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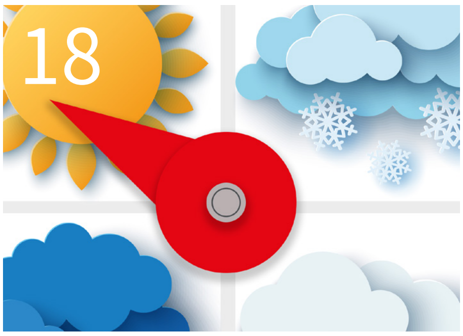


Daniel **Coatsworth**

Investors beware: the Government has its eyes on your dividends

The Autumn Statement could see major changes to personal finance-related tax

There is growing speculation that chancellor Jeremy Hunt will increase taxes on individuals who owns shares when he announces the UK Autumn Statement on 17 November. This threatens to eat into people's returns and make investing less appealing to those not already doing it.

Media reports suggest the chancellor might increase the dividend tax rate and reduce the tax-free allowance for dividends. Currently investors can receive up to £2,000 in dividends a year before paying dividend tax at three levels: 8.75% for basic rate taxpayers, 33.75% for higher rate and 39.35% for additional rate.

The dividend allowance was slashed from £5,000 to £2,000 in 2018; now it could be halved to £1,000 alongside a 1.25 percentage point increase for the dividend tax bands.

The Government is desperate to improve its finances and so we can expect significant changes to the tax system and widespread spending cuts from 2023.

Whether the changes to the dividend tax system happen or not, this is a stark reminder to make the most of tax shelters. Putting money into an ISA or pension means all capital gains or dividends from investments are tax-free. You should only use investment or dealing accounts if you've maxed out your £20,000 annual ISA allowance and don't want to tie up all your money in a pension.

Those new to investing might not realise the tax benefits of an ISA over an investment or dealing account. They may think, 'I want to invest my money via share dealing, so an investment or dealing account sounds perfect for me.' Yes, these accounts would enable them to invest, but any capital gains or dividends will be taxed once you've used up the respective tax allowances.

If you are a higher or additional rate taxpayer and have maxed out your £20,000 annual ISA allowance and want to invest some money outside of a pension for easier access, you might want to rejig your portfolio. You could, for example, put income-paying investments inside an ISA or pension and non-income paying ones in a dealing account. This is because dividends in an investment or dealing account are taxed at a higher level (unless you are a basic rate taxpayer) than the 20% you pay on capital gains. Note that you also get a more generous capital gains allowance (£12,300) before you start paying tax.

Sadly, it's never that straightforward. There is talk the Government might cut the capital gains allowance rate and, worryingly, impose capital gains tax on the sale of a family home.

The latter might net the Treasury billions of pounds a year, but it would also threaten to destabilise the housing market. No doubt it would also lose the Conservative Party a lot of votes at the next general election.

If you're worried about the potential changes to personal finance rules at the forthcoming Autumn Statement, brace yourself for even more turmoil.

There is talk that pension tax relief could be halved for higher-rate taxpayers. There is also chatter that the pensions lifetime allowance – the maximum amount you can save into your pension without incurring an extra tax charge – might be frozen for an extra two years to April 2028.

At this rate, 17 November 2022 could go down as one of the most miserable dates in history for the UK.

Mid-cap stocks reverse losing streak versus FTSE 100

FTSE 250 index bolstered by buyout talk and recovery stocks

Buyout speculation and a pick-up in investor risk appetite has helped power UK mid-cap stocks to reverse a 2022 trend of underperformance versus their blue-chip cousins. Over the past month, the FTSE 250 index has rallied 8.3% compared with a 4.7% gain from the FTSE 100.

This represents a stark turnaround for UK mid-caps, which struggled through the first nine months of 2022 as investors turned their backs on the index as the pound slumped. Since the start of the year, the FTSE 250 has lost more than 22%, while sterling fell from $1.35 to $1.13 versus the dollar.

Takeover speculation has swirled around the UK market recently with office space firm **IWG (IWG)** the latest FTSE 250 constituent to have potentially drawn interest from private equity investor CVC Capital Partners earlier this week.

CVC was reported to have approached the UK's biggest serviced office provider about a £1.5 billion deal that could trigger a broader break-up of the group. CVC is believed to be one of several buyout firms to have approached IWG, previously known as Regus, about acquiring The Instant Group, its digital arm, although IWG has yet to officially confirm or deny the reports.

FTSE 250 index of UK stocks has just enjoyed a solid month

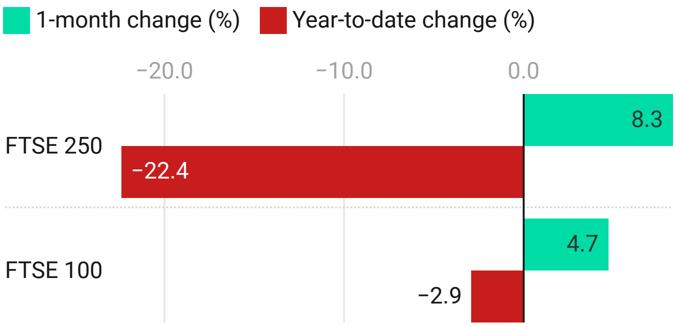


Chart: Shares magazine • Source: Google Finance, 8 November 2022

Best performing FTSE 250 stocks over the past month

Aston Martin Lagonda	**43.4%**
Wizz Air	**41.6%**
IWG	**30.9%**
EasyJet	**28.1%**
RHI Magnesita	**27.4%**

Table: Shares magazine • Source: Investing.com

Buyout talks have also landed on the airlines industry, with budget flyer **EasyJet (EZJ)** said to have emerged as a takeover target of **International Consolidated Airlines (IAG)**, with the British Airways-owner believed to be keen to expand its leisure travel operations in the face of a slow recovery of business travel.

That saw EasyJet shares rally 6% in a day (31 Oct), with the shares chalking up gains of more than 28% over the past month, with EasyJet having previously drawn interest from discount peer **Wizz Air (WIZZ)**, the Hungary-based airline.

Investors have also been backing a recovery at sports car maker **Aston Martin (AML)** despite the business remaining stubbornly loss-making. It is the best-performing FTSE 250 stock over the past month.

This year the FTSE 100 has proved to be one of the world's most robust major stock market indices, losing less than 3%. That compares to the US S&P 500's 20% decline, a 32% fall for the Nasdaq Composite and 13.5% slide of the Euro Stoxx 50. [SF]

Falling house prices and more sales cancellations: why property shares are down again

Stocks continue to fall despite so much bad news already being priced in

Shares in housing-related stocks had already been weak this year in anticipation of a property market slowdown, but new data showing an actual decline in UK house prices and a warning from housebuilder **Persimmon (PSN)** about a rise in cancellations and a reset of its dividend policy have caused more unease among investors.

According to Halifax average UK house prices fell by 0.4% between September and October, the third decline in four months and the biggest drop since February 2021.

It's worth noting the average October house price in the survey at £292,598 is still higher than it was six months ago and more than 8% above where it was a year ago.

It is a similar story with the Nationwide house price index, where October prices were 7% above their year-ago average.

However, the recent jump in mortgage rates means housing transactions are now expected to soften as affordability becomes a problem for many prospective buyers.

For the time being, a lack of supply of modern, fit-for-purpose housing, together with record high employment, are likely to keep demand for houses ticking over, albeit not at the same breakneck speed as during the pandemic.

The lettings market appears buoyant with London-based estate agent **Foxtons (FOXT)** reporting higher rents due to strong tenant demand and a dearth of rental stock while **Belvoir (BLV:AIM)** said the shortage of available property both to buy and to rent has continued to put upward pressure on house prices and rental costs.

Analysts at Liberum believe house prices are likely to fall by 5% next year while sales volumes could shrink as much as 20%, but they point out that at current prices shares in the housebuilders themselves are already discounting a double-digit fall in prices and a 30% drop in volumes.

With valuations back to 2008/09 levels and housebuilders in a net cash position rather than heavily geared as they were previously, 'the risk/reward ratio is now in buyers' favour' says Liberum about their shares.

The key issue to consider is whether Persimmon's decision to reset its dividend policy next March will prompt others to do the same. Investors have typically bought housebuilders' shares for their generous income and any cuts to dividends will not go down well. [IC]

Performance of housing-related stocks this year

Company	Share price performance year-to-date (%)
HOUSEBUILDERS	
Persimmon	−57%
Barratt Developments	−50%
Taylor Wimpey	−47%
Berkeley Group	−28%
ESTATE AGENTS	
Belvoir	−17%
Foxtons	−18%
PROPERTY PORTALS	
OnTheMarket	−46%
Rightmove	−36%
HOME IMPROVEMENT PRODUCT SUPPLIERS	
Travis Perkins	−47%
Wickes	−40%

Table: Shares magazine • Source: Sharepad, Shares. Data correct as of 7 November 2022

Chinese stocks surge on prospect of end to strict Covid measures

Many UK-listed investment trusts also rally on hopes worst is over

Shares in Chinese and China-related stocks, including specialist UK-listed investment trusts, have risen for several days on market talk Beijing could end its zero-tolerance strategy on the Covid virus in early 2023.

The official line is the government has no intention of changing course as 'previous practices have proved our prevention and control plans and strategic measures are completely correct'.

Moreover, the Shanghai Disney Resort has just been shut after a single visitor was found to have coronavirus.

Yet that hasn't stopped investors chasing up Chinese consumer-related stocks such as car-maker **Geely Automotive (175:HKG)** and sportswear firm **Li Ning (2331:HKG)**.

Heavy buying has also pushed up shares of China-focused investments trusts such as **Abrdn China (ACIC)**, **Baillie Gifford China Growth (BGCG)**, **Fidelity China Special Situations (FCSS)** and **JPMorgan China Growth & Income (JCGI)**.

Nick Yeo of Abrdn China believes Covid restrictions are unlikely to be lifted before the Chinese New Year in late January 'due to the onset of winter, low vaccination rates among the elderly and a lack of intensive care facilities in the event of a nationwide epidemic'.

Still, Yeo believes the economy will bounce back rapidly once China does reopen with consumer stocks most likely to benefit.

Investors will get a chance to gauge the strength of consumer demand themselves on 11 November with Singles Day, the biggest one-day shopping event in the world. [IC]

Veterinary group CVS plans to double profitability over the next five years

Its share price is down around 10% year-to-date yet 2023 earnings estimates have risen by 5%

VETERINARY GROUP **CVS (CVSG:AIM)** has ambitions to double EBITDA (earnings before interest, tax, depreciation, and amortisation) over the next five years.

The goal is expected to be achieved through a combination of higher organic growth and improved margins through investment in facilities and equipment.

This will involve a £30 million-to-£50 million annual investment to refurbish and relocate practices aimed at improving workflow and efficiencies.

Continued investment in people and its leading training programme is intended to increase staff retention.

The company is also planning to open three new greenfield sites in the current fiscal year and further sites over the next few years.

The planned actions are intended to drive organic sales growth of between 4% and 8% a year while adjusted EBITDA margins are expected to see a step up to between 19% and 23% compared with a five-year average of around 17%.

Acquisitions remain a key part of the growth strategy with management seeing continued opportunities in the UK and consolidation opportunities internationally.

