazine • Source: AIC

Which shares have the best total return?

	One year	Three years	Five years	10 years
Capital Gearing	2.8%	20.0%	33.0%	70.0%
Personal Assets	1.6%	18.0%	27.0%	62.0%
RIT Capital Partners	-2.5%	19.0%	36.0%	127.0%
Ruffer Investment Co	5.4%	41.0%	32.0%	70.0%

Table: Shares magazine • Source: AIC

funds to take.

Transparency also sets apart capital preservation trusts. Investors easily can find the largest holdings of Capital Gearing, Personal Assets and Ruffer on their respective websites, plus complete portfolio breakdowns on a semi-regular basis.

In contrast, RIT provides limited detail on its portfolio composition, although the Association of Investment Companies' website has more thorough information on specific stocks owned.

For example, at the end of May, Capital Gearing's largest stake was its holding in the **iShares MSCI JP ESG Screened Japan ETF (SAJP)**. For Personal Assets, gold is its biggest stake at 9.1% of the fund.

Ruffer's largest equity holding is 3.2% of assets in **BP (BP.)**. At around 30% of funds invested, Ruffer has a larger proportion of its portfolio in equities.

The difference in complexity is reflected in share price performance. RIT trades on a 9% discount to net asset, according to the AIC, whereas its capital preservation peer group remain within two or three percentage points of net assets.

BUMPY OR SMOOTH INCOME?

Dividends is another area where the pool of trusts differ. For example, Ruffer aims to distribute more than 85% of the net income received from investments each year, but it will not use capital to prop up dividends, which can mean fluctuating payouts.

Personal Assets pays quarterly dividends whereas Capital Gearing only pays them once a year.

While at first glance capital preservation trusts may look like an off-the-shelf investment option, investors should read through all the details before investing.

Some have a better record for retaining value for investors, others for consistency of income, while they all will carry varying degrees of exposure to equities and bonds, and in some cases, other more complicated assets.

By **Steven Frazer** News Editor

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Rathbone Global won't change approach despite end of winning streak

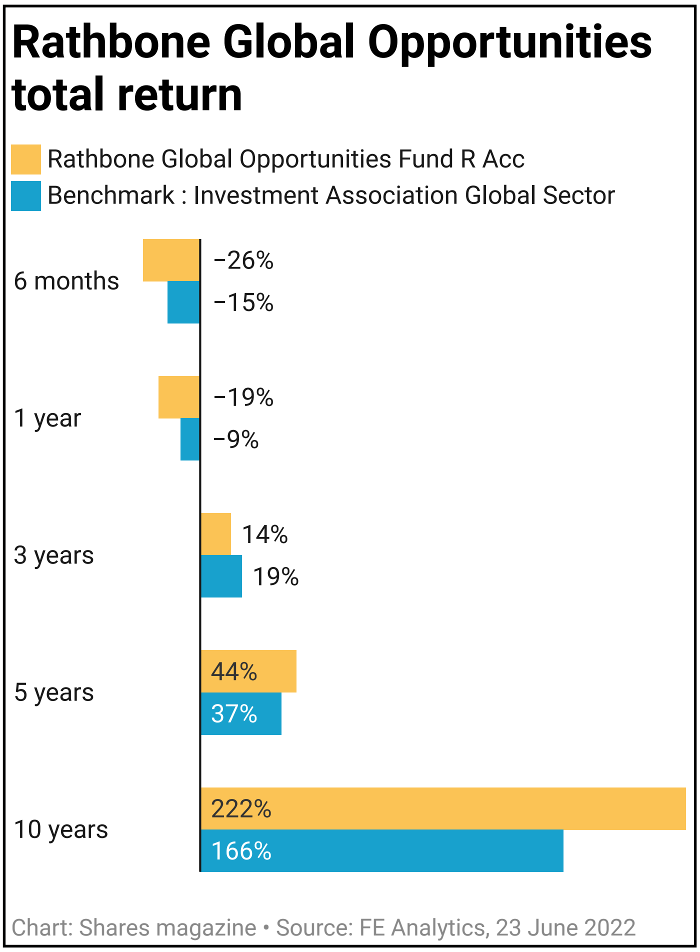
The fund is having a harder time as its investment style has gone out of favour

Many growth funds are facing the same problem. What do they do when their investing style is out of favour after a long period of being successful?

