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TERRY SMITH One of my biggest mistakes with Fundsmith Equity Fund


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Terry Smith reveals one of his biggest mistakes with Fundsmith Equity Fund

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CHINA vs INDIA

What you need to know before you invest

By James Crux

WHY THE REOPENING EXCITES

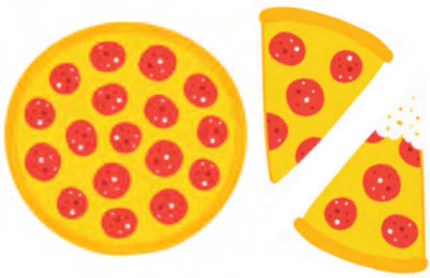
Indian stocks have performed well recently but valuations are much more attractive in China.

This week's main feature compares the two Asian countries and where the experts see good opportunities.

Visit our website for more articles

Did you know that we publish daily news stories on our website as bonus content? These articles do not appear in the magazine so make sure you keep abreast of market activities by visiting our website on a regular basis.

Over the past week we've written a variety of news stories online that do not appear in this magazine, including:



Smithson blames rising rates for 'particularly painful' performance last year

Why new CEO Schumacher needs to bring sharper focus to Unilever

Direct Line chief executive steps down after scrapped dividend fiasco

Sainsbury's shares hit nine-month high on surprise stake-building news

Why Alphabet should be afraid of Microsoft's $10 billion investment into ChatGPT

There is a good reason everyone's talking about the Chatbot

The idea of **Alphabet's (GOOG:NASDAQ)** Google search engine being disrupted seems far-fetched given its huge global market share.

But the conversation has been given more credence after **Microsoft (MSFT:NASDAQ)** announced a multi-year $10 billion investment in OpenAI's ChatGPT.

The deal comes less than two months after OpenAI launched ChatGPT which has since gone viral. The company said it has trained a model capable of interacting in a conversational way, providing answers to follow-up questions and challenge incorrect premises.

OpenAI is a not-for-profit company founded in 2015 by Elon Musk and Sam Altman to develop AI in ways which benefit mankind as a whole.

The latest deal gives Microsoft preferential rights to commercialise OpenAI's technology according to a *Financial Times* report. It also opens the prospect of the two tech giants going 'head-to-head' in the race to develop the next generation of internet search using natural language.

While Google won the 'search wars' decades ago and dominates the search landscape, Microsoft's Bing search engine still generates billion of dollars in annual revenue.

Rather than spend money overhauling the engine Microsoft has said it plans to use OpenAI's technology to find new ways of presenting information to its users while they are inside other applications and reducing the need to use a search engine.

WHY IS EVERYONE SO EXCITED BY CHATGPT?

ChatGPT is the first commercial technology which allows consumers to interact in a natural way with their computers by asking specific questions to identify what they need.

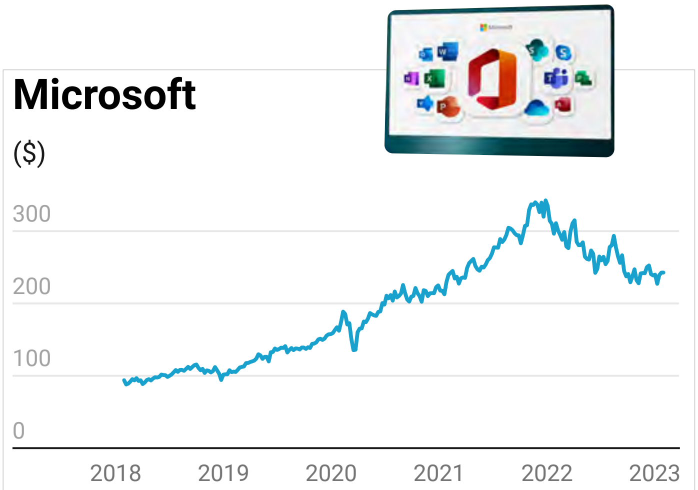


Chart: Shares magazine • Source: Refinitiv

The technology doesn't need to trawl across the internet for answers like a search engine is designed to do. Instead, it uses information studied from vast swathes of training data.

AI (artificial intelligence) researcher and economics professor Anton Korinek told *CNET*, 'ChatGPT can answer its users with a single clear response compared to the myriads links of traditional search engines.

'It also has capabilities that are far beyond traditional search engines, like [the ability] to generate new text, explain concepts, have a back-and-forth conversation.'

This should be a worry for Google because it could eventually supplant traditional search engines.

WHAT IS GOOGLE DOING IN RESPONSE?

However, Alphabet claims it has developed a more powerful chatbot called LaMDA (Language Model for Dialogue Applications) which can similarly use natural language.

The dilemma for Alphabet is that its current search business is very profitable and finding a better solution would result in fewer searches argues former Google search executive Sridhar Ramaswamy.

The official Alphabet line for not releasing its own version of ChatGPT is related to potential social and ethical risks. [MG]

Weakness in the chip industry could spell trouble for the whole tech sector

Profits this year are seen 'challenged' as supply outweighs demand

Given its historic reputation as an indicator of general risk appetite, investors may be wondering why the Philadelphia Semiconductor index, or the SOX as it is known, is falling while the broader US stock market is rising on hopes of a 'soft landing' for the economy.

The reason for the weakness is the current chaos in the $160 billion memory-chip industry, which is struggling with an inventory glut at the same time as demand for some cheaper-end memory products is falling.

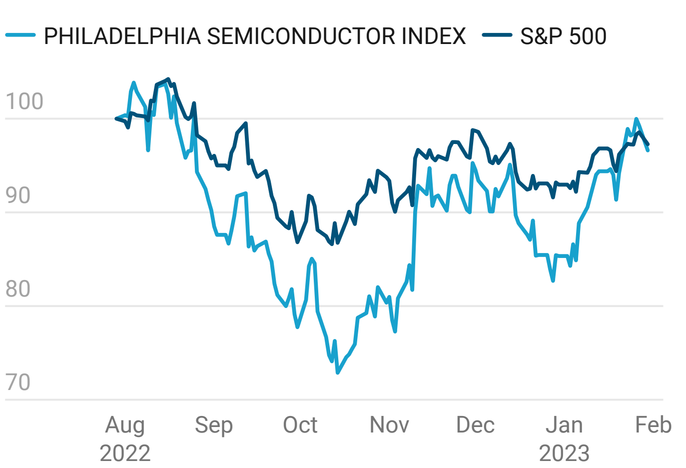


Chart: Shares magazine • Source: Refinitiv

The chip sector is notorious for swinging from boom to bust almost at the drop of a hat as the economic cycle changes, product cycles shift and manufacturers over-invest in new capacity.

Total worldwide semiconductor sales hit nearly $530 billion in 2021 as customers rushed to stock up after supplies dropped in response to Covid, but the shortfall in chips has been reduced at the same time as supply chain bottlenecks have eased.

The result is customers are cutting future orders as they already have enough stock to work with, sending chip prices tumbling.

Also, sales of some high-volume products which use lots of chips are slowing.

Take smartphones, where South Korean firms such as **Samsung Electronics (005935:KRX)** and **LG Electronics (066570:KRX)** are major players.

Both firms delivered disastrous quarterly numbers last month and warned of falling demand for phones, televisions and home appliances.

Consumer and investor favourite **Apple (AAPL:NASDAQ)** is due to report as *Shares* goes to press, but an educated guess would suggest iPhone sales won't be immune from a broader slowdown.

Sales of personal computers and tablets are also falling, with volume shipments this year expected to be around 270 million against 286 million last year and 340 million in 2021 according to Gartner.

In retrospect, it is clear higher spending during the pandemic, fueled by working from home and stimulus (or furlough) payments, simply brought sales of these items forward and now the consumer electronics industry is facing a cliff-edge in demand.

In December 2022, chipmaker **Micron (MU:NASDAQ)** reported a 38% drop in its previous quarter's revenues, together with a collapse in its gross margin, and warned the industry's profitability would be 'challenged throughout 2023'.

On 26 January its rival **Intel (INTC:NASDAQ)** reported a 32% drop in fourth-quarter sales and predicted an even bigger fall of 40% for the first quarter of 2023 due to weaker end-markets and falling prices.

As more companies report bad news, there is a risk negative sentiment starts to spread outside of semiconductors to other highly operationally-geared and capital-intensive areas of the technology sector leading to some of the biggest names being pulled down in sympathy. [IC]

Why Caterpillar's results are better news for wider economy than itself

Revenue growth across the board suggests demand remains strong but margins are under pressure

Thanks to the size and the breadth of its market exposure, the performance of US industrials firm **Caterpillar (CAT:NYSE)** is often seen as providing an insight into the health of the global economy.

The messages from its fourth quarter earnings report (31 Jan) were mixed but ultimately contained more encouragement for global economic prospects than they did for the company itself.

Sales were ahead of expectations, but the manufacturer of heavy machinery missed forecasts with its earnings for the first time since 2020. The shares fell back modestly on the announcement though notably they have, like other companies with sensitivity to the economic backdrop, enjoyed strong gains in recent months.