The company expects to invest upwards of £50 million in acquisitions over the next five years. Investment bank Berenberg sees the building of a presence outside the UK as the 'next chapter' of CVS's equity story. [MG]

Why retail investors in JP Morgan Russian Securities are sounding the alarm on changes

A shift to a broader investment objective is proving controversial with some shareholders

The board of **JPMorgan Russian Securities (JRS)** has moved to allay investor fears linked to a looming change of mandate for the investment trust.

With trading in Russian stocks suspended thanks to the country's invasion of Ukraine, the board revealed on 27 October that it was broadening the investment objective to encompass Central, Eastern and Southern Europe (including Russia), the Middle East and Africa.

The deadline to vote on these proposals on some investment platforms is likely to be several days in advance of the 23 November shareholder meeting.

Ordinary investors in the trust, some of which have contacted *Shares* directly, are concerned about the risks of a capital raise and of its Russian holdings being sold off at a significant discount.

One holder of the trust, Joseph, told *Shares* he was part of a group of around 100 private investors owning more than 5% of JPMorgan Russian Securities combined.

To facilitate the change of mandate there was a general concern the trust would pursue a capital raise. The board has acknowledged this concern and in a stock market announcement on 7 November said that there 'are currently no plans to issue shares or raise capital, even in the event the current prohibitions on the trading and receipt of dividends on Russian securities are lifted'.

There was also a nod to the existing shareholders' pre-emption rights, in other words first refusal on the issue of any new shares, and on promoting the success of the trust for the benefit of 'all members'.

However, beyond this risk of being diluted by any share issue, Joseph noted 'the new investment objective may impose a limit on the Russian exposure of the trust'. He added: 'When the Moscow Stock Exchange reopens to foreigners there may be a rush to liquidate Russian holdings by Western investors which may depress share prices.'

He expressed the worry that this could result in the trust selling shares below their intrinsic value. Its current share price is just 79p and the shares trade at a near 70% premium to net asset value.

Joseph said a current investment in a money market fund covers the running costs of the trust and therefore it 'could operate in the status quo indefinitely while it waits for the reopening of Moscow Stock Exchange to foreigners'.

When contacted by *Shares* on this point JPMorgan Asset Management declined to comment beyond the statement already put out by the trust's board. [TS]

Strong customer demand puts Caterpillar shares 10% ahead on the year

Profit margins are rising and dealers are busy restocking equipment

GLOBAL ECONOMIC ACTIVITY has not ground to a halt if you look at construction and mining bellwether **Caterpillar (CAT:NYSE)**. Its revenue has been soaring thanks to higher prices and greater sales volumes.

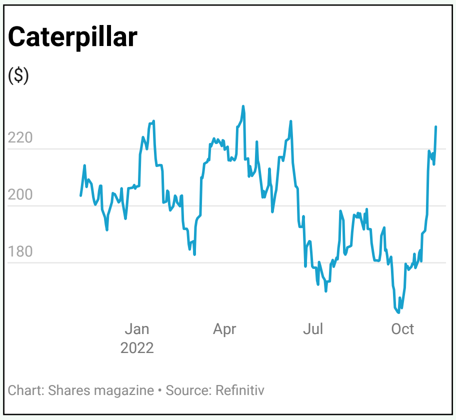
The 28% share price jump over the past month has not only recovered all the previous losses seen during the summer, but also put the stock 10% ahead year-to-date.

Demand has been helped by dealers restocking inventories at levels above Caterpillar's expectations. It says inventories remain near the low end of its typical range.

While profit margins are expected to be even higher in the fourth quarter than the previous three months, Caterpillar warned that full-year margins would be at the low end, or slightly below the low end, of its target set out at the May investor day.

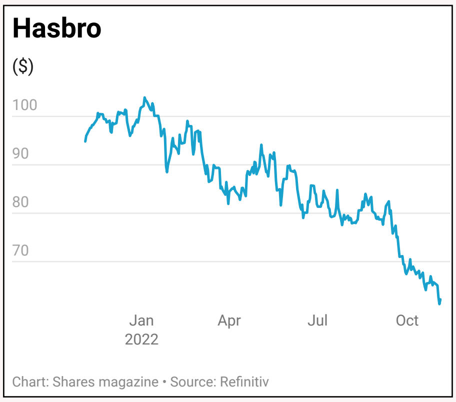
Investors seem to be more focused on demand where there is no cause for concern. Caterpillar believes non-residential construction in North America will strengthen. In Asia-Pacific (excluding China), moderate growth is expected; and in China ongoing weakness is likely.

However, suggestions that China might relax its Covid policies and start reopening in early 2023 bodes well for an increase in infrastructure and construction activity. [DC]



Hasbro hurt as toy demand drops following price hikes

A plan to focus on its biggest brands has also failed to revive its shares



THE DEFINITION OF a company with pricing power is one that can put up prices without causing a drop in customer demand. Toy maker **Hasbro (HAS:NASDAQ)** doesn't make the cut as its price hikes have weakened demand, leading it to miss its latest quarterly earnings estimates.

Consumers are looking for bargains in the current economic climate which means shops are relying on promotions to shift products and are ordering less stock from suppliers.

That explains Hasbro's recent share price weakness, yet its stock has been in decline all year, down 39% so far. In June, the company fought off pressure from activist investor Alta Fox who wanted to shake up the board and split up the business.

Over the years Hasbro has leaned heavily on its toy brands including Transformers to create TV and films. It bought Peppa Pig brand owner and production conglomerate Entertainment One in 2019 for $3.8 billion to get an even bigger foothold in Hollywood.

In October, Hasbro announced a new strategy to focus on its biggest brands and franchises only, suggesting it could offload some assets. So far, the market hasn't got excited about the plans with the shares down at levels not seen since the global Covid-induced market sell-off in March 2020. [DC]

Marston's share price is far too low: discover why you should buy now

The business has been simplified and there are near-term catalysts to drive trading

Famed investor Howard Marks is fond of saying that good businesses do not always make good investments and vice-versa. In other words, start with what the market has already priced in.

Shares believes there is too much doom and gloom priced into **Marston's (MARS)** shares, leaving plenty of scope for recovery in both the valuation and the fundamentals of the business.

Marston's is trading at half book value while the shares are roughly 70% below pre-pandemic levels. Historically the shares have only traded at such a large discount to book value during the depths of prior economic crises.

There are clear pathways to rebuild the Covid-19 related mark-downs in book value which should allow the excessive discount to book value to narrow, supporting the shares.

The latest trading update was encouraging with 3% like-for-like sales growth over the 10 weeks to 2 October compared with the last uninterrupted trading period in 2019. Drinks outperformed food, reflecting resilience in the 'community-led' estate.

This is an improvement on the 2% drop seen in the prior 42 weeks, albeit the period did benefit from unseasonably warm weather. Total sales across managed and franchised pubs are around 2% above 2019, while management reaffirmed full-year guidance.

Shore Capital analyst Greg Johnson increased his full-year pre-tax profit estimate by 3% to £28 million and expects 2023 pre-tax profit to reach £51.7 million.

The new financial year which began on 2 October should benefit from the football World Cup later this month bringing more people into its pubs – a significant proportion will be showing the games – as well as the first uninterrupted Christmas trading period in three years.

Around 85% of Marston's borrowings are long-term, asset-backed and securitised to 2035. As of 1 October, net debt (£1.22 billion) was £16 million below the prior year.

MARSTON'S
BUY
(MARS) 37p
Market cap: £230 million

Johnson believes the reduction in debt and second half weighting should allow some partial recovery of the Covid-19 impairments which have totalled £380 million over the last two years.

Given a net asset value of 71p per share at the halfway stage Johnson sees scope for a 'significant' uplift in net asset value towards 100p per share.

Marston's is targeting a reduction in net debt to below £1 billion by 2025 which should benefit shareholders as more cash is available to invest in the business and pay dividends.

Longer term the company plans to 'get back to a billion' of annual revenues. Johnson sees the potential for Marston's to increase like-for-like sales by around 2%-to-3% a year, implying above market growth. [MG]

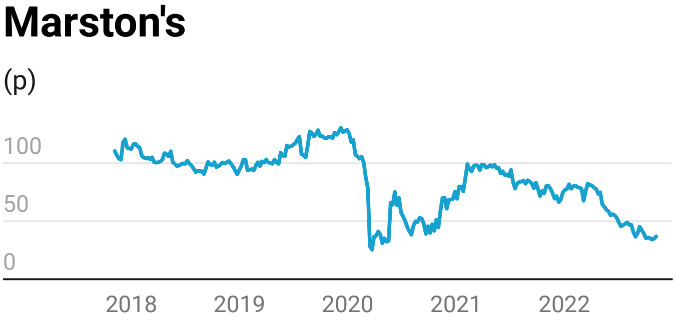


Chart: Shares magazine • Source: Refinitiv

Why smart cookies should invest in Oreo maker Mondelez

The biscuits, chocolates and chewing gum maker is a quality compounder with a recipe for global growth

MONDELEZ INTERNATIONAL
BUY
(MDLZ:NASDAQ) $63.22
Market cap: $86.65 billion

Risk-averse investors concerned about a global recession should seek out high-quality compounders that can continue to grow sales and earnings during tougher economic times.

One such name is **Mondelez International (MDLZ:NASDAQ)**, the snacking giant with strong market positions in chocolate, sugar, and gum confectionery as well as sweet and savoury biscuits known for iconic brands including Oreo, Cadbury Dairy Milk and Ritz crackers.

While Mondelez's products are not completely immune from the threat of downtrading, its brands are demonstrably resilient and enjoy high levels of loyalty from consumers who should continue to spend on tasty snacks that provide a bit of succour during straitened economic times.

RECIPE FOR SUCCESS

Separated from Kraft Foods a decade ago in 2012, Mondelez is one of the world's biggest snack companies with products sold in over 150 countries. The $86.65 billion cap holds the number one global position in biscuits (cookies and crackers), is the world's number two player in chocolate, and is also growing rapidly in the highly fragmented baked snacks market.

Arguably best known for Oreo, the world's top selling cookie, Mondelez's enviable portfolio of brands also includes the likes of Trident gum, belVita breakfast biscuits, Milka and Toblerone chocolate, Sour Patch Kids sweets and recently acquired brands Clif Bar and Chipita.

Guided by CEO and chairman Dirk Van de Put and finance director Luca Zaramella, Mondelez offers a play on the growing global trend of snacking.

Despite already bestriding the biscuits and chocolate worlds like a colossus, Mondelez's brands still boast scope for growth around the globe, notably in emerging markets, with Oreo in big demand in nations such as India, for example.

Mondelez International

Year	Revenue ($bn)	Adjusted pre-tax profit ($bn)	EPS ($)	DPS ($)
2021 (A)	28.7	4.6	2.87	1.36
2022 (F)	31.3	4.8	2.93	1.47
2023 (F)	32.5	5.0	3.12	1.50
2024 (F)	33.9	5.4	3.40	1.63

Table: Shares magazine • Source: Company data, Berenberg. EPS = earnings per share. DPS = dividend per share. A= Actual. F=Forecast

A veritable free cash flow monster, Mondelez continues to return copious amounts of capital to shareholders through dividends and share buybacks, with a bumper $3.3 billion returned year-to-date.

MONDELEZ HAS MOMENTUM

Third quarter results (1 November) were better than expected, with organic growth of 12.1% coming in comfortably ahead of the 8.2% forecast, with pricing up 11.4% and volumes confounding expectation of a modest decline by coming in 0.7% higher. Raising prices without shedding volume clearly demonstrates that Mondelez has both brand strength and pricing power.