In this scenario investors should be most concerned when a fund manager changes their approach to try and make gains from whatever is working in the market.

It rarely works out well when portfolio managers move out of their comfort zone and change their investment style.

James Thomson, lead manager on popular fund **Rathbone Global Opportunities (B7FQLN1)**, is adamant he won't go down this route.



He tells *Shares* that while it is true that we're going back to investing in a world which isn't so binary and it is important for investors to have balance in their own portfolios, he is not going to change how his fund is run.

Thomson says: 'You shouldn't rip up the script in difficult times – styles come in and out of favour – but we have a track record of long-term success.'

This means the fund will continue to avoid the commodities sector, where companies' fortunes are dictated by market prices which are outside of their control. Thomson will also avoid firms in what he calls 'sunset industries' where there is waning or no growth.

Aiming to be consistent doesn't mean doing nothing. In 2021 the Rathbone fund moved out of some of the 'stay at home' Covid winners like **Netflix (NFLX:NASDAQ)** and software firm **Salesforce (CRM:NYSE)**. The fund also reduced its technology exposure from 29% during the height of the pandemic to less than 20% today.

TRACK RECORD

On a one and three-year view Rathbone Global Opportunities has underperformed its benchmark, the Investment Association's global sector. However, over five years it has returned 44.4%

against 37.1% from the benchmark, which equates to an annualised return of 7.6%. Over 10 years it has returned 222.5% versus 165.6% from the benchmark or an annualised return of more than 8%.

Investors might need to be patient and past performance is no guarantee of success, but this does at least suggest the fund can deliver on a longer-term view.

THE SECRET SAUCE

The strategy which has underpinned this performance is relatively straightforward. Thomson and his team, which includes co-manager Sammy Dow, look to buy what he describes as 'under the radar growth companies which are shaking up their industries and have high levels of recurring revenue'.

Investment decisions are based on 'qualitative judgements' on individual stocks and Thomson suggests this, rather than any particular metric, is the fund's 'secret sauce'.

Under the radar doesn't necessarily mean businesses which are obscure – Thomson cites the example of **Amazon (AMZN:NASDAQ)** which was added to the portfolio 12 years ago.

'It was well known even then but the growth potential and the ability to go to different areas, get involved in different markets and create another floor for its business was underappreciated,' he says.

The £3.5 billion Rathbone fund is comprised of around 60 mainly large cap companies. The

Rathbone Global Opportunities – geographical split

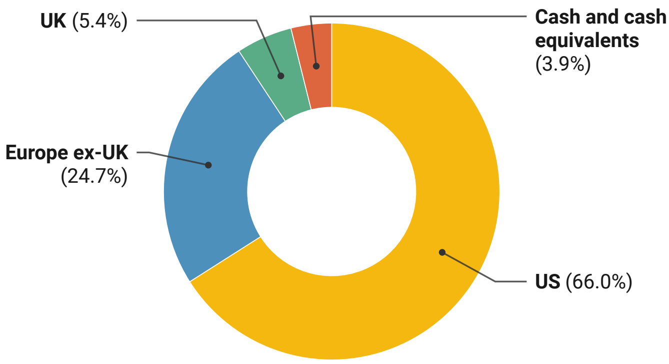


Chart: Shares magazine • Source: Rathbone, 31 May 2022

Why the Rathbone fund has invested in Home Depot

HOME DEPOT HAS been caught up in the consumer discretionary storm that's hitting many retailers. But it could buck that negative trend for several reasons, says Rathbone.

First, 90% of US DIY customers own their own homes, which means they continue to benefit from the strong rise in house prices seen in the country.