This reflects increasing hopes of a soft landing, with central banks able to ease up on interest rate hikes before inflicting too much pain on the economy. Since the beginning of October, Caterpillar's share price is up nearly 60%.

Demand doesn't seem to be a problem as Caterpillar's revenue for the three months to 31 December increased 20% to $16.6 billion; for the entirety of 2022 it was up 17% to $59.4 billion. Revenue across all three of its main business areas, construction, mining, and energy and transportation was higher than forecast.

However, the company was tripped up by supply chain issues and higher manufacturing costs which hit margins, particularly in the energy and transportation part of the business. Currency movements, principally the continuing strength of the dollar, also impacted earnings per share to the tune of $0.41. This helped earnings to fall short of the consensus forecast of $4.05 at $3.86.

With the US currency starting to weaken, Caterpillar could get some relief in this area in the first quarter. A drop in margins raises some questions about its pricing power and whether the company is sacrificing some profitability to maintain its market share or is simply facing a lag in passing on higher costs. [TS]

Caterpillar Q4 earnings

	Actual	Consensus	Beat/miss
Revenue	**$16.6 billion**	**$16.01 billion**	**Beat**
Construction industries	$6.85 billion	$6.52 billion	Beat
Resource industries	$3.44 billion	$3.23 billion	Beat
Energy & transportation	$6.82 billion	$5.51 billion	Beat
Operating income	**$2.81 billion**	**$2.69 billion**	**Beat**
Construction industries	$1.49 billion	$1.27 billion	Beat
Resource industries	$605 million	$565 million	Beat
Energy & transportation	$1.18 billion	$1.06 billion	Beat
Operating margin	**17.0%**	**16.8%**	**Beat**
Construction industries	21.7%	19.5%	Beat
Resource industries	17.6%	17.5%	Beat
Energy & transportation	17.3%	19.2%	Miss
Adjusted earnings per share	**$3.86**	**$4.05**	**Miss**
Operating cash flow	**$2.74 billion**	**$3.5 billion**	**Miss**

Table: Shares magazine • Source: FE Analytics, Google Finance, in local currency, as of 30 Jan 2023

New boss has his say as Rolls-Royce stages big share price recovery

Incoming CEO Tufan Erginbilgic delivers withering assessment of the company's track record

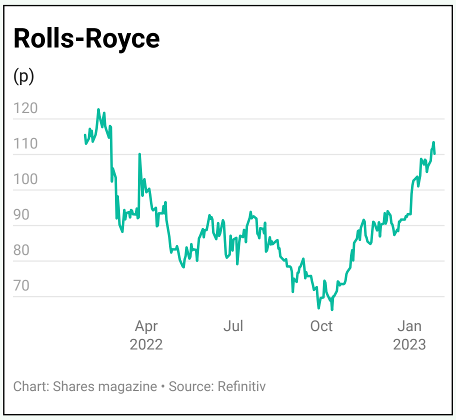
Aircraft engine maker **Rolls-Royce (RR.)** has been pulled higher in the slipstream of a recovering aviation sector in recent months to trade within sight of 52-week highs.

Rolls is reliant on lucrative spares and repairs revenue on an installed base of aircraft engines. This revenue stream is directly linked to the number of hours planes are in the air.

However, its new CEO Tufan Erginbilgic sounded anything but complacent in recent comments to staff subsequently reported by *Reuters* and the *Financial Times*.

Colourfully describing Rolls-Royce as a 'burning platform' he said the company's investments 'destroy value' and added that 'we underperform every key competitor out there'. Erginbilgic also announced a transformation plan targeting efficiencies while putting the position of low returns business units on notice as having no place in the group's portfolio.

Jefferies analyst Chloe Lemarie commented: 'We would welcome further restructuring announcements and especially a tighter focus on investment as the group R&D spend has remained elevated since 2014 despite the lack of meaningful opportunities within its Civil (aerospace) business.' [TS]



Why British American Tobacco has run out of puff

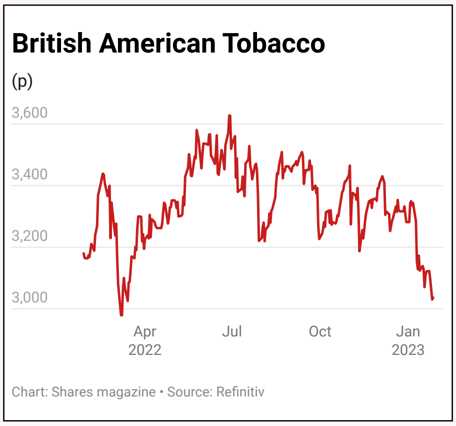
Investors have taken profits on the tobacco stock and switched into higher risk names

Having been as high as £36.28 in June 2022, shares in **British American Tobacco (BATS)** have subsequently run out of puff. They have fallen 16.5% to £30.31 since last summer's peak and down 8.3% in 2023-to-date.

This reverse reflects profit-taking as well as a wider investor sentiment switch from 'risk-off' to 'risk-on', with many high-quality and defensive dividend payers that found favour in 2022 such as British American Tobacco ditched for riskier stocks, often lower-quality cyclical names.

In its second half trading update (8 December 2022), British American Tobacco confirmed it was on track to hit 2022 guidance and also highlighted a robust showing for its 'New Category' business, i.e. vaping and e-cigarettes, which continued to enjoy strong volume, revenue and market share growth.

The FTSE 100 giant behind brands including Dunhill and Lucky Strike also said it was confident its cigarette brands would prove resilient across Asia-Pacific, the Middle East, the Americas, Africa and Europe. In the US however, volumes are under pressure thanks to macro-economic factors and a post-Covid 'normalisation' of consumption patterns. [JC]



UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS
7 February: BP, Kosmos
8 February: Hardide, Smurfit Kappa

HALF-YEAR RESULTS
7 February: Alumasc, Feedback, Genus, Mattioli Woods
8 February: Ashmore, Barratt Developments, CAP-XX
9 February: AstraZeneca, Redrow, Unilever

TRADING UPDATES
6 February: Darktrace
7 February: SSE, Syncona
8 February: Severn Trent
9 February: Bellway, Compass, Watches of Switzerland

Watches of Switzerland is ticking along

INVESTORS ARE LOOKING FOR ANOTHER ROBUST UPDATE FROM THE SPECIALIST RETAILER

A third quarter update (9 February) from **Watches of Switzerland (WOSG)** provides a window to see if the luxury watch retailer continued to trade positively over Christmas and New Year. On 14 December the Rolex-to-Breitling purveyor, which benefits from pricing power and longstanding brand partnerships and which has momentum in the US, reported a 31% jump in first half sales to £765 million. Watches of Switzerland also reiterated full year guidance citing ongoing 'strong demand' for high-end timepieces and jewellery, while CEO Brian Duffy highlighted an 'encouraging ongoing improvement in airport business'. Luxury goods groups have hitherto proven immune from cost-of-living pressures given well-heeled customers have the means to splash the cash on prestige products. These include Rolex and other collectable watches, which history suggests can appreciate in value. [JC]

AstraZeneca looks to beat earnings again

UK MARKET'S LARGEST FIRM HAS A RECENT RECORD OF OUTPERFORMING

The UK's largest listed company **AstraZeneca (AZN)** is due to report fourth quarter and full year results on 9 February and if the past is a good guide, it has a good chance of beating estimates.

According to Nasdaq.com the firm's quarterly earnings have consistently come out ahead of analysts' forecasts by around 10% over the past four quarters.

Analysts are looking for $0.71 of earnings per share, down from $0.84 per share reported a year ago. [MG]

Disney under the spotlight

RETURNING CEO BOB IGER HAS PLENTY TO PROVE

This a momentous year for **Walt Disney (DIS:NYSE)** as it turns 100 years old.

However, investors fear the firm is losing its appeal with audiences as households swap cable TV for streaming services and children swap cartoons for online gaming.

Analysts at US bank Wells Fargo expect chief executive Bob Iger to 'come out swinging' with a revamped strategy for Disney's own streaming service, which remains loss-making, when the firm releases its first-quarter earnings on 8 February.

As well as reanimating the brand, Iger, who ran Disney from 2005 to 2020, has to fend off demands from Trian Management founder Nelson Peltz for a seat on the board of directors.