Mondelez also raised both its full year organic sales and earnings per share growth guidance to 10%-plus. And while the company faces elevated commodity and other costs, investment bank Berenberg insists the sales outlook is supported by 'pricing, resilient volumes from robust biscuits and chocolate category demand, and improving retailer service levels in North America'.

Earnings per share growth should be underpinned by margin upside from operating leverage as the company passes on cost inflation to consumers, as well as further share buybacks and bolt-on acquisitions enabled by over $3 billion of annual free cash flow generation, which allows the company to support a high leverage ratio of three times net debt to EBITDA (earnings before interest, tax, depreciation and amortisation).

Berenberg argues the Chicago-based company is 'one of the more reliable compounders' in its sector. Mondelez's 4%-plus organic growth levels, says the broker, should support a higher multiple than the current 20 times forecast earnings on which Mondelez trades for 2023, with top-quartile peers trading on 22 to 24 times earnings.

For the years to December 2023 and 2024, Berenberg forecasts a rise in earnings per share from $2.93 for 2022 to $3.12 and $3.40 respectively as sales grow from $31.3 billion in the current year to $32.5 billion next, to the best part of $33.9 billion in 2024. Twice covered by earnings, Mondelez's dividend is estimated to rise from $1.47 this year to $1.50 next year, and $1.63 thereafter. [JC]

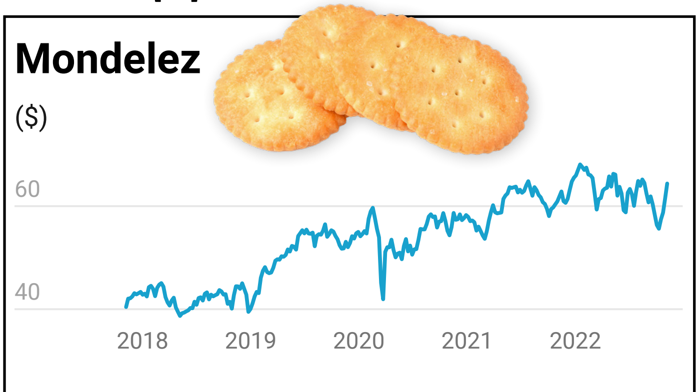


Chart: Shares magazine • Source: Refinitiv

Why you should keep buying global income star Murray International

The trust's largest holding, Mexican airport operator ASUR, recently beat earnings expectations

MURRAY INTERNATIONAL
(MYI) £12.70

Gain to date: 4.4%

WE ADDED **MURRAY International (MYI)** to the *Great Ideas* portfolio at £12.16 on 7 July 2022 in the hope veteran fund manager Bruce Stout's experience and the trust's diversified exposure would be prized in the current environment.

So far, we've been vindicated as the trust has continued to outperform its closest peers and the wider market.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

The shares are only modestly higher on our entry point but that compares favourably to an MSCI World index down around 4% over the same timeframe.

Investment bank Stifel noted on 25 October that 'over the past year, performance has benefited from the trust avoiding growth stocks and instead having a focus on defensive income type companies.'

The trust is comfortably the best performer in the Association of Investment Companies' Global Equity Income sector with a one-year share price total return of 17.4% against an average of just 4.5%. The worst performer is **Majedie Investments (MAJE)**, down more than 20%.

Murray's largest holding, at 5.2% of total assets, is Mexican airport operator **Grupo Aeroportuario del Sureste (ASURB:BMV)** which recently beat expectations with third quarter numbers. Earnings per share and revenue were 3.1% and 3.2% ahead of analysts' estimates respectively as

the company benefited from a strong recovery in air traffic in the wake of the pandemic.

WHAT SHOULD INVESTORS DO NOW?

We continue to see a place for Murray International in investors' portfolio as we rate Stout's abilities to manage the trust effectively and think its strong dividend growth credentials are of value in the face of inflationary pressures.

The stock is currently trading at a 2% discount to net asset value, which is roughly in the middle of a range for the last 12 months, identified by Stifel, which has run from a 6% discount to a 2% premium. On this basis investors should keep buying the shares. [TS]

Chart: Shares magazine • Source: Refinitiv

Loungers is great at cafés but can it also succeed with roadside eateries?

It's hoping to thrive where Little Chef failed with smart outlets on A-roads

LOUNGERS

(LGRS:AIM) 194.4p

Loss to date: 30%

WE ORIGINALLY SAID to buy all-day café operator **Loungers (LGRS:AIM)** at 278.5p on 23 December 2021 as an attractive growth story, and one where its proposition fitted nicely with the rise of hybrid working where people would spend more time in their local community.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

The shares have suffered from the broader sell-off in equities and concerns about a slowdown in consumer spending.

However, trading has been good this year, with Loungers saying in October that it had significantly outperformed the market over the previous six months.

It now intends to launch a new roadside restaurant brand situated mainly on A-roads. Called Brightside, it will be an attempt to bring back 'genuine' hospitality to a sector which has been dominated in recent years by drive-thru and quick service restaurants.

Chairman Alex Reilly commented: 'Brightside will have a contemporary, welcoming, and warm feel, whilst also evoking nostalgia for a time when motoring in the UK was a more exciting experience.'

The roadside hospitality industry is often associated with the Little Chef chain, which launched in the 1950s, hit its peak in the 1980s but then struggled. Efforts to reboot the brand via TV chef Heston Blumenthal weren't successful.

Analysts at Shore Capital say Brightside could position Loungers well in the context of increased electric car ownership which typically takes 15 to 20 minutes to charge rather than refuelling which requires less than three minutes.

They also see merit in these types of drivers trading up to a full-service, higher quality food and drink proposition when having a break on a journey given electric cars tend to be driven by more affluent customers.

WHAT SHOULD INVESTORS DO NEXT?

Loungers will face competition from growth in drive-thru outlets from the likes of Greggs, Costa and Starbucks, but the Brightside concept is arguably a different experience.

It has a good track record of developing leisure outlets that do well, and we think Brightside could be good if the set-up costs aren't high and that it can find good locations on attractive financial terms. Keep buying the shares. [MG]

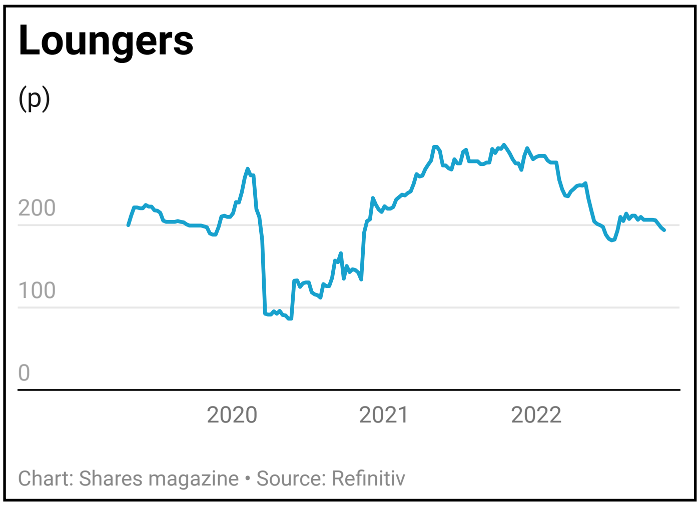


Chart: Shares magazine • Source: Refinitiv

Rain or shine

Defensive stocks that can weather any economic backdrop

By **Ian Conway** Companies Editor

THE CLASSIC DEFINITION of a 'defensive' stock is one which provides stable earnings and consistent returns in all market environments, but especially when market conditions are tough.

They usually have a big installed customer base, so there is a constant demand for their products or services, and they tend to operate in what is known as an oligopoly or an area of limited competition.

However, as we show in this article, some stocks which seem to fit the defensive tag can turn out to be plodders while some which seem riskier can be a better investment.

WHICH STOCKS ARE TRADITIONALLY DEFENSIVE?

For many years consumer staples, healthcare, personal care, telecoms, and utilities companies have been viewed as defensive.

Defensive stocks tend to have good balance sheets, so that when the economy turns down they can weather the storm and keep investing in the business while maintaining their dividend without having to look for outside financing.

Another feature of defensive stocks which matters for investors is the fact their share prices tend not to be very volatile, in other words they have a low 'beta' compared with the market.

In a paper written in 2016, professor Robert Novy-Marx of the University of Rochester, New York, looked at the popularity of defensive stocks and explained what drives their performance. He said: 'Low volatility and low beta strategies are popular with institutional investors, pension funds, and insurance companies. Retail defensive equity funds have also seen robust inflows and compete with "quality" strategies and managed futures as the new strategies most favoured by active managers.'

Defensiveness doesn't depend on a company's size – although larger stocks tend to be less volatile than smaller stocks – or its valuation, although that can be a contributing factor, argued Novy-Marx. It all comes down to profitability.

He commented: 'High profitability is the single most significant predictor of low volatility, exceeding the power even of market capitalisation. Defensive strategies consequently tilt strongly towards profitability. This also tends to obscure the true extent to which defensive strategies tilt toward value.'

Because profitability and value tend to be negatively correlated, the 'profitability effect' of holding defensive stocks outweighs the 'value effect' said Novy-Marx.

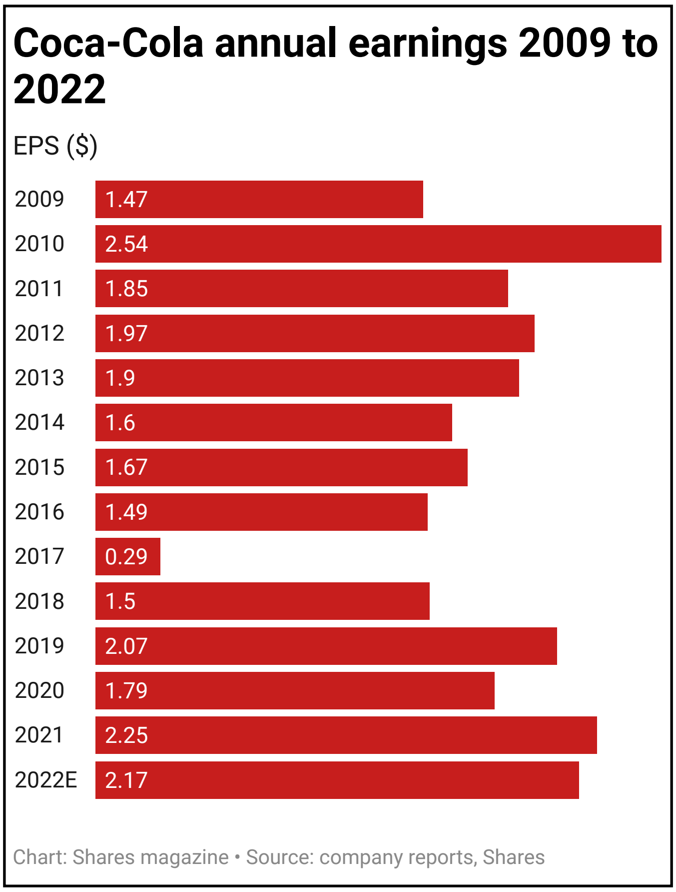
In other words, classic defensive stocks may be larger and cheaper than the average company but what makes a company truly defensive is the reliability of its earnings.

HOW DO CLASSIC DEFENSIVES MEASURE UP?

To test both the market wisdom that sectors like healthcare, and consumer staples are defensive, and professor Novy-Marx's finding that companies with higher profitability are defensive, we have taken four well-known stocks from the S&P 500 at random.