In addition, Home Depot's sales to professional customers are almost exclusively destined for jobs for homeowners.

Furthermore, 93% of Home Depot's home-owning customers have a fixed-rate mortgage (most US mortgages run for 30 years) so they're somewhat shielded from rising rates.

The retailer's professional customers simply pass on their inflated costs to the underlying homeowner.

Arguably, Home Depot is shielded from some of the headwinds confronting more generic retailers.

These positives, combined with one of the lowest valuations seen for this retailer in 20 years, have driven the Rathbone fund back into the stock after selling it last year following the immediate post-pandemic reopening rally.

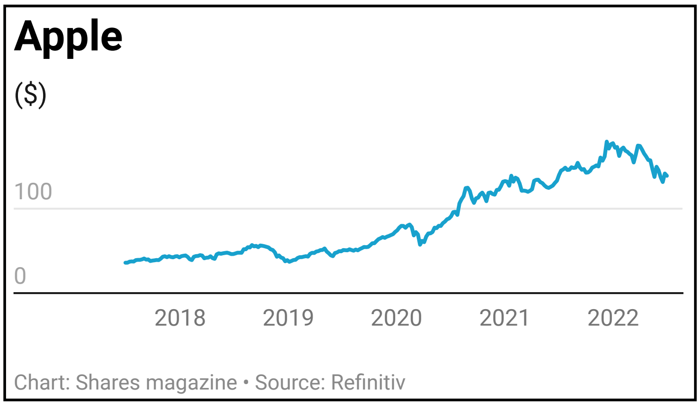
top holdings include membership-only retailer **Costco (COST:NASDAQ)** and chipmaker **Nvidia (NVDA:NASDAQ)**.

There are also some lesser-known names including French medical equipment maker **Sartorius Stedim Biotech (DIM:EPA)** and US electronics specialist **Amphenol (APH:NYSE)**.

SELL-OFF CREATES OPPORTUNITIES

In theory the widespread sell-off in growth stocks means there should be plenty of opportunities to benefit from similarly 'underappreciated' growth to that which Thomson perceived in Amazon all those years ago.

Recent additions to the portfolio include **Apple (APPL:NASDAQ)**, Louis Vuitton-owner **LVMH (MC:EPA)** and US DIY store chain **Home Depot (HD:NYSE)**.

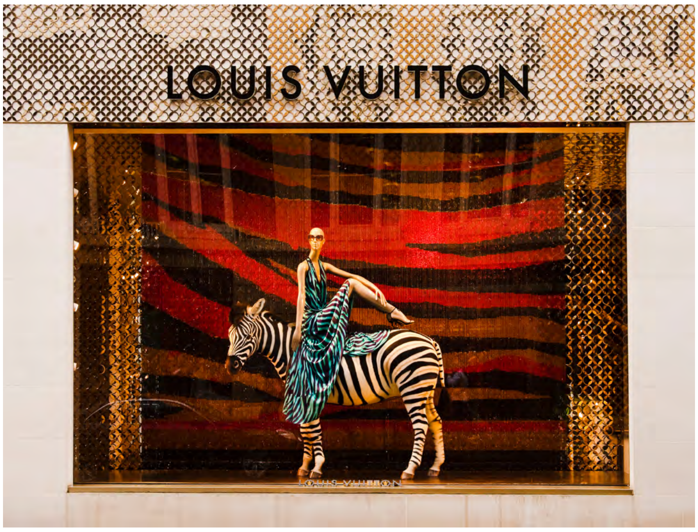


Thomson says the market is acting as if their 'growth potential is permanently impaired rather than there being a temporary pause in their potential'.

In terms of which stock in the portfolio excites him most, Thomson's response is to self-deprecatingly reveal he has never prevailed in the team's stock picking competition in nearly 20 years of trying.

'It is about trying to build a portfolio, so you have lots of shots at a goal. You don't know which will work best but by buying high quality growth companies with a track record of success over multiple cycles you're not going to go too far wrong.