One thing the results are sure not to be is dull. [IC]

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

3 February:
Aon, Cigna, Regeneron Pharma

6 February:
Activision Blizzard, Pinterest, Take-Two Interactive Software

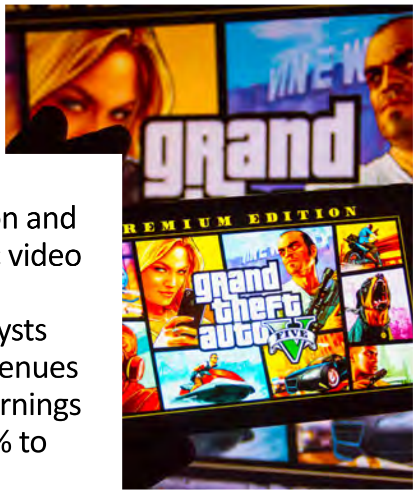
7 February:
Chipotle Mexican Grill, Gilead Sciences, Illumina, Vertex

8 February:
CME, CVS Health, Uber, Walt Disney

9 February:
AbbVie, PayPal, PepsiCo, Philip Morris International

Expectations low at Take-Two

INVESTORS WILL BE LOOKING FOR SIGNS THAT THE GAMING MARKET HAS STABILISED



Expectations for third quarter earnings on 6 February have come down dramatically at *Grand Theft Auto* game maker **Take-Two Interactive Software (TTWO:NASDAQ)**.

In November 2022 the company downgraded full-year revenue guidance to the end of March by around 8% to between \$5.4 billion and \$5.5 billion as the post-pandemic video gaming hangover continues.

For the upcoming quarter analysts have penciled in a 3% drop in revenues to \$1.46 billion while adjusted earnings per share are expected to fall 33% to \$0.88. [MG]

The easy way to get a decent income from stocks around the world

Vanguard FTSE All-World High Dividend Yield ETF has a lot going for it

VANGUARD FTSE ALL-WORLD HIGH DIVIDEND YIELD ETF

(VHYL) Price: £49.48

Ongoing charge: 0.29%

Would you like an income superior to the best-buy easy-access savings rate while also having the potential for capital gains? This is exactly what the **Vanguard FTSE All-World High Dividend Yield ETF (VHYL)** offers.

The £2.8 billion exchange-traded fund provides exposure to approximatley 1,800 high yielding stocks across the developed world and emerging markets. The 12-month historical yield from the ETF is 3.7% which gives you an indication of the potential income stream on offer. Dividends are paid quarterly.

While that level of income is comparable to the FTSE 100 (3.6% prospective yield), you're getting exposure to a much broader group of companies and geographies with the Vanguard ETF. The yield is certainly better than the 2.92% interest from the best paying easy access cash account as of 31 January, according to MoneySavingExpert data.

FE Fundinfo data shows the Vanguard ETF returned 6% in 2022 including dividends, outperforming the 4.7% total return from the FTSE 100. On a five-year basis it has generated 6.2% annualised returns, according to Morningstar.

The Vanguard FTSE All-World High Dividend Yield ETF looks to replicate the FTSE All-World High Dividend Yield Index, taking stakes in large and mid-sized companies all over the globe that pay generally higher than average dividends.

"taking stakes in large and mid-sized companies all over the globe that pay generally higher than average dividends"

It favours sectors like financials, consumer staples and healthcare, with about 44% of stocks US-listed and 7% in UK. This list includes many of the world's best-known names, such as **Johnson & Johnson (JNJ:NYSE)**, **Exxon Mobil (XOM:NYSE)**, **JPMorgan Chase (JPM)** and **Nestle (NESN:SWX)**.

Morningstar says high-yield stocks tend to be associated with more mature, profitable businesses that can grow as well as provide a stream of income.

However, some stocks offer a high yield because their share price has fallen, and analysts have yet to change dividend forecasts. A falling share price is the market's way of saying it is worried about something, and sometimes – not always – subsequent bad news from a company can result in a cut in the dividend. This is particularly true if cash is needed elsewhere in the business or there has been a shortfall in earnings.

Investors must understand this risk and that dividends in general are not guaranteed to be paid by companies. If you're happy with these risks, we do find the Vanguard ETF to be an attractive diversified source of income.

For those who do not currently need to collect the distributions as cash, there is an alternative version of the ETF that automatically reinvests the quarterly dividends, listed under the VHYG ticker. [SF]

Vanguard FTSE All-World High Dividend Yield ETF

Total return index

Chart: Shares magazine • Source: Refinitiv

Why shares in pawnbroker-to-jewellery retailer Ramsdens have further to rise

It's not too late to ride the rally

RAMSDENS
(RFX:AIM)
Price: 228.5p
Market cap: £71 million

Pawnbroker-to-jewellery retailer **Ramsdens (RFX:AIM)** has rallied hard off its Covid lows and shares in the Middlesbrough-based company are up 18% year-to-date. Yet despite such strength, we think the share price rise has further to go, with group profits now ahead of pre-pandemic levels. Consider this a short-term trade rather than a long-term investment.

Like peer **H&T (HAT:AIM)**, Ramsdens is benefiting from the cost-of-living crisis, yet the pressure on disposable incomes should only intensify from here, suggesting investors might be willing to pay a higher multiple of earnings (a 'rerating') given the positive tailwind for the company's earnings.

Guided by CEO Peter Kenyon, the diversified and defensive financial services provider and retailer operates from 158 UK stores and has a growing online presence.

Results for the year to September 2022 breezed past previously upgraded estimates, with underlying pre-tax profit rising from £600,000 a year earlier to £8.3 million on revenue up 63% to £66.1 million.

Profit growth was mainly driven by a rebound in Ramsdens' foreign exchange volumes and increased demand for its value-for-money jewellery. 'This momentum continued through Q1,' said Kenyon, 'with strong jewellery sales during December driven by continued consumer demand for premium watches.'

The £71 million business is seeing strong trading in its pawnbroking arm, a beneficiary of rock-bottom confidence around personal finances being helped by weaker consumer credit competition.

It is also worth noting that Ramsdens' retail jewellery sales are spread equally across premium watches, new jewellery and pre-owned jewellery. Growth in Ramsdens' precious metals buying business should be supported by the gold price remaining high.

Admittedly, there is a risk that foreign exchange demand falters as some customers buckle under the strain of rising interest rates and energy bills, but there is also the possibility the average consumer prioritises a summer holiday and needs travel money, which could offset a drop-off in demand from lower income customers.

'We strongly believe that Ramsdens can deliver growth in any environment provided that stores remain open,' says Liberum Capital.

The broker has increased its 2023 underlying pre-tax profit forecast by 4.7% to £8.9 million and its earnings per share estimate by 6.1% to 21.3p, estimates leaving Ramsdens on an undemanding prospective price to earnings ratio of 10.7-times.

Liberum argues Ramsdens is 'significantly undervalued' given that net cash of £8.8 million plus inventory of £22.8 million speak for roughly 45% of the current market cap. Liberum forecasts a rise in the dividend from 9p to 9.6p for the current year, implying a prospective yield of 4.2%. [JC]

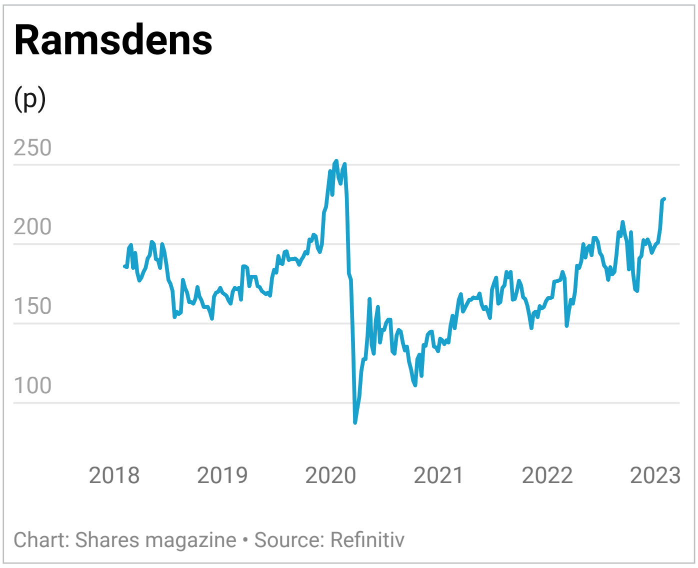


Chart: Shares magazine • Source: Refinitiv

On The Beach has finally done well, now it's time to take profits

Business is picking up but so is the amount it is investing, so margins could stay depressed

On The Beach
(OTB) 177p

Gain to date: 37.2%

We originally flagged **On The Beach (OTB)** at 129p in July 2022 noting the shares were trading at their lowest valuation in the seven years since they had listed. We argued this had created an excellent opportunity to invest in a financially strong and 'fundamentally sound' business with good longer-term prospects.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

Initially it looked like we had gone positive too early with the shares. They dropped to 52-week lows below 90p in October. Since then, they have roared back along with a revived travel sector to leave our trade well in the money.

Comments on trading in the interim have been mixed. On 8 December the company announced a return to profit for the 12 months to 30 September 2022 but also warned on 2023 trading and announced that its CEO and founder Simon Cooper would stand down within a year – with chief financial officer Shaun Morton stepping up in his place.

> **"68% rise in the total transaction value of holidays sold versus the same period a year ago"**

Annual pre-tax profit of £14.1 million compared with the previous year's £18.4 million loss. This was still some way below 2019's £34.5 million pre-tax profit.

A trading update on 27 January pointed to bookings having 'materially increased' since Christmas with a 68% rise in the total transaction value of holidays sold versus the same period a year ago.