All are household names, and all have been going about their business without any significant acquisitions or disposals within the last 10 to 12 years which might distort their earnings.

In each case we have taken diluted underlying earnings per share as reported under US GAAP (generally accepted accounting principles).



Thanks to its formidable marketing, **Coca-Cola (KO:NYSE)** is possibly the best-known brand in the world if not necessarily the most highly valued – that accolade goes to **Apple (AAPL:NASDAQ)**.

Coca-Cola is famous for reliably growing its earnings through thick and thin as consumers gulp down its fizzy drinks, either at home or in restaurants and bars the world over.

However, between the end of 2009 and the end of 2021 the firm has only grown its earnings per share by 53%, and this year earnings are expected to fall slightly.

As a rule of thumb, if earnings grow at 7% per year, then in 10 years they will have doubled.

At the same time, by reversing the formula, if earnings grow at 10% per year, then they will double in seven years.

Coca-Cola earnings clearly haven't doubled, nor have they grown by 7% a year (and we're being generous here as we're looking at 12 years not 10).

Johnson & Johnson annual earnings 2009 to 2022

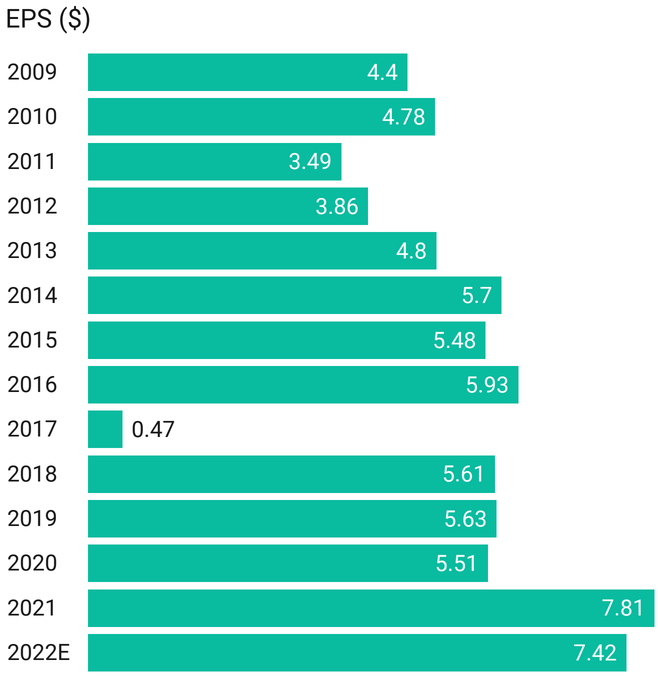


Chart: Shares magazine • Source: company reports, Shares

By the same token, personal care firm **Johnson & Johnson (JNJ:NYSE)** – which, like UK group **Reckitt (RKT)**, sells small-ticket instantly-recognisable branded consumer health products around the world – ought to generate a resilient flow of earnings.

Yet over the same period from the end of 2009 to the end of 2021 the firm has grown its per-share earnings by 77%, meaning it too has failed to beat the 7% per year hurdle.

If we included the forecast for 2022, earnings would only be up 69% as the forecast for this year is for profits to fall by mid-single digits like Coca-Cola.

McDonald's annual earnings 2009 to 2022

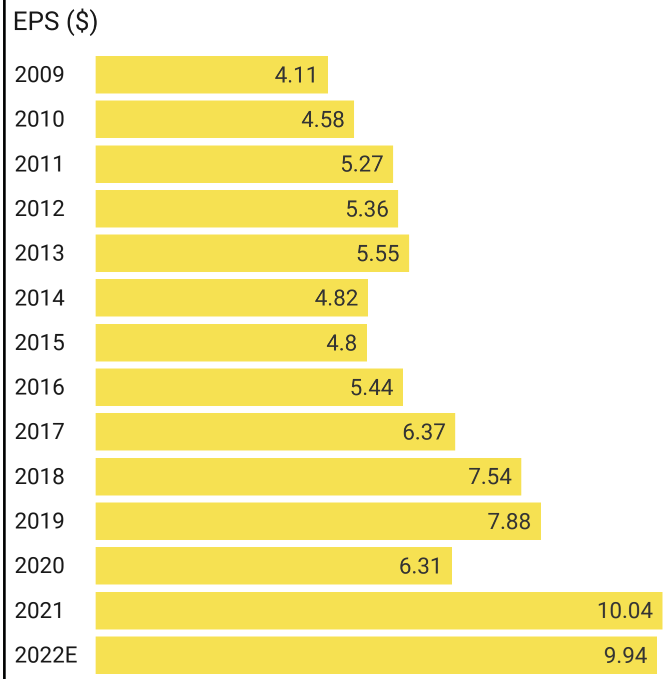
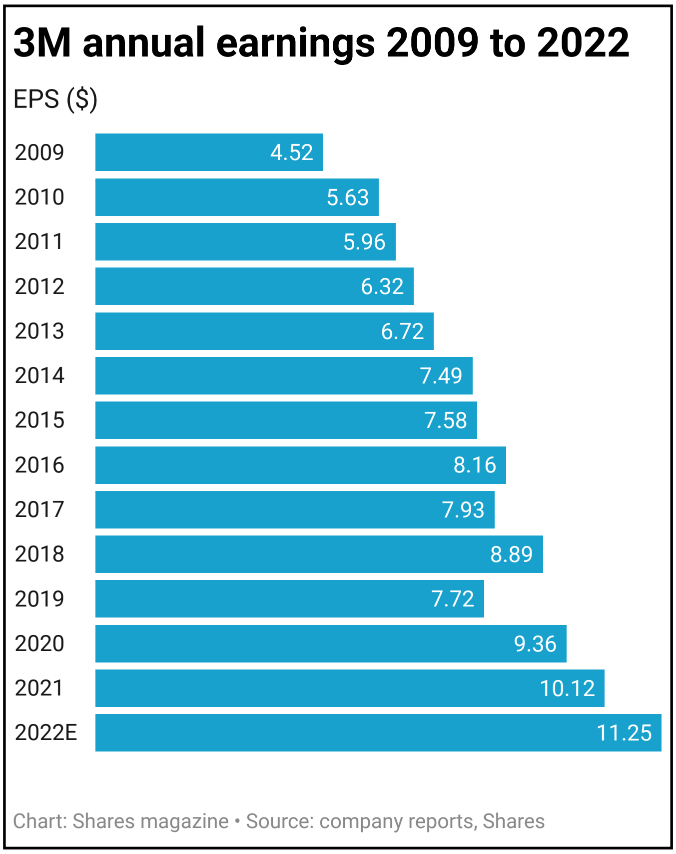


Chart: Shares magazine • Source: company reports, Shares

If we took a hospitality company on the other hand, specifically restaurant operator **McDonald's (MCD:NYSE)**, it would be reasonable to assume its business was dependent on consumer confidence and that the repeated lockdowns caused by the pandemic had a devastating impact on earnings.

Yet, over the same period as the other two stocks, McDonald's hasn't just doubled its earnings, it has increased them by 143% with surprisingly little lasting damage from Covid.



Even more unexpectedly, manufacturing group **3M (MMM:NYSE)**, which produces everything from stationery to industrial coatings and materials for the automotive and aerospace sectors, has also more than doubled its earnings, again showing very little impact from the pandemic.

What this shows is that what may look like a defensive stock doesn't necessarily behave like one in terms of earnings, while stocks which might appear to be cyclical or tied to consumer discretionary spending can turn out to be more defensive than they seem at first glance.

For the record, investor Warren Buffett doesn't buy stocks because they are defensive, he buys them because he has high conviction in their business models. If he wants to be defensive, he dials down his exposure to equities altogether.

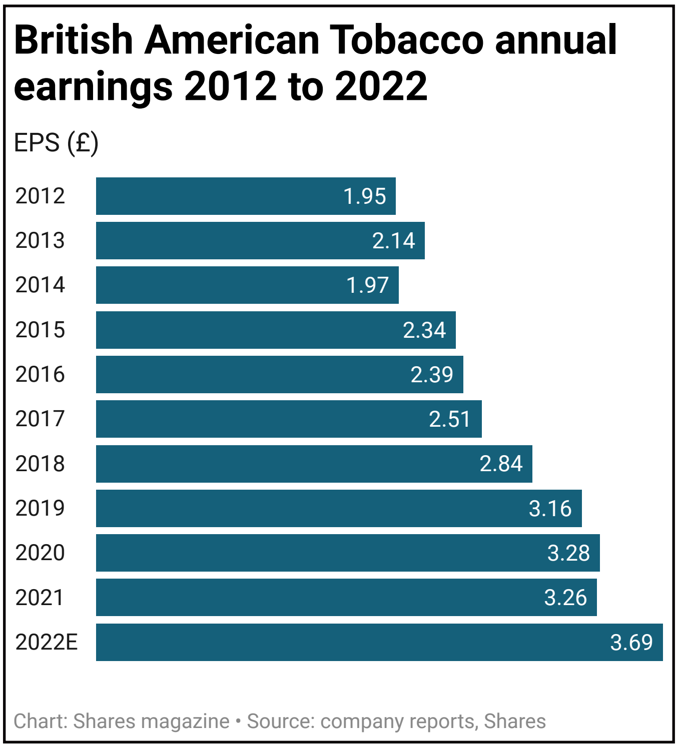
IS IT THE SAME STORY FOR UK 'DEFENSIVES'?

While we don't have quite the same calibre of companies to choose from in the UK, the same principles would seem to apply here as in the US market.

For classic defensive stocks we have looked at the earnings profile of cigarette maker **British American Tobacco (BATS)** and consumer goods and healthcare giant **Unilever (ULVR)**, while for more cyclical business we have analysed pest control firm **Rentokil (RTO)** and fantasy miniatures maker **Games Workshop (GAW)**.

This time we took diluted earnings per share from the end of 2012 to the end of 2021 using earnings from continuing operations to weed out gains on asset disposals.

© British American Tobacco plc



Unilever annual earnings 2012 to 2022

EPS (€)

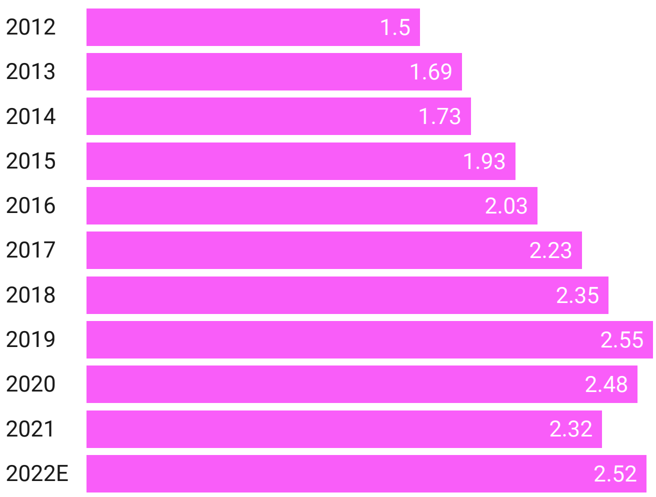


Chart: Shares magazine • Source: company reports, Shares

Once again, the classic defensives under-clubbed it relative to the ostensibly more cyclical stocks with British American Tobacco posting 67% growth and Unilever posting 55% growth while Rentokil managed 116% growth and Games Workshop racked up a scarcely believable 633% growth.