'Whether it is Apple, Home Depot or LVMH we've bought after 30% to 40% pullbacks in the belief they will be outstanding long-term investments, even if we can't say with precision which will be at the top of the list.'



VALUATION FOCUS

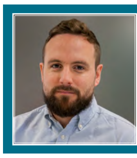
While it is a growth fund, Thomson and Dow do pay attention to valuation and how this compares with a company's prospects, with Thomson observing unprofitable technology stocks 'went parabolic' during the pandemic.

However, he says many of the large cap, mainstream 'mission-critical' tech companies with 80% to 90% recurring revenues and deeply embedded into clients' work and consumers' lives now have reasonable valuations.

He points to the fact that 20 years ago during the dotcom bubble the tech industry didn't really make any profits. In 2022 many of its constituents do and yet the pain being felt in share price terms is similar. Thomson flags the average earnings multiple for the sector is now around 25-times compared with more than 80-times when the dotcom bubble burst.

Rathbone Global Opportunities' performance has struggled along with so many other investments this year, but Thomson has been managing the fund for almost two decades and won't be too fazed by short-term volatility in the markets.

For patient investors, now could be a good time to buy the fund as the indiscriminate selling seen in recent months should be fertile ground for those under the radar growth opportunities sought by Thomson and the team. The fund's ongoing charge at 0.77% is reasonable.



By **Tom Sieber** Deputy Editor

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Is your fund performing badly? Here's what you need to do

Investors with money in Fundsmith Equity and Scottish Mortgage should take note

Two of the most popular active funds of recent years, **Fundsmith Equity (B41YBW7)** and **Scottish Mortgage (SMT)**, have had a terrible 2022 so far.

Fundsmith Equity has fallen in value by 18% and Scottish Mortgage is down by 44% in the space of just six months.

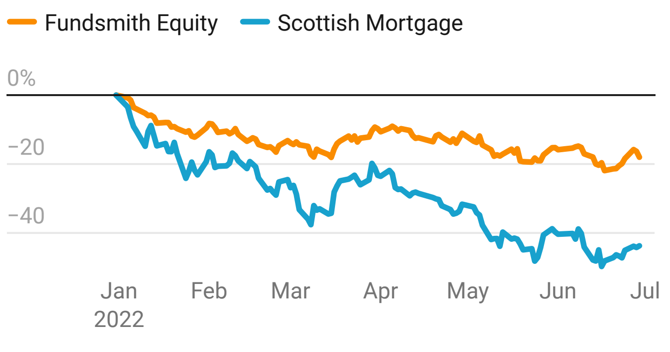

Chart: Shares magazine • Source: FE Analytics

Investors might normally be spitting feathers at such performance, but these two funds have delivered exceptional returns for investors over many years, and so the managers have considerable credit in the bank.

All long periods of underperformance start with a short period of underperformance though, so how do you know when it's time to ditch your active manager?

1 STEP ONE: BENCHMARK COMPARISON

The first thing to do is assess performance properly. Fund price movements up and down are clearly what ultimately matter most to investors, but if you're evaluating an active manager, you need to set their performance in context, by comparing it to an appropriate benchmark.

Both Fundsmith Equity and Scottish Mortgage are global funds, so it makes sense to compare them to the performance of the global stock market, through a broad index like the MSCI World.

If you were assessing a UK fund you would probably use the FTSE All-Share as a comparator, or for a European fund it would be the FTSE World Europe ex-UK index. Most funds will provide a benchmark on their factsheet or in their prospectus if you need a point in the right direction.

The MSCI World index has fallen by 10% this year, so by this measure, Fundsmith Equity and Scottish Mortgage still fall short of the mark. But six months is a really short time over which to judge performance.

If you're not prepared to accept six months of underperformance every now and then, you should probably opt for index tracker funds rather than active funds.

Looking at the examples of Fundsmith Equity and Scottish Mortgage over a longer period, things start to look better.

Over five years Fundsmith Equity has returned 62%, Scottish Mortgage has returned 92%, and the MSCI World index has returned 57% in sterling terms. In these cases, investors have got the outperformance which they come to expect from active funds.