Cooper said the group was 'significantly increasing' investment in its brand, technology and customer proposition to capitalise on this momentum and grow its market share, particularly at the premium end.

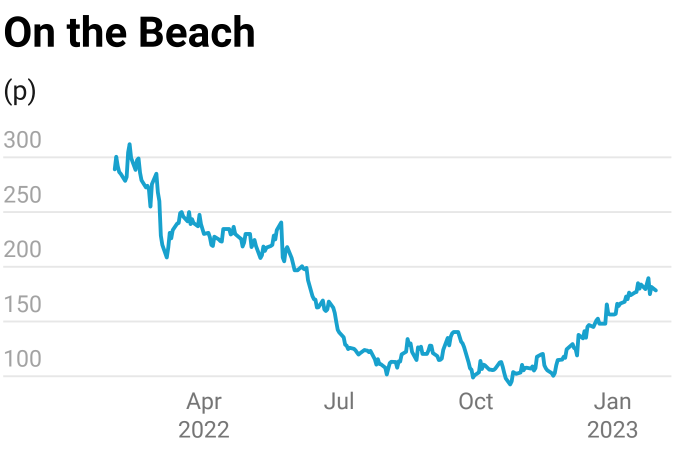


Chart: Shares magazine • Source: Refinitiv

WHAT SHOULD INVESTORS DO NOW?

Take profits. On The Beach is in a confident mood and there is evidence of resilient demand for holidays despite pressures on household budgets. However, news it is ramping up spending might weigh on profit margins short-term, even though it might have long-term benefits by helping it win greater market share. Liberum says: 'Capturing market share is expensive and likely to take time.' [TS]

Terry Smith reveals one of his biggest mistakes with Fundsmith Equity Fund

The manager on why he was late to the party with Apple and is keeping faith with Meta

Noted fund manager Terry Smith says one of his biggest mistakes is not to have invested in **Apple (AAPL:NASDAQ)** and **Amazon (AMZN:NASDAQ)** on the day of launching his **Fundsmith Equity Fund (B41YBW7)** in 2010. While both stocks now feature in his portfolio, he only invested in Apple in late 2022 and Amazon a year earlier.

In an exclusive interview, Smith says there was a turning point with Apple that made him realise it had all the right qualities for the Fundsmith investment strategy. That lightbulb moment was down to two factors, one was the rapid growth in recurring revenue from its services arm, and the other was a sell-off in the share price which made the stock's valuation more attractive.

'The thing that's changed about the story, and I was dismissive about but I'm now growing convinced it is a reality, is the services part of the business,' he says.

'This is now getting on for a third of the revenue, it has 70% gross margins which is twice what you get in the handsets, tablets and devices part of the business, and it's growing at about twice the rate of the remaining business.'

Smith has already shown a fondness of companies that sell services based upon an installed base of equipment. Until recently Fundsmith held a stake in Finnish group **Kone (KNEBV:HEL)** – in addition to making and selling elevators, escalators and automatic building doors, it provides maintenance solutions to keep them working. This theme extends to UK testing and certification business **Intertek (ITRK)** which has previously featured in the Fundsmith portfolio, generating a constant stream of revenue by checking products contain what's on the label.

Apple also plays to this theme. It has created an ecosystem that starts with someone buying one of its electronic devices and then subscribing to its content across films, fitness and more, as well as using its payment services. 'It's got to the point

Why is Fundsmith sticking with its investment in Meta Platforms?

While **Meta's (META:NASDAQ)** shares are up 20% year-to-date, they had a miserable time in 2022, falling 64%. It's a similar story with **PayPal (PYPL:NASDAQ)** which was recently jettisoned from Fundsmith's portfolio. Why ditch one and not the other?

Terry Smith has previously talked about PayPal's lack of engagement with new customers, costs that seemed out of control and value-destructive acquisitions. Meta also comes with its own unique set of problems, but Smith is prepared to sit and wait.

On the plus side, Meta's Facebook platform has 1.8 billion daily users and 12 million businesses advertising on the social network, bringing in significant revenue.

On the downside, it no longer has a duopoly with Alphabet on digital advertising, with names like Amazon and Apple now also big in this space. Digital advertising has proven to be more cyclical than previously thought, and Meta has regulatory problems.

There is also the elephant in the room – big spending on the metaverse and no idea when there will be any payback.

'The attempt to regulate advertising worries me quite a bit,' says Smith. 'With the metaverse, I'm convinced something real is going to emerge, it's just difficult to envisage because it doesn't currently exist. But you only have to go back 10 years and see people who are pretty knowledgeable poo-pooing the concept of the cloud.

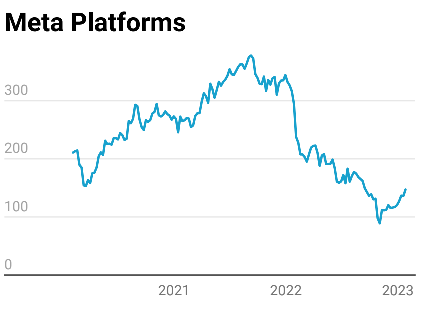


Chart: Shares magazine • Source: Refinitiv

'If I was looking for a single event to get us from the point of "it's a bit of mystery and they're spending a lot of money on it and we don't know how it works" to "that's interesting", it will be the first person to sell some glasses that start to deploy what this is. I suspect that is going to be Apple. That still doesn't mean Meta is going to be the winner or a winner, there are still levels of uncertainty here that I don't like.'

where I think Apple TV, Apple Music, Apple Pay is real and it's going to keep coming,' says Smith.

By waiting 12 years to put Apple in Fundsmith's portfolio, Smith has missed out on approximately 1,350% total return (share price and dividends reinvested) from the iPhone maker. A cynic might even suggest he's far too late to the party because all the easy money has been made from the stock. In Smith's view, there are still plenty of future rewards to be had.

The Fundsmith boss is a dab hand at remembering classic investment-related quotes to help illustrate a situation. He recalls something Warren Buffett wrote in the 1993 letter to **Berkshire Hathaway (BRK.A:NYSE)** shareholders, citing a remark from a 1938 issue of *Fortune* magazine: 'Several times every year a waiting and serious investor looks long and with profound respect at **Coca-Cola's (KO:NYSE)** record but comes regretfully to the conclusion that he is looking too late. The spectres of saturation and competition rise before him.'

The value of Coca-Cola has risen significantly since 1938, suggesting that it's never too late to back an exceptional company. And Smith certainly seems to think that's true with Apple.

'Me buying into Apple at $125 or whatever we paid for it to start a holding in November clearly isn't as good as buying it at $6, but equally if we think there is value in here and it is a very good business, looking in the rear-view mirror isn't going to help you. We have to think about the future.'

NEXT STEPS FOR UNILEVER

Smith is not short of an opinion on any stock in his portfolio and **Unilever (ULVR)** has been on the receiving end of some choice words in recent years. The fund manager has criticised the FTSE 100 company's management for spending too much time on ESG (environmental, social and governance) matters and not enough on the day-to-day running of the business. He's also attacked strategy plans and accused the company of ignoring his request for an audience despite being a long-time shareholder.

Unilever has just appointed Hein Schumacher as its new chief executive, replacing Alan Jope. What are the key priorities for the new boss, in Smith's opinion?

'I hope the new chief executive will stop the process of playing what Warren Buffett characterises as Gin Rummy management. You've got a set of cards; you keep discarding one and picking up a new one. "Let's get out of spreads and tea and buy Glaxo's consumer healthcare product business." No, stop it.

'I think the first thing the new Unilever chief executive should do is make each of the business segments it has – food, household cleaning products, wellbeing and beauty products, and ice cream – why don't you make each of them the best you can in terms of organic sales growth, profitability and returns on capital. Let's get it all working properly first, then think about whether we want to make any changes.'

FOCUS ON WHAT YOU DO BEST

Smith objects to companies which stray too far away from their core business. He says for innovation to work and deliver value to investors it 'almost always' must be within an existing franchise. Here, staff already have knowledge and the means to bring the product or service to market. Just consider how **Reckitt (RKT)** launched the Cillit Bang cleaning product in 2005 and less than 20 years later it is considered a 'power brand' by its owner.

'When people try to develop outside of the core business, guess what, it doesn't work very well,' says the Fundsmith boss. 'If we take a fast-moving consumer goods business like **Procter & Gamble (PG:NYSE)** and Unilever which are big in household cleaning and personal care products, they go "It's only a short step outside that into beauty". No, it's not. It's like Neil Armstrong's giant leap for mankind.'

> **"When people try to develop outside of the core business, guess what, it doesn't work very well"**

Procter & Gamble failed with its attempts at the beauty industry and wisely sold its operations. Unilever also ventured into this space, with limited success. It spent $2.7 billion in 2017 on cosmetics firm Carver Korea which Smith calls a 'clearly bad' deal. He has even worse things to say about Unilever's $1 billion purchase of male grooming brand Dollar Shave Club. 'That acquisition has basically been buried in an unmarked grave. These are not businesses where they had an existing core franchise.'