Even if we account for forecast earnings for the current financial year, the so-called defensive stocks still come out second-best.

Rentokil annual earnings 2012 to 2022

EPS (p)

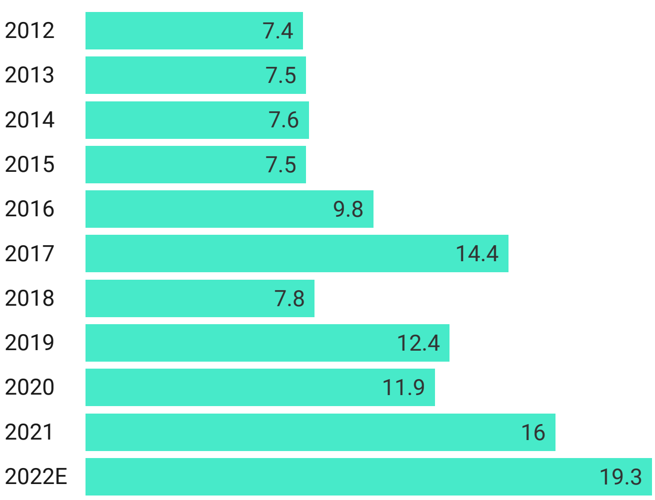


Chart: Shares magazine • Source: company reports, Shares

Games Workshop annual earnings 2012 to 2022

EPS (£)

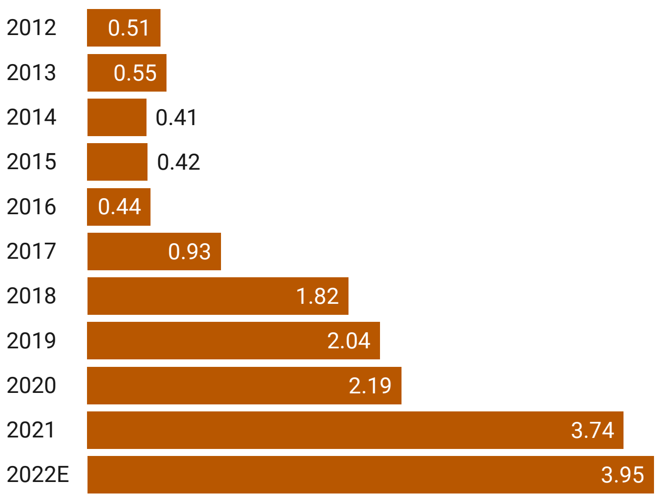


Chart: Shares magazine • Source: company reports, Shares

It could be argued Rentokil benefited from the pandemic due to the increase in demand for hygiene, but at the same time many of its customers had to shut their businesses for long periods of time so it was far from a one-way street.

Games Workshop enjoyed a quantum leap in earnings thanks to its decision to embrace digital marketing and get involved with the video games industry, and it is doubtful the firm will see the same uplift in earnings as it has in the last few years.

Yet what is clear is that stocks with what may appear to be the defensive qualities needed to ride out the ups and downs of the market don’t always do what they say on the tin, while stocks which might not pass the test at first glance can in fact turn out to do a better job.

Find out why stock markets have not fully factored in rising rates

It's useful to understand how discounted cash flow models work

As reflected in the underperformance of the technology heavy Nasdaq Composite index, high growth shares are sensitive to interest rates due to the fact a big chunk of their value is based on cash flows far into the future.

It's not just growth shares though, all shares are impacted by rising interest rates through the mechanism of a higher discount rate.

But have markets discounted the full impact of higher rates? Arguably, falls of 1% in the FTSE 100, 18% in the DAX and 20% in the S&P 500 over the past 12 months look tame relative to the quantum leap in interest rates.

Market strategists at Morgan Stanley and Goldman Sachs are in the camp arguing for a bigger market derating before a market bottom has been reached.

This article takes a closer look at the dynamics of discounted cash flow and the findings suggest markets are vulnerable to further erosion in the ratings at which stocks trade.

DISCOUNTED CASH FLOW

Discounted cash flow is a common investment approach used to value companies in the stock market. It is based on shareholders' claims on a firm's cash flows.

The idea is to add up estimated future cash flows, discount them back to a 'present value' and compare it with the current share price. If the price is below the value of a firm's discounted cash flows, the share is cheap and vice-versa.

WHY ARE CASH FLOWS DISCOUNTED?

Future cash flows are discounted (reduced) for two reasons; first, because of the uncertainty of them

The Nasdaq index has often moved in the opposite direction to US government bond yields

Rebased to 100

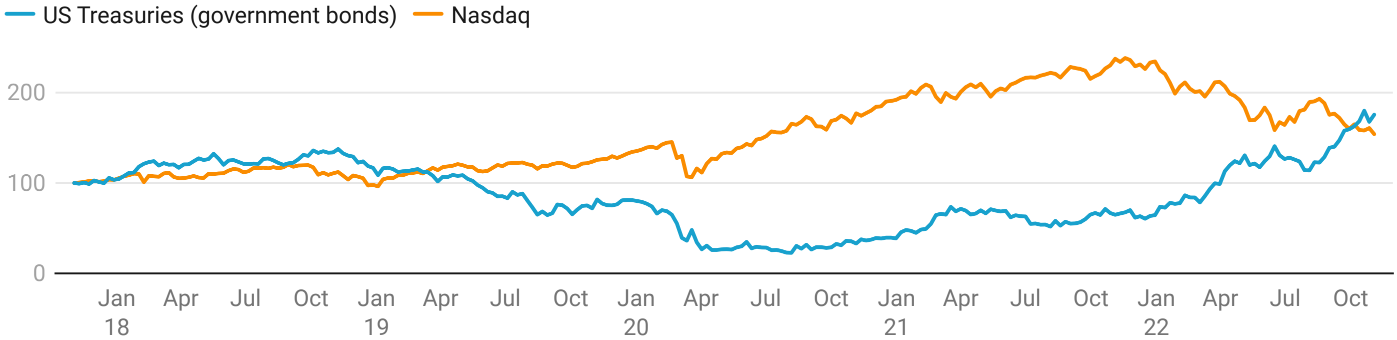


Chart: Shares magazine • Source: Refinitiv

occurring and second, due to the opportunity cost of capital.

Opportunity cost refers to the idea that if the capital is not invested in shares, it could earn a risk-free rate of return in government bonds.

WHAT IS AN APPROPRIATE DISCOUNT RATE?

To answer the question some context is needed because the discount rate is comprised of a risk-free rate and a risk premium, which are explained below. But first, some context.

Up until 2021, government bonds yielded close to zero, even at the 10-year investment horizon, and many bonds traded with negative yields. It may sound crazy today but not long ago, investors were willing to pay borrowers to lend them money.

Ultra-loose monetary policy led to a cost of capital which was virtually zero. But historically 10-year bond yields have traded on average at close to 4% in most developed economies.

Theoretically, zero risk-free rates reduce the return that investors expect to receive which makes higher growth shares more valuable. This was a strong driver of rising price to earnings ratios for growth companies.

Investors were happy to pay 30, 40 or even 50 times expected earnings to own a stock that offered the promise of rapid growth in the future. Today they are less willing to pay such multiples of earnings.

RISK PREMIUM

The risk premium is related to the idea that investors in shares demand a higher return than bonds because they are taking more risk.

The equity – which is another word for stocks and shares – risk premium is measured by comparing long-term share and government bond returns. Historical studies have shown the extra annual return earned by shares has ranged between 4% and 6%.

WHAT DOES A RISING DISCOUNT DO TO SHARE VALUATIONS?

Ten-year bond yields (i.e., risk-free rates) have increased by up to four percentage points in the

Discounted cash flow calculation using 5% cost of equity

	Cash flow (£)	Present value (£)
Y1	115	110
Y2	132	120
Y3	152	131
Y4	175	144
Y5	201	158
Y6	231	173
Y7	266	189
Y8	306	207
Y9	352	227
Y10	405	248
Sum of discounted present values (A)		1,706
Perpetuity rate	0.05	
Present value of cash flows in perpetuity (B)		4,967
Total present value (A+B)		**6,673**

Source: Shares magazine

Discounted cash flow calculation using 9% cost of equity

	Cash flow (£)	Present value (£)
Y1	115	106
Y2	132	111
Y3	152	117
Y4	175	124
Y5	201	131
Y6	231	138
Y7	266	146
Y8	306	154
Y9	352	162
Y10	405	171
Sum of discounted present values (A)		1,359
Perpetuity rate	0.09	
Present value of cash flows in perpetuity (B)		1,899
Total present value (A+B)		**3,257**

Source: Shares magazine

US and UK over the last year. Assuming the risk premium has remained the same then taking the mid-point of the historical average (5%) implies a four-percentage point increase in the discount rate to 9%.

To illustrate the impact of a four-percentage point increase in the cost of capital for a growth company, *Shares* has used an annual growth rate of 15% for cash flows over a 10-year time horizon.

Growth at 15% means £100 of cash flow will quadruple over 10 years. The rule of 70 can be helpful here. Simply divide the growth rate (15%) into 70 to estimate how many years it would take to double.

The answer is roughly five years, which means over 10 years the cash flow will double again. Each year's cash flow must be discounted by the 5% rate, compounded each year.

As illustrated in the table, in year one cash flow of £115 is discount by 5% (divided by 1.05), year two cash flow of £132 is discounted by 1.05x1.05=1.1025 and so on.

Present value cash flows are then calculated. The year 10 discount rate is 1.6289 which reduces the value of that year's cash flow by around 40% to £248.

Total cash flows add up to £1,706. Remember, cash flows can theoretically go on forever, so a value needs to be placed on them.

The simplest way is to do this is to perform a perpetuity calculation. Year 10 cash flow is multiplied by the inverse of the discount rate (5% = 20 times) and then divided by the year 10 discount rate of 1.6289.

The process is repeated using 9% cost of equity and table two shows the present value falls by half. Also note the bulk of the fall sits in the perpetuity calculation. In other words, cash flows far into the future are impacted the most.

By **Martin Gamble** Education Editor

Janus Henderson INVESTORS

Henderson International Income Trust – 2022 Global Dividend Cover Report

This year's edition of Henderson International Income Trust's Global Dividend Cover Report shows how the world's companies face tougher economic times, but they entered 2022 with their dividends better supported by profits, cash flow and balance sheets than they have been for more than 10 years.

Read the report

KEY TAKEAWAYS

Profits

- Global profits jumped 78% in 2021 to a new record of £2.85 trillion.
- Profit rebound led by oil and financial companies, but all sectors and almost every country saw growth.
- Forecast: 2022 profits set to reach record £3.03 trillion.
- Companies face 2023 slowdown from a position of strength.

Dividends

- Global dividends leapt 21.7% to a record £1.10 trillion in 2021, boosted by post-pandemic catch-up.
- H1 2022 global dividends jumped a further 19.1%.
- Forecast: H2 2022 dividends will rise more slowly as catch-up effects fade, but we could see record pay-outs of £1.25 trillion for the full year.

Dividend cover

- Dividend cover was the strongest since 2011 in 2021 at 2.6x.
- US, UK and Europe have seen the strongest rise in cover and most sectors saw improvement.
- Dividend cover is high measured against both profits and cash.
- Forecast: Dividend cover will dip slightly in 2022, but remains above the historic average – good news as the economy slows.