HOW LONG SHOULD YOU SUFFER UNDERPERFORMANCE?

- After 1 year: **Put the fund on a watchlist**
- After 3 years: **Serious review whether to keep or sell**
- After 5 years: **You need some very good reasons to keep the fund, otherwise get out**

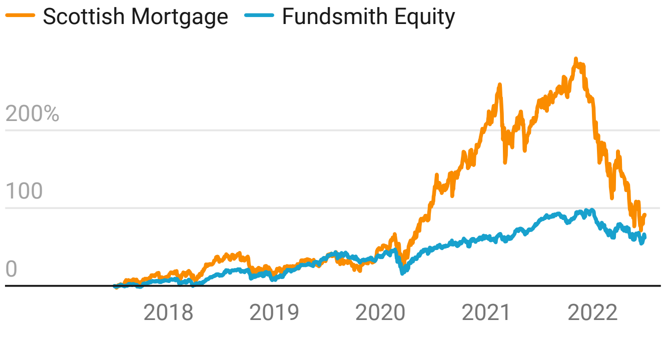

Chart: Shares magazine • Source: FE Analytics

2 STEP TWO: IS THE FUND'S STYLE IN OR OUT OF FAVOUR?

As an active fund investor, when your fund does underperform the relevant benchmark index, you also must give due consideration to the style of the manager.

Fundsmith Equity, for instance, runs a highly concentrated portfolio of only 30 companies. Performance can therefore deviate substantially from the market, for better or worse.

Fund manager Terry Smith also has a distinct preference for growth companies with robust finances which generate reliable profits.

These stocks have been in the ascendancy for most of the last 10 years, but more recently, higher interest rates and rising inflation have led to a reversal in fortunes.

Similar comments apply to Scottish Mortgage. Its managers run a high conviction portfolio of companies they believe are future leaders of the global economy. This has led to heavy exposure to the technology sector, which has seen a sell-off this year after an astonishingly strong bull run.

3 STEP THREE: WHY DID YOU ORIGINALLY INVEST?

If your fund is underperforming, ask yourself why you invested in the first place. Consider if anything has fundamentally changed that should lessen the original conviction you had in the fund manager.

In the case of both Fundsmith Equity and Scottish Mortgage, the managers haven't changed their investment approach, it's just the market has turned against their style of investing. The longer underperformance goes on, the more that will legitimately undermine investors' confidence.

Markets can turn against a particular style of investing for long periods. As a rule of thumb, a year of underperformance should put a fund on the watchlist, three years should be a serious review when you decide to renew your vows or part ways, and after five years of underperformance, you need good reasons to keep the fund in your portfolio.

4 STEP FOUR: UNDERSTAND THE ROLE OF EACH FUND IN YOUR PORTFOLIO

A truly diversified portfolio of funds should have a mix of different fund manager styles, and at any one time some will be desperately unfashionable, and others will be flavour of the month. As time goes on, different fund styles will have their day in the sun.

Active fund investors have a choice when it comes to dealing with fund underperformance. Either you cut and run at the first sign of trouble, or you sit and wait it out.

If you jump ship quickly, you might get out of some funds before a long downturn in performance, but equally you will miss out if the performance improves again.

Meanwhile, you also rack up trading costs and spend a lot of time and effort moving your portfolio around. If you move your money into another fund, who's to say the one you choose is not about to endure a period of underperformance too.

If you choose the patient route, you avoid these issues. Sometimes you will hold a fund for longer than you would with perfect hindsight, but in a diversified portfolio, other funds should take up the slack. On balance it's probably better to show a little faith in your chosen fund manager, even if occasionally it's not rewarded.

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

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

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What are the allowances around pension contributions?