The new head of Unilever mustn't play the blame game, adds Smith. 'Stop blaming the previous CEOs for everything,' he says, adding that good companies have seamless changes in management and don't go around saying the last person did it all wrong.

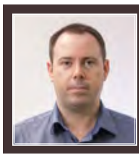
Given these comments, it's clear Smith is more sceptical of the management than the business itself. If it was the other way round, the shares would have been sold a long time ago.

DISCLAIMER: The author has a personal investment in Fundsmith Equity Fund

By **Daniel Coatsworth** Editor

CHINA vs INDIA

What you need to know before you invest



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

China's abrupt Covid U-turn has created the best opportunity in years for Asia and emerging market equities to outperform developed markets on a sustainable basis. It is likely to be one of the select few major economies where growth could accelerate in 2023 as China, where equity market valuations remain undemanding, enjoys a reopening recovery like much of the rest of the world witnessed in 2022.

And yet it is India that remains the best structural domestic demand story in the Asia and emerging market universe. India's growth trajectory is forecast to outpace nearly all emerging and developed economies in 2023, with an International Monetary Fund estimate of 6.1% growth versus 5.2% for China, but investors must pay up to access this expansion, since inflows from domestic retail and institutional investors have resulted higher valuations versus other emerging markets.

Given this tantalising set-up, which of these two emerging market giants offers adventurous investors the superior risk/reward profile in 2023 and beyond? In this article, we lay out the opportunities and threats in both markets with input from investment experts who run money in these vast economies on a day-to-day basis.

CHINA

WHY THE REOPENING EXCITES

Deeply out-of-favour with investors in recent years due to concerns around its property sector and the continuation of Xi Jinping's draconian 'zero-covid' policy, stock markets cheered after the policy was relaxed in December 2022. The exit from zero-Covid after three years of strict curbs is expected to be the catalyst for a year of cyclical recovery in China, which experienced 3% GDP growth in 2022, its second lowest level of annual growth since the 1970s.

Chinese equity markets have rallied strongly since the authorities' abrupt abandonment of zero-covid – the MSCI China index is up 50% since the trough in October last year – with support for the property sector, the pro-growth policy shift signalled at the annual Central Economic Work Conference in December and a more benign regulatory environment for large internet companies also lifting sentiment.

OPPORTUNITIES IN YEAR OF THE RABBIT

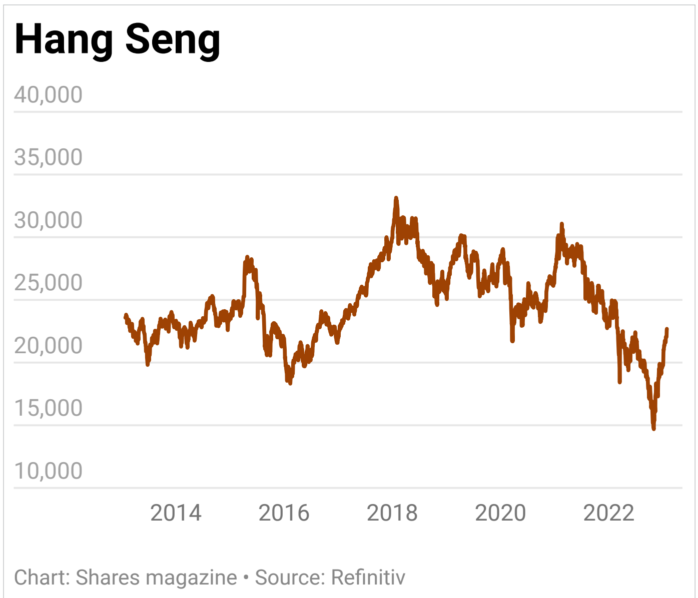
22 January officially marked Chinese New Year, the Year of the Rabbit, a symbol of longevity, peace and prosperity, and managers of dedicated China funds are full of optimism at this early stage of 2023.

Dale Nicholls, manager of **Fidelity China Special Situations (FCSS)**, says the reversal in the zero-Covid policy has played out faster than he expected. He adds: 'This focus on restoring confidence and reviving growth underpins an increasingly positive outlook for China.'

Singapore-based Chetan Sehgal, the lead manager of **Templeton Emerging Markets Investment Trust (TEM)** which invests in both China and India, expects China to follow a similar pattern of post-Covid consumption to other emerging markets.

An estimated RMB 6.6 trillion in excess savings has been built up during three years of zero-Covid policy, which should in part act as a driver, he explains, adding that Chinese purchasing power is not expected to weaken. Inflation is forecast to remain subdued in China, partially due to the decline in energy prices from their peak, a stable domestic supply of agricultural products and commodities sourced from Russia.

Sehgal argues corporate earnings should deliver, 'eventually', though the near-term outlook remains weak as companies struggle to scale up production and distribution in the face of the pandemic. He says the real estate sector outlook is lacklustre, and credit demand may take time to recover, which is likely to act as a drag on the financial sector. Nevertheless, he expects earnings to recover in the second half of the year as supply chain issues are addressed and the real estate sector stabilises.



Joseph Little, global chief strategist at HSBC Asset Management, expects 2023 to be a year of cyclical recovery for China with GDP growth of 5% to 5.5%, though he warns the country's growth profile is likely to remain 'volatile' in the first quarter due to Covid-related disruption, ahead of 'a boomlet of activity' from the second quarter onwards driven by a renewed surge in consumer activity and a significant revival in tourism.

Elizabeth Kwik, co-manager of investment fund **Abrdn China (ACIC)**, believes this could be an 'excellent time' to get into China as she believes the stars are aligned for a meaningful recovery in

growth, driven by consumption.

Once China's reopening benefits fully materialise in the months ahead, Kwik expects to see a drawdown of consumers' excess savings, which she believes will benefit sectors ranging from consumer and healthcare to property and finance.

On the geopolitical front Jerry Wu, manager of Polar Capital's **China Stars Fund (BG43Q64)**, sees 2023 as the year of a 'relationship reset' with the West. China has struck a balance in handling its relationship with both Russia and the West since the Ukraine invasion, but 'a more volatile Eurasia and closer alliance between the US and Europe is certainly not what China wants,' explains Wu. 'Behind closed doors China will be seeking to assure European leaders that they want a peace deal and are willing to participate in rebuilding Ukraine.'

HONG KONG: Hang Seng top 10 by index weight

STOCK	SECTOR
Tencent	Information Technology
AIA	Financials
HSBC	Financials
Alibaba	Information Technology
Meituan	Information Technology
CCB	Financials
HKEX	Financials
JD	Information Technology
Ping An	Financials
China Mobile	Telecommunications

Table: Shares magazine • Source: HSI, as of December 2022

RISKS TO CONSIDER

One risk to weigh is how infections during China's Lunar New Year migration affect public and corporate behaviour. Adrian Lim and Pruksa Iamthongthong, managers of **Asia Dragon Trust (DGN)**, which has 32.4% of assets in China versus 17.6% in India, believe the China reopening will be bumpy at the start with infections peaking in different phases, starting with cities before moving to rural areas. That said, they expect a multi-stage recovery 'where domestic consumption normalisation has a long runway ahead, supported by excess savings among households.'

Carlos Hardenberg, who manages **Mobius Investment Trust (MMIT)** alongside legendary emerging markets investor Mark Mobius, is 'constructive' with regards to China's recovery potential but warns we must be mindful and prepare for a stony path into the recovery.

Exports this year could be negatively impacted by weak demand from the EU and the US, booster rates among the elderly in China remain very low and the desire to reach herd immunisation can take time.

HSBC's Joseph Little warns the reopening upswing in China is likely to be less pronounced than what we saw in Western economies, due to softer consumer confidence and headwinds in the services and construction sectors.

Potential headwinds identified by Kwik at Abrdn include a further escalation of US-China tensions, particularly over Taiwan. 'This remains a lingering issue, but we do not at this point expect any sudden surprises considering the tone adopted by both countries following last November's meeting between presidents Xi Jinping and Joe Biden,' she explains.

INDIA

CAN IT SUSTAIN HOT RETURNS?

India was poised for a cyclical rebound before its momentum was derailed by Covid, but the growth story is now playing out with many global companies being drawn to the opportunities its domestic economy offers.

On course to being the fastest-growing major economy in the coming years, India is one of the world's largest consumer markets outside the US and China, underpinned by a young, dynamic population with expanding disposable income.

Also blessed with an entrepreneurial culture, bulls believe the country will benefit from increased infrastructure investments, rising digital adoption, evolving healthcare trends and its deep pool of Indian software talent.

DEMOGRAPHIC DIVIDEND EXCITES

BambuBlack Asset Management's Jane Andrews, who runs the **SVS BambuBlack Asia Ex-Japan All-Cap Fund (B5448K8)**, sees India's long-term outlook as 'very positive', with its young population providing a demographic tailwind. 'Gen Z and Millennials are estimated to account for over 50% of the population by 2030, and this demographic tends to have the greatest propensity to spend,' explains Andrews.