Watch out for yield traps

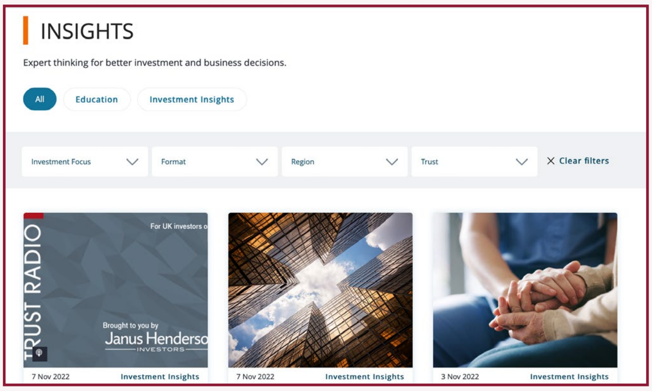
- One company in eight is a yield trap - no increase compared to 2021.

Viewpoint

- Ben Lofthouse: Income is vital in a time of economic uncertainty, and the ability of dividend income.

Visit the website for more information about the [Henderson International Income Trust plc](#).

For more insights, research and commentary on the range of Janus Henderson Investment Trusts, visit the [Insights Hub](#).



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DANNI HEWSON
AJ Bell Financial Analyst

Can a big hospitality winner emerge during recession?

Some companies are benefiting from resilient spending despite the gloomy backdrop

Talk of recession gives investors pause for good reason and over the last year there's been plenty of rebalancing of portfolios undertaken as global economies spluttered and, in some cases, stalled.

Among the first casualties are often hospitality businesses, perceived wisdom is that people cut out discretionary spend, all those nice to haves when times get tough. Certainly, there's been plenty of evidence that people are cutting back, but recent earnings updates show they're not cutting out leisure activities entirely.

Perhaps after a long period when Covid restrictions prevented a trip to the pub or cinema or eating out, people are willing to prioritise and this show of resilience has stoked renewed interest in a sector that's seen valuations plummet since the start of the year.

Recent recessions have seen customers trading down and there are plenty of big names hyper aware that value creates opportunity, but with employment levels still high there are consumers whose budgets are, for now, surprisingly robust. But where is the sweet spot especially as we head towards a predominantly Covid-free Christmas?

Ultimately it will come down to customer base and the ability of brands to really understand and capitalise on that base.

PAYING A PREMIUM

Brian Niccol chair and CEO at **Chipotle Mexican Grill (CMG:NYSE)** commented during a recent earnings call that the 'majority of (its) customers are from higher-income households, which continue to increase purchase frequency' something which has enabled the business to pass on costs with 'minimal resistance' and helped it grow revenues by 13.7% year-on-year. For him it's about giving customers the best 'experience' and making sure that 'pricing stacks up relative to people's alternatives'.

Knowing those alternatives, knowing the customer inside and out has never been more crucial to success. More than half of **Starbucks (SBUX:NASDAQ)** US customer base are Gen Z or Millennials, a customer that 'tends to have significantly more discretionary money at their disposal,' according to the company's interim CEO Howard Shultz.

Despite gloomy global sentiment, September delivered the brand's biggest sales week ever with young coffee lovers downing expensive cold caffeine beverages by the bucket full. It tracks customer trends through its rewards app and targets promotions with pinpoint precision to 29 million members a number which shot up 5% in the last quarter alone.

DANNI HEWSON
AJ Bell Financial Analyst

Shultz says that customer loyalty to Starbucks has been 'quite significant and predictable' and that despite 'almost 6% price increases' that loyalty and transaction numbers haven't been affected.

THE VALUE GAME

But while wealthier people continue to buy pricier food and drinks lower income families are being drawn in by the value offer presented by the likes of **McDonald's (MCD:NYSE)** and KFC-owner **Yum! Brands (YUM:NYSE)**. People do still want to enjoy their lives even if they've got less money to play with.

It's the lipstick effect that was spoken about so often during the financial crisis, consumers want a bit of comfort, a bit of normal, and if they can't afford big ticket items they'll settle for little luxuries.

Yum! Brands CEO David Gibbs is confident his businesses are striking the right note with all their consumers from those looking for pure value to those trading down '…there's a little bit of K-shaped demand for value on the high end.

'That's why you're seeing us do things like the Double Steak Grilled Cheese Burrito at Taco Bell, which is at a higher price point that normal, but still a great value.'

He believes the recessionary environment is actually one that is likely to be beneficial to the whole business which has also been keeping a close eye on consumer insights and market analytics to give customers what they want at the price they want to pay.

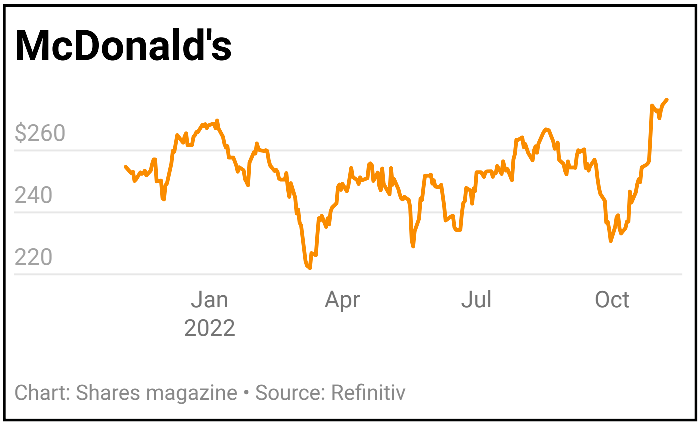
McDonald's certainly seems to have played the pricing game perfectly with global comp sales up almost 10% in the last quarter. President and CEO Chris Kempczinski said on an earnings call 'when we look at consumer scores around value for money, affordability… we continue to lead in this, and it's allowed us to push through some of this pricing …(and) consumers are willing to tolerate it'.

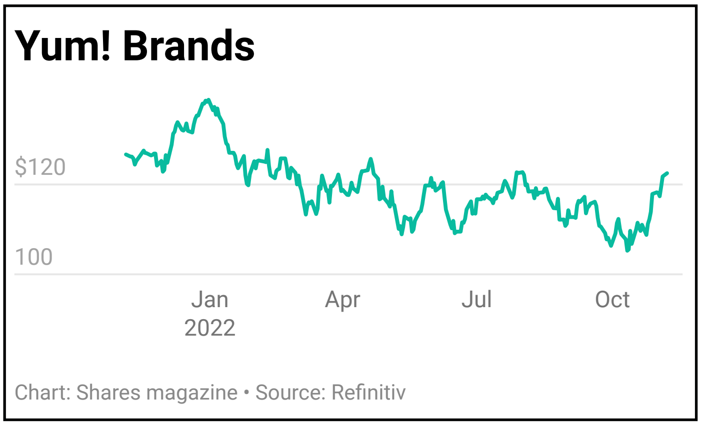
WHY SCALE IS SO IMPORTANT

Scale is likely to play a massive part in the ability of companies to successfully navigate a downturn. Chris Kempczinski made it clear some parts of the world were struggling more than others and said, 'there is increasing uncertainty and unease about the economic environment,' but said he and the franchisees he works with were confident they had the right plans in place to drive growth and would consider implementing country specific help like that employed during Covid lockdowns.

It's clear competition for every consumer penny will be fierce this Christmas with beleaguered retailers hoping people won't ditch gift buying in favour of experiences. For hospitality there will be a place for fine dining but those aspirational customers, customers who trade up for special occasions, are likely to be fewer and trading down has already become a well-worn phrase.

With McDonald's one of the few hospitality businesses enjoying share price growth this year it is clear investors are betting value will be the victor but it's worth thinking about what value means for different demographics and whether value outfits can generate the volumes needed to maintain margins.





VIETNAM HOLDING

Advertorial

Investing better with Vietnam Holding

"We are a long-term investor, and responsible investing helps us select quality companies with sustainable business models and identify and manage potential risks in our portfolio."

Sean Hurst, Chair of VNH's ESG Committee

Over the last year, Vietnam Holding (VNH) has established itself as a leader in responsible investing activities in the Southeast Asian country. VNH received five-star scores for its 2021 PRI reporting, which is the largest global reporting project on responsible investment. The carbon footprint of VNH's 2021 portfolio, meanwhile, is 67.5% lower than the Vietnam All Share Index (VNAS) benchmark, while also outperforming the VNAS index on a year-on-year basis. This can be attributed to sector allocation - with a focus on less carbon-intensive non-manufacturing sectors - as well as stock selection, featuring best-in-class companies actively pursuing emissions reduction initiatives.

Over the last 12 months, Dynam Capital, VNH's investment manager, has also been active in company engagement through both private meetings and collaborative engagement. In March, for example, Dynam hosted a webinar for 50 companies operating in Vietnam to talk about how to increase the accuracy of carbon footprint reporting. This was organized together with Vietnam Energy and Environment Consultancy JSC.

ESG, short for Environmental, Sustainable, and Governance, is an increasingly common phrase in the corporate and investment sectors, but it is not without its critics. Hurst acknowledged these issues, while also affirming that VNH is extremely careful in approaching the topic. "There is a growing concern among some investors about the practice of 'greenwashing,' a fear that ESG has somehow gone too far," he said. "For VNH, we look at each sector separately, and the 'E' is increasingly important, and we were one of the first funds in Vietnam to estimate the carbon footprint of our portfolio."

Carbon footprint reporting is still new in Vietnam, with less than ten listed companies disclosing emissions data in their annual reports. VNH, for its part, uses an external professional firm to help estimate the annual footprint of each portfolio company. "But we have seen greater interest in and willingness to do so from companies in the next few years," said Craig Martin, Chairman of Dynam Capital. "Especially since Prime Minister Pham Minh Chinh announced at COP26 that Vietnam will make efforts to achieve its net-zero targets in 2050." This serves as crucial context for VNH's responsible investing efforts, as the fund announced its own net-zero goals just before COP26, aligning with the Vietnam's government's agenda.

Officials have taken several steps down this path in the months since the climate summit. In January, a new decree outlined regulations on the reduction of greenhouse gas emissions and protection of the ozone layer. Then, in June, a circular development scheme was approved. It aims to, among other goals, reduce the intensity of greenhouse gas emissions per GDP by at least 15% by 2030. Perhaps most noteworthy is the Power Development Plan 8 (PDP8), which will guide Vietnam's energy policy until 2030 with a vision to 2045. While the plan has not been finalized and is overdue, drafts have outlined a continuation of the country's strong renewable energy development in recent years, especially in terms of solar and wind. The most recent PDP8 draft envisions a power mix of 50.7% wind and solar by 2045, with possibly just 9.6% of power coming from coal. Offshore wind, which remains largely untapped, is expected to be a major generator of electricity in the future.

To be sure, these are hugely ambitious goals that will require massive financial investments, but the guidelines are promising, and both investors and private companies have important roles to play." After COP26, the government's efforts in changing its energy strategies and relevant policies have shown the country is willing to address climate change," Martin said. "We think institutional investors in the Vietnamese market have a role in encouraging change, alongside the government and business. Some investors are also specifically looking to invest in companies that provide low-carbon solutions and technology to help the country speed up its decarbonization journey."

VISIT WWW.VIETNAMHOLDING.COM FOR MORE INFORMATION

Discover how to invest in the big automation megatrend transforming our world

Why this is an attractive area for investment and the funds to help you get exposure

The robots are coming. No, this is not a re-run of Orson Well's infamous 1938 'War of the Worlds' Halloween radio show prank, but it could be a solution to a productivity conundrum with which mature economies have been grappling for decades.