A reader wants to better understand how the system works

Can you clarify how the pension contribution allowances apply, especially when you're in work and after you've retired?
Steve

Tom Selby, AJ Bell Head of Retirement Policy says:

One of the key benefits of pensions is they benefit from generous income tax relief, where you get back the tax you have paid on your income:

- The part of your income on which you have paid up to 20% tax gets 20% relief
- The part on which you have paid 40% tax gets 40% relief
- The part on which you have paid 45% tax gets 45% relief

To control the cost of incentivising retirement saving, the Government places limits on how much you can contribute to a pension each year and benefit from tax relief.

The first of these limits is your annual earnings. The amount you personally contribute to a pension each year is restricted to 100% of your 'relevant earnings'.

So, if your relevant earnings are £30,000, this is the total you can personally contribute to a pension in that tax year and receive tax relief. In other words, you contribute £24,000 and HMRC contributes £6,000.

Relevant earnings include things like salary and bonuses. They do not include pension income, investment income or any earnings you receive from buy-to-let properties.

If you don't have any relevant earnings, you can still contribute up to £3,600 – inclusive of tax relief – into a pension each year. Once you reach your 75th birthday, you are no longer entitled to tax relief on your pension contributions.

The overall total that can be paid into your pensions in the tax year is controlled by the 'annual allowance', which for most people stands at £40,000. This annual allowance includes your personal contributions, any employer contributions you receive and upfront tax relief.

It is also possible to 'carry forward' unused allowances from the three previous tax years, although your personal contributions will still be limited to 100% of your earnings.

There are two further allowances – the 'money purchase annual allowance' (MPAA) and the 'tapered annual allowance'.

If you flexibly access taxable income from your pension, the MPAA will kick-in, reducing your annual allowance from £40,000 to just £4,000. You will also lose the ability to carry forward unused allowances.

Your annual allowance may also be lower than £40,000 if you are a very high earner. The annual allowance 'taper' applies if you have 'adjusted income' of over £240,000 and 'threshold income' of over £200,000.

The taper reduces your annual allowance by £1 for every £2 of income over and above the £240,000 adjusted income threshold, to a minimum of £4,000 for those with adjusted income of £312,000 or more.

If you are affected by the taper, this guide might be useful. If you're a high earner or looking to make large contributions, I'd consider speaking to a regulated financial adviser to better understand the rules and your options.

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*.

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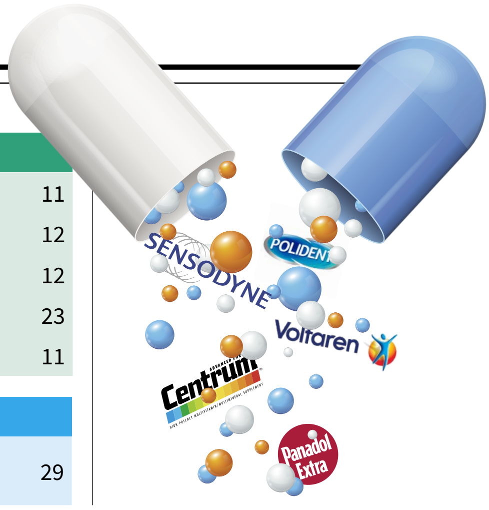

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:
12 July: System1, Sosandar, Adept Technology, Totally, Purplebricks. **13 July:** Loungers, Ilika, Renold. **14 July:** DSW Capital.

Half-year results:
13 July: Getbusy.

Trading Announcements
11 July: MJ Gleeson. **13 July:** Pagegroup.
14 July: Severn Trent, Ashmore, Experian, Hays.
15 July: Rio Tinto, Burberry.

WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

COMPANIES EDITOR Ian Conway @SharesMagIan

EDUCATION EDITOR Martin Gamble @Chilligg

SENIOR REPORTER: Mark Gardner

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

ADVERTISING
Senior Sales Executive
Nick Frankland
020 7378 4592
nick.frankland@sharesmagazine.co.uk

CONTACT US:
support@sharesmagazine.co.uk

Website: sharesmagazine.co.uk
Twitter: @sharesmag

PRODUCTION
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Designers: Rebecca Bodi, Kevin Sharpe

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