This year, India is set to overtake China in terms of total population and given China's ageing society, time will tell whether they can avoid the middle-income trap, she says. 'India is also about 18 to 20 years behind China in terms of manufacturing and urbanisation, especially in the development of lower tier cities.'

India: S&P BSE 100

Chart: Shares magazine • Source: Refinitiv

Narendra Modi's government has implemented economic and business-friendly policies in recent years, making the country more attractive to foreign investment. And US-China rivalry is providing a tailwind as manufacturers move toward a 'China-plus-one' strategy, establishing an additional manufacturing base outside China to mitigate against supply chain risks.

For example, **Apple (AAPL:NASDAQ)** is assembling its latest iPhone models in India, marking a major break from its practice of reserving much of that activity for Chinese factories run by its main Taiwanese assemblers.

Also weighing in is Swathi Seshadri of the investment team at Mobius, who points out credit growth continues to do well after a strong recovery in 2022 and domestic consumption remains stable and aids manufacturing and service-oriented companies in India. 'Exporters have benefited from the disruption in China and depreciation of the rupee over the last year, but we remain cautious on companies that rely on US and European spending in 2023, for example, Indian IT.'

ARE INDIAN EQUITY VALUATIONS TOO SPICEY?

Templeton Emerging Market's Sehgal says Indian equities will likely continue to outperform other emerging markets amidst expectations for continued strong economic growth. But BambuBlack's Andrews warns the outlook this year is 'less compelling' as India's valuations are stretched versus many other emerging markets, as well as their historic trading range.

In comparison, with China having ended its tech sector crackdown and relaxing restrictions on property developers, Andrews believes China's short-term outlook is more positive with valuations looking attractive.

Ocean Dial Asset Management's Gaurav Narain, principal adviser on the **India Capital Growth Fund (IGC)**, informs *Shares* that India has had two very good years as a market and was one of the best performers last year. 'The domestic economy is really robust, a lot of growth and capital expenditure, everything is trending well. But the big issue is valuations look very expensive relative to other emerging markets like China.' Valuations are not very supportive, says Narain, so it is critical that India lives up to its growth story.

INDIA: S&P BSE 100 top 10 by index weight

STOCK	SECTOR
Reliance Industries	Energy
HDFC Bank	Financials
ICICI Bank	Financials
Infosys	Information Technology
Housing Development Finance	Financials
Tata Consultancy Services	Information Technology
ITC	Consumer Staples
Kotak Mahindra Bank	Financials
Axis Bank	Financials
Larsen & Toubro	Industrials

Table: Shares magazine • Source: S&P, as of 30 Dec 2022

Self-confessed 'India bull' James Thom, one of the managers on **Aberdeen New India Investment Trust (ANII)**, concedes there are headwinds for investors short term, as India's good run means it is a natural place for global allocators to take profits. 'That's happening to an extent, but I think it will be a relatively short-lived rotation effect. If you're taking a longer perspective than the next quarter or two, then I'm quite positive on the India story for this year.'

Like Andrews and Narain, Thom concedes India is expensive, but he says that's nothing new. 'India has always been expensive and traded at a premium to the rest of Asia. If anything, that premium has come off a little bit.'

Asia Dragon's Lim and Iamthongthong point out India's capital market has expanded rapidly in recent years. 'The country is home to some of the highest quality companies in the region, with strong market positions – at home and abroad – superior return metrics, solid balance sheets, consistent growth through cycles and some of the most capable management teams anywhere in Asia.

'This is why our Asian portfolios have consistently been overweight India despite the valuations and despite the macro highs and lows.'

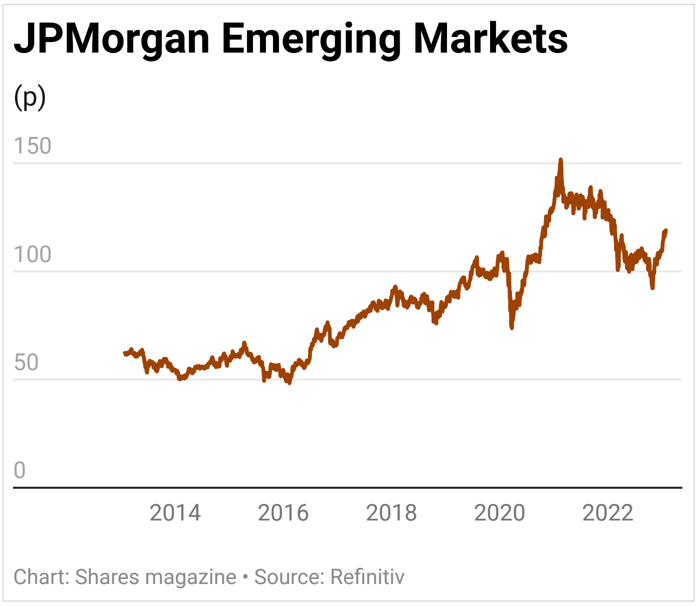
The Abrdn duo argues India excels in industries such as financial services, the consumer sector and healthcare, where they hold companies including **HDFC (HDFC:NSE)**, **Maruti Suzuki (MARUTI:NSE)** and **Hindustan Unilever (HINDUNILVR:NSE)**.

While the IT services sector faces near-term challenges due to worries around a potential recession on the horizon, the Asia Dragon managers regard this as 'an attractive segment' in the long term, along with internet and renewables companies, where they hold names such as **PB Fintech (POLICYBZR:NSE)**, which runs the online insurance aggregator Policybazaar.

GOOD WAYS TO GET EXPOSURE TO CHINA AND INDIA

FOR RISK MANAGEMENT reasons, retail investors should consider obtaining their exposure to China and/or India through broader Asian or global emerging market funds including investment trusts, whose closed-ended structure is well-suited to holding often illiquid emerging market stocks.

One solid selection is **JPMorgan Emerging Markets (JMG)**, which according to the Association of Investment Companies is one of the best 10-year performers in the global emerging markets sector, having delivered a healthy share price total return of 114% over that period.

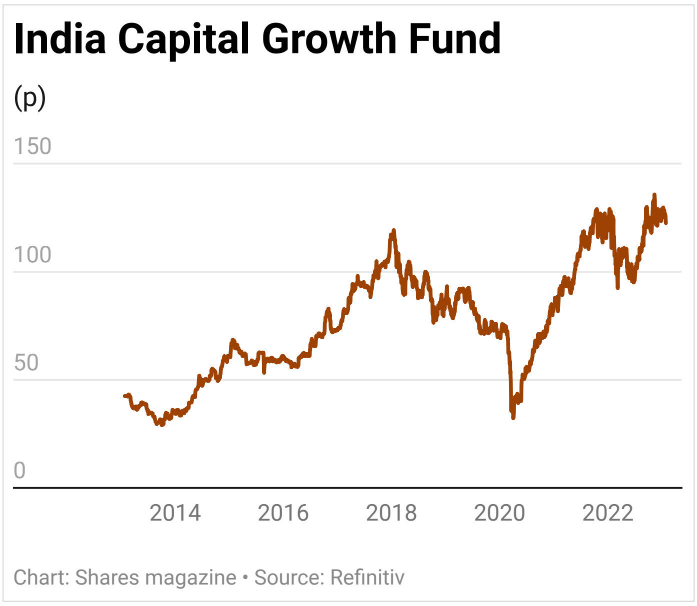


The trust, which trades at a 5.7% discount to net asset value, has ongoing charges of 0.84%, among the lowest in the sector reflecting the benefits of its scale.

Managed by seasoned emerging markets expert Austin Forey alongside John Citron, India is its biggest regional allocation at 22.5% followed by China at 21.7%, with top 10 positions including Chinese internet group **Tencent (0700:HKG)** and India's **Infosys (INFY:NSE)**, the Bangalore-based business consulting-to-information technology firm.

Investors seeking single-country exposure to China might look to the best 10-year share price total return performer in the AIC's China/Greater China sector, namely the aforementioned Fidelity China Special Situations, up over 250% on a decade-long view and invested in the likes of **Ping An Insurance (2318:HKG)**, e-commerce-to-internet group **Alibaba (9988:HKG)** and privately-owned TikTok-parent Bytedance.

Investors with a taste for the hot returns offered by India long-term might be tempted by the top-performing **India Capital Growth Fund (IGC)**, although you'll have to pay up for the privilege as ongoing charges of 1.5% are the highest in the AIC India sector.



For reference, the largest India investment trust in terms of assets is **JPMorgan Indian (JII)**, currently trading on a 16.1% discount.

The trust on the widest discount, 17.9% at the time of writing, is Aberdeen New India, a quality company-focused trust which has faced a style headwind.

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OROCO

OROCO RESOURCE CORP (TSX-V:OCO.V)
The Santo Tomas deposit is an emerging copper giant, with a multi-million tonne resource demonstrated by exploration.