Experts are calling automation an investment megatrend, including analysts at Goldman Sachs, Morgan Stanley, JPMorgan and Pictet. And thanks to the emergence of dedicated low-cost ETFs and tracker funds, it's never been easier for ordinary investors to back the theme.

The website Just ETF lists a handful of robotics and automation ETF options for UK investors, while there are several managed funds, if that's what you prefer.

But why should investors put their hard-earned cash to work in the automation theme?

REASONS TO INVEST IN AUTOMATION

This is an area seeing a lot of investment. Data from Statista shows that global sales volumes of industrial robots have tripled over the past 15 years or so, peaking at around 422,000 units in 2018, before easing back during the pandemic. 384,000 units were sold in 2020.

During the early 1990s, say Canaccord Genuity analysts, there were on average 20 industrial robots per 10,000 employees. That has increased 10-fold for the wider manufacturing industry to 200 per 10,000, yet this is still way behind the automotive industry, the most robot-embracing industry of all. Canaccord estimates that there are about 1,200 robots per 10,000 employees among vehicle makers.

'**Amazon (AMZN:NASDAQ)** has about 3,000 robots per 10,000 human workers,' adds Canaccord.

In 2020, the worst year for global GDP since the Second World War, automation capital spending was the fastest-growing segment of GDP, according to Chris Versace, the chief investment officer and thematic strategist at Tematica Research.

'This could mean great things for more than just the bottom line of those companies providing such technologies,' says Versace.

'Better electronics, microchips, network connectivity and artificial intelligence are improving the capabilities of robots and automation systems at a rapid pace and leading to a sharp rise in the number of so-called "dark factories".'

New installations of industrial robots worldwide in 2020, by industry

Electronics	109,000
Automotive	80,000
Metals & machinery	41,000
Plastics & chemicals	19,000
Food	12,000
Unspecified others	86,000

Table: Shares magazine • Source: Statista

> *Though it sounds like a dream, lights-out factories are the industry 4.0 future that's already in action.*
>
> **ASE Group**

These are manufacturing hubs that are fully automated, need no human workforce, and therefore don't need lighting, freeing humans from boring and repetitive tasks, cutting errors and allowing people to use their soft skills, like customer service.

'Though it sounds like a dream, lights-out factories are the industry 4.0 future that's already in action,' says ASE Group, which operates several dark factories in its homeland of Taiwan.

On a simple level, automation is about getting bang for your buck, both for companies implementing automation strategies, and for investors. 'When a company spends money, they are trying to generate higher return on investment,' says Xuesong Zhao, who runs the **Polar Capital Automation and Artificial Intelligence Fund (BF0GL54)**.

'Even though the initial investment is high, it will solve problems for the long-term.' This is not always appreciated by investors, Zhao believes.

INSIGHT FROM FOOD AND FARMING

Agriculture is a useful case study about investing in automation, when the tractor transformed agriculture from a human and horse-powered

US-listed Robo Global Robotics and Automation ETF top holdings

Intuitive Surgical	US	2.20%
Autostore	Norway	1.91%
Keyence	Japan	1.87%
Cognex	US	1.83%
Rockwell Automation	US	1.79%
Illumina	US	1.78%
Harmonic Drive Systems	Japan	1.75%
IPG Photonics	US	1.75%
Novanta	US	1.66%
ATS Automation Tooling Systems	Canada	1.64%

Table: Shares magazine • Source: ROBO Global, 3 November 2022

industry into a mechanised one, increasing farm productivity dramatically.

Between 1950 and 2015, total farm output nearly tripled, while employment dropped by more than two-thirds. Farms also switched from horses consuming the equivalent of 22% of farm-produced crops to tractors fuelled by another source of energy, which freed up crops for sale. Overall, the combined impact was to increase returns on capital employed.

Robotics is affecting every link in the food supply chain, from farm to fork. The value of the global food automation industry is expected to double in the next five years, reaching $2.5 billion this year.

'If we look at the summer earnings season that we've just had, we've got aggregate robotics and automation company sales growth set to reach 13% for 2022,' says Richard Lightbound, who has worked for 20-plus years in the financial and treasury services industry and is currently CEO of ROBO Global Partners, which runs the index behind **L&G ROBO Global Robotics & Automation ETF (ROBG)**.

According to Lightbound, average sales growth of companies in the ROBO ETF since inception nine years ago is 8%. 'Step back and look where we are in the world. We've got inflation, we've got labour shortages, we've got supply chain constraints, the obvious answer is automation.'

With machine learning and connected sensors, low price robots of all sizes and capabilities should continue to empower humans. Over time, most robots will become collaborative, aiding humans and turbocharging productivity as the digital economy empowers the physical economy.

Polar Capital's Zhao says **Siemens (SIE:ETR)** is a good example of this inter-connectedness. The German engineering firm has 20 manufacturing hubs that can communicate, collect vast amounts of data, crunch the numbers and come up with predictive outcomes that allow engineers to be directed to where problems are likely to occur soon, rather than waiting for kit to become faulty, potentially saving millions of manufacturing downtime.

French engineering software company **Dassault Systemes (DSY:EPA)** has a suite of tools designed to develop industrial automation control systems. Its ControlBuild suite is being provided to customers across the industrial sphere, in packaging, metallurgy, power plants for energy, healthcare, food and drink, and more, demonstrating the scope for automation to increasingly touch more parts of our lives.

Examples of 'dark factories' in action

	Robotics	FANUC in Japan has been building robots with other robots in dark factories for 20 years
	Devices	Philips in the Netherlands produces electric razors with a dark factory manufacturing line of 128 robots
	Food and beverage	The UK's Ocado is an online-only grocer with a warehouse of 3,000 robots used to fulfil orders
	Semiconductors	ASE in Taiwan uses completely automated factories to help create, assemble and test semiconductor devices

Table: Shares magazine

London-listed Robotics & Automation ETF options

ETF	Ongoing charges
Lyxor MSCI Robotics & AI (ROAI)	0.4%
iShares Automation & Robotics (RBOD)	0.4%
Global X Robotics & Artificial Intelligence (BOTZ)	0.5%
L&G ROBO Global Robotics and Automation (ROBG)	0.8%

Table: Shares magazine • Source: JustETF

Leeds-based **Tracsis (TRCS:AIM)** does something similar for the UK's rail network, providing remote monitoring systems across the thousands of miles of Network Rail's track, points and junctions.

SOLVING REAL WORLD PROBLEMS

Robots and automation have the scope to increase productivity, reduce costs and help solve the challenges linked to an increasingly elderly population. As this becomes increasingly apparent, investors can expect to see the automation industry grow significantly faster than the broader economy over the coming years.

'I've got an electric car,' ROBO Global's Lightbound says. 'It had a software upgrade recently and the acceleration was significantly different afterwards,' he says. 'I didn't take it to a garage, did nothing mechanical, it was purely just the software upgrade, delivered remotely, that made the car more efficient and powerful.'

The bottom line for investors is that the pace of automation is likely to accelerate significantly in the coming years, and with it, we will see the potential for dramatic improvements in the quality of life and pace of economic growth along with enormous shifts in the labour force. That sounds like a megatrend that may be worth backing.

By **Steven Frazer** News Editor

Corporate bonds are looking more attractive – here's how they stack up

The easiest way to invest in this space is via a fund

Two developments have combined in 2022 to make corporate bonds a potentially more attractive option for investors.

First the risk-free rate (the yield on government bonds) which all other bonds are priced against has gone up. At the same time, the difference between the risk-free rate and the yield on corporate debt, which is known as credit spreads, has also moved higher.

The combination of these intertwined factors has prompted Lesley Dunn, manager of **Baillie Gifford Strategic Bond Fund (0594774)**, to say: 'This is the first time in a long time we have been excited about valuations in the corporate bond market.'

She observes the yield on the Baillie Gifford fund has roughly doubled to 4.1% thanks to this move higher in both the risk-free rate and credit spreads. The fall in bond prices means there is scope for capital appreciation from this asset class as bond prices recover, again for the first time in ages.

WHAT ARE CORPORATE BONDS?

Companies sell bonds to investors in exchange for cash which they have to repay over an agreed timeframe – this can range from a few months to 30 years.

They pay a regular interest payment to the investor which is called 'the coupon'. In most cases the coupon remains fixed until the end of life of the bond.

The issue price of the bond is called 'par value' and once the bond term ends, referred to as 'maturity', the initial amount of money received for the bond is paid back at par value.

While payments from bonds are not guaranteed, creditors are above shareholders in the pecking order if a company was to run into financial trouble and there were claims on its assets.

With bonds, the investor (the person buying the bond) must weigh up the creditworthiness of the issuer or borrower (the entity issuing the bond), especially in higher risk corporate bonds, because there is always a chance that the original capital will not be paid back in full.

Corporate bonds are separated into investment grade and non-investment grade. In the latest trading update from aerospace engineer **Rolls-Royce (RR.)**, for example, it talked about aiming 'to return to an investment grade credit profile in the medium term supported by free cash flow generation' as it pays down debt which piled up during the pandemic.

HOW TO INVEST IN BONDS THROUGH FUNDS

Investing in corporate bonds can be difficult for ordinary investors so bond funds are an alternative way of putting cash into this part of the market

Baillie Gifford Strategic Bond top holdings

Bharti Airtel 5.65% 2025 Perp	2.7%
Virgin Media 5% 2027	2.6%
EDP 4.496% 2024/79	2.5%
NatWest Gp 2.875% 2026	2.4%
LeasePlan 7.375% 2024 Perp AT1	2.3%
Netflix 4.625% 2029	2.0%
Co-operative Group 7.5% 2026	2.0%

Table: Shares magazine • Source: Baillie Gifford, data to 30 September 2022.

and benefiting from the higher yields available. The performance of bond funds has been poor over the last 12 months thanks to the big drop in bond prices. Lower prices now make them more attractive.

Some funds specialise in high-yield bonds, some are narrowly focused on investment grade or government bonds, while 'strategic' bond funds have more flexibility to invest in different types of fixed-income assets.

Baillie Gifford Strategic Bond Fund takes this a step further by pursuing a definite 'bottom-up approach'. Where some issuers might be disregarded by investors thanks to the wider macro environment, Dunn and her colleagues are prepared to keep an open mind. The fund takes at least a three-to-five-year view with its investments.

The historic returns delivered by the fund are not outstanding compared with the strategic bond peer group, but the current market conditions and the indiscriminate way bonds have been sold off are fertile ground for its bottom-up strategy. Ongoing charges are 0.52% and it pays out a monthly dividend.

Dunn observes that the fund has been buying bonds from banks which should benefit from rising interest rates. '**Santander (SAN:BME)** bonds are yielding 7.5% despite it always delivering in the past and even bonds from names like **Barclays (BARC)**, **JPMorgan (JPM)** and **Natwest (NWG)** are offering 6% yields,' she says.

HOW DOES ESG COME INTO IT?