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Our top ways to invest in lithium miners and the outlook for prices

The mineral is critical in the production of batteries for electric vehicles

In 2022 there was a 'white gold' rush as lithium prices soared thanks to huge Chinese demand. The chemical element is a key component in the manufacture of batteries for electric vehicles and the storage of energy generated by renewable sources. China is at the forefront of battery production.

Many analysts are forecasting a decline in lithium prices, but several executives have told *Shares* they are not so sure the experts have their numbers right. In this article we will look at the short and long-term prospects for the lithium market, examine the UK and overseas-listed names with big exposure to lithium and highlight our best ideas to play the theme.

Battery grade lithium spot price (China)

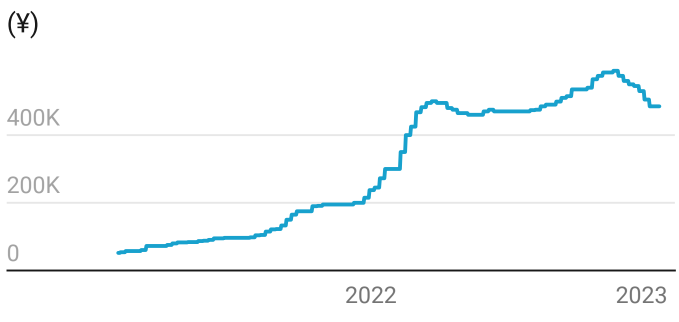


Chart: Shares magazine • Source: Refinitiv

CHINA'S 'INSATIABLE' APPETITE FOR LITHIUM

Evidence of soaring demand for lithium can be tracked in the surge in Chinese spot prices for lithium carbonate over the last 12 months or so – with China buying up vast quantities of the element to support production of lithium-ion batteries.

According to research provider Bloomberg New Energy Finance, China accounted for 77% of the world's battery manufacturing capacity in 2022 and is still expected to account for more than two thirds by 2027.

The failure of the UK's Britishvolt venture has put the spotlight on how other countries are far behind China with battery production.

Anthony Viljoen, CEO of **Andrada Mining (ATM:AIM)**, which recently changed its name from Afritin as a precursor to expanding focus from its tin output in Namibia towards lithium, says the 'geopolitics are fascinating' with China demonstrating 'an insatiable desire to control every lithium deposit on the planet'.

This was reflected in the £285 million takeover of UK-listed Bacanora Lithium by Ganfeng Lithium in 2021 and **Kodal Minerals' (KOD:AIM)** recent deal with China's Hainan Group to give the latter 41% of its Bougouni mine in Mali in exchange for £81 million to help fund its development.

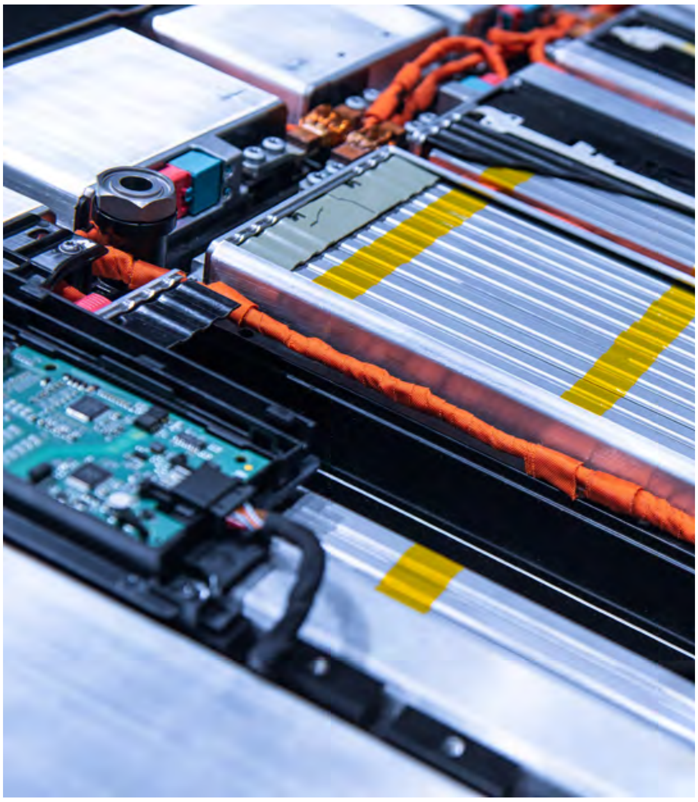
Viljoen even says German car manufacturers are hiring their own geologists as they look to secure new sources of supply.

Perhaps unsurprisingly given the scale of gains for lithium in 2022, with prices hitting a record high of $84,000 per tonne, the big investment banks are forecasting that prices will moderate in 2023.

In November 2022 Morgan Stanley put out a forecast for prices of $67,500 per tonne in the first half of 2023, falling to $47,500 per tonne in the second half of the year. Goldman Sachs went even further in December with a forecast of $53,300 for 2023 as a whole and just $11,000 for 2024 – compared with a consensus forecast of $29,063.

Charles FitzRoy, the chief executive of prospective lithium miner **Bradda Head (BHL:AIM)**, says: 'I think it's important to say analysts were forecasting $30,000 per tonne for 2022 and spot prices are currently above $70,000 so whatever people are forecasting now is probably worth seeing in that context. We're seeing a new developing market so it's not surprising analysts find it so hard.

'If you listen to the research the price was supposed to drop off in the second half of last year,



Chemistry lesson: where lithium comes from

Lithium miners derive the element from three main sources. The most established process is to target pegmatite crystals. A pegmatite is a type of igneous rock made up of interlocking crystals like spodumene.

Lithium can be extracted using conventional open-pit or underground mining techniques and the mineral is then processed and concentrated using a variety of methods.

Another approach is extracting lithium from brine. The brine is typically found underground with drilling taking place for access. Most extraction sites are in a set of salt flats found in an area of south-west South America although other sources include oil and gas fields and geothermal waters. The main recovery technique is to pump salt-rich water to the surface and into a series of evaporation ponds.

Over a period of months, the water evaporates, and a variety of salts precipitate out, leaving a brine with an ever-increasing concentration of lithium. Once this concentration hits a certain threshold it is pumped to a recovery facility to extract the lithium.

Less well-established is the method of extracting lithium from clay. Despite having clay-based lithium prospects in his company's portfolio, Charles FitzRoy from miner Bradda Head acknowledges 'clays are an unknown' and notes costs are currently higher than extracting from pegmatites.

it didn't really happen because there was more demand than we thought and it's an important factor that China is opening up again.'

He also points out that while it is relatively straightforward to scale up and predict lithium supply from pegmatite sources, the same is not necessarily true for brines and clays. There are also big technical challenges with recycling lithium-based batteries.

Naturally, those engaged in lithium mining are unlikely to talk down prices, but FitzRoy points out operating costs are below $5,000 per tonne on pegmatite lithium deposits, so most miners would be able to generate substantial margins even at materially lower prices than we see today.

WHICH ARE THE MAIN LITHIUM COMPANIES ON THE STOCK MARKET?

The biggest lithium-related stock on the US market is **Albemarle (ALB:NYSE)**. The speciality chemical company is a leader in lithium and lithium derivatives and owns lithium brine and pegmatite deposits. There is also **Piedmont Lithium (PLL:NASDAQ)** which recently updated a supply agreement with electric vehicle manufacturer **Tesla (TSLA:NASDAQ)**.

Australia is a hub for pegmatite lithium mining as well as having a large listed contingent. As the executive chair Neil Herbert of **Atlantic Lithium (ALL:AIM)** told *Shares* late last year when explaining why the company had sought a dual listing in Australia, 'No disrespect to the London market but we don't have serious competition, whereas in Australia the projects are really good – there's a lot more understanding of and investment in lithium.'

For UK investors diversified miner **Rio Tinto (RIO)** has a burgeoning footprint in lithium – it acquired the Rincon project in Argentina for $825 million in 2022, for example. However, the largest pure

Albermarle

($)

Chart: Shares magazine • Source: Refinitiv

UK-listed lithium stocks

Stock	Code	Market cap	12-month share price performance
Premier African Minerals	PREM	£123 million	191%
Cleantech Lithium*	CTL	£57 million	54%
Kodal Minerals	KOD	£74 million	28%
Atlantic Lithium	ALL	£251 million	20%
Rio Tinto	RIO	£105 billion	13%
Andrada Mining	ATM	£84 million	−10%
Savannah Resources	SAV	£45 million	−39%
European Metals	EMH	£71 million	−49%
Bradda Head	BHL	£26 million	−50%

**Since 17 March 2022 listing*

Table: Shares magazine • Source: SharePad, Google Finance

lithium miner listed in London is Atlantic Lithium.

The company owns the Ewoyaa lithium project in Ghana. This is projected to produce more than 30 million tonnes of high-quality lithium ore. Atlantic is partnered on the project with Piedmont Lithium.