When the Baillie Gifford fund researches a bond issuer it is looking for resilience and part of that

Strategic bond funds ranked by performance

Fund	One-year performance (%)	Three-year performance (%)	Five-year performance (%)	10-year performance (%)
Jupiter Merian Global Strategic Bond L Inc	1.4%	11.8%	**20.5%**	19.8%
Allianz Strategic Bond C	-17.2%	-1.5%	**13.6%**	36.9%
Invesco Tactical Bond (UK) X Acc	-6.9%	7.8%	**10.3%**	n/a
Invesco Monthly Income Plus (UK) No Trail Acc	-10.9%	2.8%	**6.4%**	46.1%
AXA Framlington Managed Income Z Gross Acc	-11.3%	-0.2%	**5.1%**	60.9%
M&G UK Inflation Linked Corporate Bond R Inc	-1.5%	2.7%	**4.9%**	16.6%
Schroder Strategic Credit Z Acc	-10.4%	-2.0%	**2.8%**	24.4%
Royal London Short Duration Credit M Inc	-8.3%	-3.3%	**2.7%**	n/a

Table: Shares magazine • Source: FE Analytics, data to 4 November 2022. Total return in GB

WHICH STRATEGIC BOND FUNDS HAVE PERFORMED BEST?

The table in this article shows a selection of larger corporate bond funds and how they have performed over time.

It has been a difficult period for the sector, particularly of late as years of consistent gains for the wider asset class have unwound due to rising interest rates and mounting inflation.

Merian Global Strategic Bond (B1XG8J6) and **Allianz Strategic Bond (BYT2QW8)** impress on a five-year view.

The Allianz product uses derivatives to take currency exposure and short and long positions on the bond market and made some smart investment decisions during the pandemic-inspired volatility in 2020.

On a 10-year view the best performer is **GAM Star Credit Opportunities (B54L8Q5)**, which benefits from the four-decade experience of its well-regarded manager Anthony Smouha, though investors do have to pay higher ongoing charges of 1.11% for this expertise.

is considering ESG (environmental, social and governance) factors.

Dunn explains this doesn't mean excluding specific sectors. She cites the example of a US oil company whose bonds the fund recently sold because they were insufficiently committed to the energy transition, drawing the contrast with another holding, the debt of UK-based Neptune Energy, which has credible targets in place.

'While we don't exclude sectors, there are some like tobacco, where we don't have an allocation, and they would have a hard time fitting in our sustainability framework,' Dunn adds.

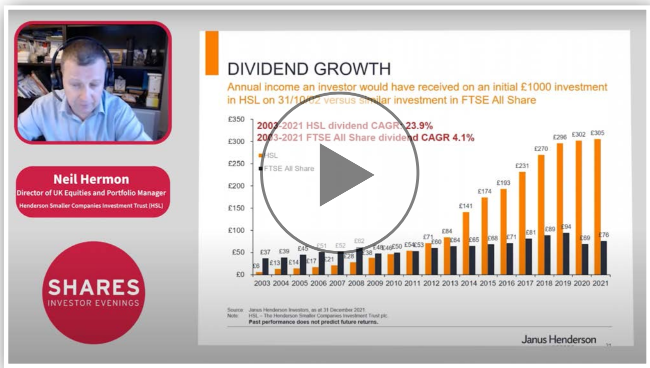
The fund has a higher allocation to the debt of US and UK companies than it does to European firms and has recently been moving out of higher yielding bonds and into investment grade bonds. This reflects improved valuations for the latter thanks to the recent sell-off and an aim to protect the portfolio against default risk amid a downturn in the global economy.

By **Tom Sieber** Deputy Editor

WATCH RECENT PRESENTATIONS

Mercia Asset Management (MERC)
Dr. Mark Payton, CEO &
Martin Glanfield, CFO

Mercia Asset Management is a proactive, specialist asset manager focused on supporting regional SMEs to achieve their growth aspirations. It provides capital across its four asset classes of balance sheet, venture, private equity and debt capital; the Group's 'Complete Capital Solution'.



Henderson Smaller Companies Investment Trust (HSL)
Neil Hermon, Director of UK Equities

Henderson Smaller Companies Investment Trust aims to maximise shareholders' total returns (capital and income) by investing in smaller companies that are quoted in the United Kingdom by following a disciplined process of investment in a diversified portfolio of companies.

Seraphim Space (SSIT)
Rob Desborough, Managing Partner & CEO, Seraphim Accelerator

Seraphim Space are the global leader in SpaceTech investment. We endlessly explore the ecosystem to discover and invest in the brightest minds and smartest ideas which will provide trailblazing, high value solutions that disrupt, transform and improve life as we know it.

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I've paid too much tax on my pension withdrawals. How do I get it back?

HMRC often overtaxes people with pensions but it's easy to recover the money

I've taken a £50,000 ad-hoc lump sum out of my pension and by my calculations HMRC has overtaxed me by several thousand pounds. What's the quickest way to get my money back?
Sandeep

Tom Selby, AJ Bell Head of Retirement Policy, says:

You might think that when you access your pension pot in line with Government rules, you will pay the correct amount of tax on your withdrawals automatically.

This should be the case if you take a regular income from your pension, but if you take a single taxable withdrawal – either via drawdown or an ad-hoc lump sum (sometimes referred to as a 'uncrystallised funds lump sum' or UFPLS) – you will likely be overtaxed by HMRC.

Since 2015, HMRC has chosen to tax the first flexible withdrawal someone makes in a tax year on a 'Month 1' basis.

This means HMRC divides your usual tax allowances by 12 and applies them to the withdrawal, often landing hard-working savers with shock tax bills.

For those taking more than one withdrawal in the tax year, your tax code should automatically adjust. However, this is not the case where you only make a single taxable withdrawal. If you just take your 25% tax-free lump sum, you should not pay any tax regardless.

A staggering £925 million has been reclaimed by people who have filled out the correct forms since April 2015. In July, August and September of 2022 alone, more than £33 million was reclaimed by almost 10,000 people, with an average reclaim of more than £3,300.

The true figure is likely to be higher as many of those who have been overtaxed will not fill in one of these forms but wait for HMRC to correct the situation at the end of the tax year.

HOW TO GET YOUR MONEY BACK

If you are taking a steady stream of income via drawdown then you shouldn't need to take any action, as HMRC will adjust your tax code to ensure that over the course of the year you are taxed the correct amount.

However, if you make a single withdrawal then you will either need to fill out one of three forms or rely on HMRC putting you in the correct position at the end of the tax year.

Which form you need to fill out will depend on how you have accessed your retirement pot:

- If you've emptied your pot by flexibly accessing your pension and are still working or receiving benefits, you should fill out form P53Z,
- If you've emptied your pot by flexibly accessing your pension and aren't working or receiving benefits, you should fill out form P50Z,
- If you've only flexibly accessed part of your pension pot, then use form P55.

Provided you fill out the correct form HMRC says you should receive a refund of any overpaid tax within 30 days.

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.

Five ways to avoid inheritance tax

Gifting, SIPPs, trusts, AIM shares and certain insurance policies can help

Taxes don't generally win popularity contests, but if there is one that gets heckles up, inheritance tax is probably it. Only around one in 25 deaths result in an inheritance tax liability, but at a tax rate of 40%, it can really eat into the money you leave to your heirs if you fall foul of it.

There is a relatively generous amount that can be passed down the generations with no tax to pay, which currently sits at £325,000 per person, with an additional £175,000 allowance for homes worth under £2 million.

Assets passed onto your spouse or civil partner also aren't subject to inheritance tax, and you can pass your tax-free allowance on too. Beyond that though, there are further legitimate steps you can take to mitigate inheritance tax or avoid paying it all together. Here are five of them.

GIFT SOME OF YOUR MONEY TO FAMILY

1 Gifting is probably the simplest way to pass your assets on to your children and grandchildren without paying inheritance tax. However, if you die within seven years of making a gift, inheritance tax will be payable on a sliding scale.

There are some notable exemptions to this seven-year rule. Everyone can gift up to £3,000 of their assets to beneficiaries each tax year without that sum becoming liable to inheritance tax, no matter when they die.

A family wedding could be another occasion to consider passing some money on. Gifts of up to £5,000 to children made in advance of a wedding are protected from inheritance tax, irrespective of when you die, and up to £2,500 for grandchildren.

You are also allowed to make gifts from your surplus income, provided they are regular and documented. The rules around this form of gifting are complex, so it's probably a good idea to seek the services of a qualified financial adviser if you are going down this route.

USE A SIPP PENSION

2 A SIPP (self-invested personal pension) could also be a useful tool to pass wealth onto younger generations, though its purpose first and foremost is to provide you with a retirement income.

You can nominate beneficiaries for your SIPP in the event of your death, which must be officially submitted to your pension provider, and inheritance tax is not generally payable.

If you die after the age of 75 though, your beneficiaries will need to pay income tax on money they take out of the pension, which could be 20%, 40% or 45%, depending on whether they are a basic, higher, or additional rate taxpayer.

The amount of income tax paid can be mitigated by withdrawing money from the SIPP gradually. Or non-taxpayers, such as children, would pay no tax on withdrawals up to the annual tax-free income allowance, currently set at £12,570.

USE A TRUST

3 Setting up a trust to hold your assets is another option to consider, though this is a complex area, which requires a financial adviser to walk you through it.

The benefit is that whoever you appoint as the trustee can control the assets rather than being passed onto the beneficiaries right away.

This might be useful if you are concerned about gifting assets to a loved one who is perhaps not renowned for their financial prudence, or perhaps to young grandchildren.

Trusts can be expensive to run and subject to tax charges, which together with their complexity generally makes them worthwhile in only a few circumstances.

INVEST IN CERTAIN AIM-QUOTED SHARES

4 Investing in certain AIM shares also comes with inheritance tax benefits, because many stocks on London's junior market qualify for business property relief.

You must hold the shares for a minimum of two years before you are eligible for this IHT exemption, and not all AIM shares qualify.

HMRC has published the rules which determine which sort of businesses qualify for this relief, but they don't publish a definitive list unfortunately.

So, there is some risk of misinterpreting the rules.

You also shouldn't invest in a company simply for tax purposes. If you make a poor investment it can end up costing an awful lot more than 40% inheritance tax. If you don't wish to select shares yourself, there are some professionally managed AIM portfolios available on the market, though they do tend to be quite expensive in terms of charges.

OBTAIN AN INSURANCE POLICY

5 A final option to consider is setting up an insurance policy which pays out when you die, and thereby covers any inheritance tax liability.

The policy should be written in trust, so the pay-out doesn't fall into your estate and therefore be subjected to inheritance tax itself. Again, the guidance of a financial adviser should be sought here.

This route offers you peace of mind that your beneficiaries won't struggle with a huge inheritance tax bill when you die, but you are effectively paying at least part of that bill while you are alive through your monthly premiums, which can be substantial.

If you die quite young, you probably get a good deal from the insurance policy, but if you live to a ripe old age, you won't.

However you choose to deal with the question of inheritance tax, the most important thing is to make a plan in good time. It can be a difficult subject to bring up, particularly for those who stand to be beneficiaries, so if you're in the fortunate position of having a large pool of assets to pass on, it's probably a good idea to start the conversation yourself.

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

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:
16 November: Sage. **17 November:** Grainger.

Half-year results:
11 November: Urban Logistics REIT. **14 November:** SRT Marine Systems, Totally. **15 November:** Cropper (James), Wincanton. **16 November:** Castings, CMC Markets, Premier Foods, Schroder Real Estate Investment Trust. **17 November:** Burberry, Halma, Intermediate Capital, Investec, Syncona. **18 November:** Liontrust Asset Management.

Trading updates
11 November: Regional REIT, Vistry. **14 November:** S4 Capital. **17 November:** Spirax-Sarco Engineering.

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