Limiting their environmental footprint is an important consideration for lithium miners. This is logical. Environmental factors are a big driver for growth in the electric vehicles space and manufacturers will want to demonstrate that their supply chains are as clean as possible.

For Bradda Head's FitzRoy this is about limiting use of water and chemicals and developing local projects for domestic supply – so you don't have supply chains stretching out to China.

Chile-focused **CleanTech Lithium (CTL:AIM)** is looking to pioneer 'Direct Lithium Extraction' powered by clean energy sources to reach its goal of producing carbon-neutral lithium.

It recently published a scoping study for its Laguna Verde project. Canaccord noted the results 'confirm our expectations for Laguna Verde to eventually be a low-cost producer among brine projects globally.'

Direct Lithium Extraction uses an absorbent to extract lithium from brine water without the need for evaporation – meaning the water can be reinjected into the underground basins once the lithium has been extracted.

THREE INTERESTING WAYS TO INVEST

Investors wary of the risks of a short-term slump in lithium prices could get diversified exposure through Rio Tinto which has lithium interests alongside other metals like copper and aluminium necessary for the transition to renewables and electric vehicles. Despite a strong recent run the shares trade on just 10 times forecast earnings and offer a dividend yield of around 6% and should be a beneficiary of Chinese reopening.

Global X Lithium & Battery ETF

Chart: Shares magazine • Source: Refinitiv

An alternative option is **Global X Lithium & Battery ETF (LITG)**, a type of tracker fund which mirrors the performance of a basket of lithium miners and battery technology firms, with Albemarle the largest holding. Investors should note this product does have a relatively high charge of 0.6% for an exchange-traded fund and is small with assets of around £30 million.

Of the UK-listed lithium miners Atlantic Lithium has the most advanced project. Canaccord Genuity describes its Ewoyaa development as a 'world-class asset' and sees it as one of the lowest cost and least capex-intensive hard rock lithium projects available for development globally, adding that it benefits from close proximity to port and infrastructure.

Neil Herbert argues that Australian firm **Core Lithium (CXO:ASX)** is around two years ahead of Atlantic in its development but has five times the market valuation. With Atlantic's shares significantly below highs of 66p hit last year at 41.4p, there could be a good opportunity to invest for those prepared to bear the development risks.

Broad parts of the market have rallied since October 2022 – can the good times last?

Small, mid and large caps are moving higher, while cryptos and commodities are also in vogue

On 6 October 2022, *Shares* wrote that it was time to start looking at small cap stocks again. The timing was impeccable, with this part of the market having perked up only a few weeks later.

In the UK small cap investment trust space, **Rockwood Strategic (RKW)** has risen by 39% in value since our October article, while **Montanaro UK Smaller Companies (MTU)** is up 25%.

We argued that valuations were compelling and that historically, UK smaller companies have outperformed larger stocks over time. The fact many share prices in this space have since moved up will be of great relief to retail investors given small caps suffered such dramatic falls in early 2022.

This isn't the only area of the market on the move. Many of the big US-listed stocks which had an awful time on the stock market last year are rebounding fast. For example, **Tesla (TSLA:NASDAQ)** is up 65% so far this year. Facebook-owned **Meta Platforms (META:NASDAQ)** jumped by 22% in January.

Bitcoin is also staging a comeback, advancing 40% over the past month alone. When the frothier end of the market is jumping, you must start asking questions why investor sentiment has improved.

Firstly, many people believe we're close to the peak in this cycle for interest rate rises. That's led to a rotation away from defensive stocks in recent months to more of a 'risk-on' trade. Secondly, there are hopes that the looming recession won't be as devastating as experts previously thought.

Earnings misses, cautious outlook statements by management, downgraded earnings forecasts – many of these bits of bad news are seemingly being ignored by the market. That is something to watch. It stokes the argument that we may be in a bear market rally, rather than the start of a sustained recovery.

Performance since respective late 2022 low

Asset or index	Description	Price rise
Bitcoin	Cryptocurrency	**47%**
MSCI UK Small Cap	UK small caps	**21%**
FTSE 250	UK mid caps	**19%**
Russell 2000	US mid/small caps	**16%**
FTSE 100	UK large caps	**14%**
S&P 500	US large caps	**14%**
Gold	Commodity	**10%**

Table: Shares magazine • Source: FE Analytics, Google Finance, in local currency, as of 30 Jan 2023

A bear market is when share prices fall 20% or more from recent highs amid investor pessimism typically linked to concerns about the economy, monetary policy or geopolitics. A bear market rally is a description for a sharp, short-term rebound in share prices despite a continuation of the difficult backdrop.

Bloomberg says there have been 20 bear-market rallies in the US S&P 500 index bigger than 15% since 1927. Some of these rallies lasted about 30 to 50 days, but one ran for 393 days. At the time of writing, the FTSE 100 index in the UK and the S&P 500 were both trading approximately 14% higher than their October 2022 lows.

The Federal Reserve was expected to have put up US interest rates as this issue of *Shares* was being prepared for distribution, while the Bank of England could do the same today (2 February). The scale of any rate hikes and associated commentary could play an important role in deciding where the market goes next. It's great to see share prices moving higher, just don't assume it will always be this easy to make money.

Tesla aims for recovery after a torrid 2022 for the electric vehicle leader

Looking at whether a recent rebound in the shares can be maintained

There's no denying that 2022 was a torrid year for **Tesla (TSLA:NASDAQ)** shareholders. The stock fell 65% leaving many nursing big losses. The changing fortunes of the electric car maker, which had become a retail investor favourite, will have been discombobulating as its share price performance since 2020 had delivered spectacular returns.

But alongside tales of Tesla-made ISA millionaires there were plenty of commentators who warned the bubble was likely to burst, that the company was massively overvalued, and any setbacks would result in the stock underperforming.

In 2022 those commentators were proved right. China's zero-Covid policy not only impacted production in Asia but it also dented sales there, just at the time that raging inflation was eating into discretionary income in the West.

As demand slowed, and with its boss seemingly distracted with his new social media toy Twitter, the company had to take serious strategic action and reach for the sale stickers.

HAS CUTTING PRICES WORKED?

Cutting prices is a strategy that appears to have paid off, at least for now. Tesla's fourth quarter earnings boasted record profits, record deliveries and a forward order book that Elon Musk referred to as 'high'. He noted there are 'a vast number of people who want to buy a Tesla car but can't afford it' so the recent price changes are likely to widen the pool of potential buyers.

The company's share price enjoyed its best week in almost 10 years before the earnings update and more than one recommendation jumped from hold to buy, with the latter camp now overwhelmingly in the majority. But there are still a number of Tesla bears with five analysts keeping their feet planted firmly in the sell camp.

Tesla share price performance over the past five years

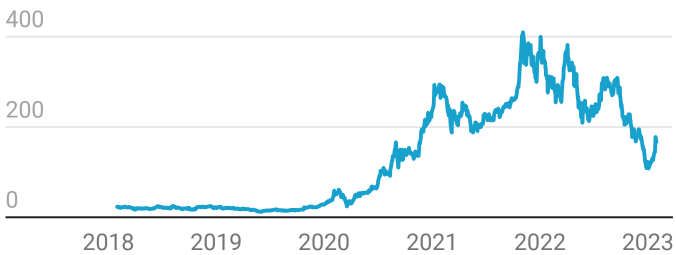


Chart: Shares magazine • Source: Refinitiv

PLENTY OF POTENTIAL POTHOLES

It's not unusual for there to be a spread of broker recommendations but it does raise questions about Tesla's outlook.

The EV giant expects to continue with its growth spurt, though its own forecasts suggest at a slightly slower pace. In 2022 it delivered just over 1.3 million vehicles and this year the company is

forecasting a 37% increase to 1.8 million, though the company's controversial boss believes two million is well within reach.

But using price to stoke demand has already had an impact on margins which were shaved to a two-year low of 25.9% in the last quarter and those discounts were only just beginning to filter through.

Speculation mounted that the move to cut prices wouldn't just affected profitability it would also spur on competitors to follow suit and **Ford (F:NYSE)** was the first to jump, cutting the price on its Mustang Mach-E crossover. And competition might just be the strongest headwind to buffet Tesla over the next year.

The car industry has been in a state of flux as the world transitions from the combustion engine. Established players have been slow to act something which gave Tesla a distinct advantage. But that advantage has been eroded by time. Tesla is no longer the new kid on the block, the disruptive start-up with the wind in its sales.

China's **BYD (1211:HKG)** overtook Tesla last year as the leading seller of electric cars. Traditional giants like **Hyundai (005380:KRX)**, Ford and **General Motors (GM:NYSE)** have put their foot on the accelerator and new entrants like **Rivian (RIVN:NASDAQ)** and **Lucid (LCID:NASDAQ)** in the US and China's **Nio (NIO:SGX)** are giving customers greater options.

Tesla has promised new models but put them on the back burner to focus on supply chain issues and boosting production leaving investors dangling and customers perhaps a little bored. Tesla now says the next generation is in the works and that the long awaited Cybertruck pick up will begin production later this year.

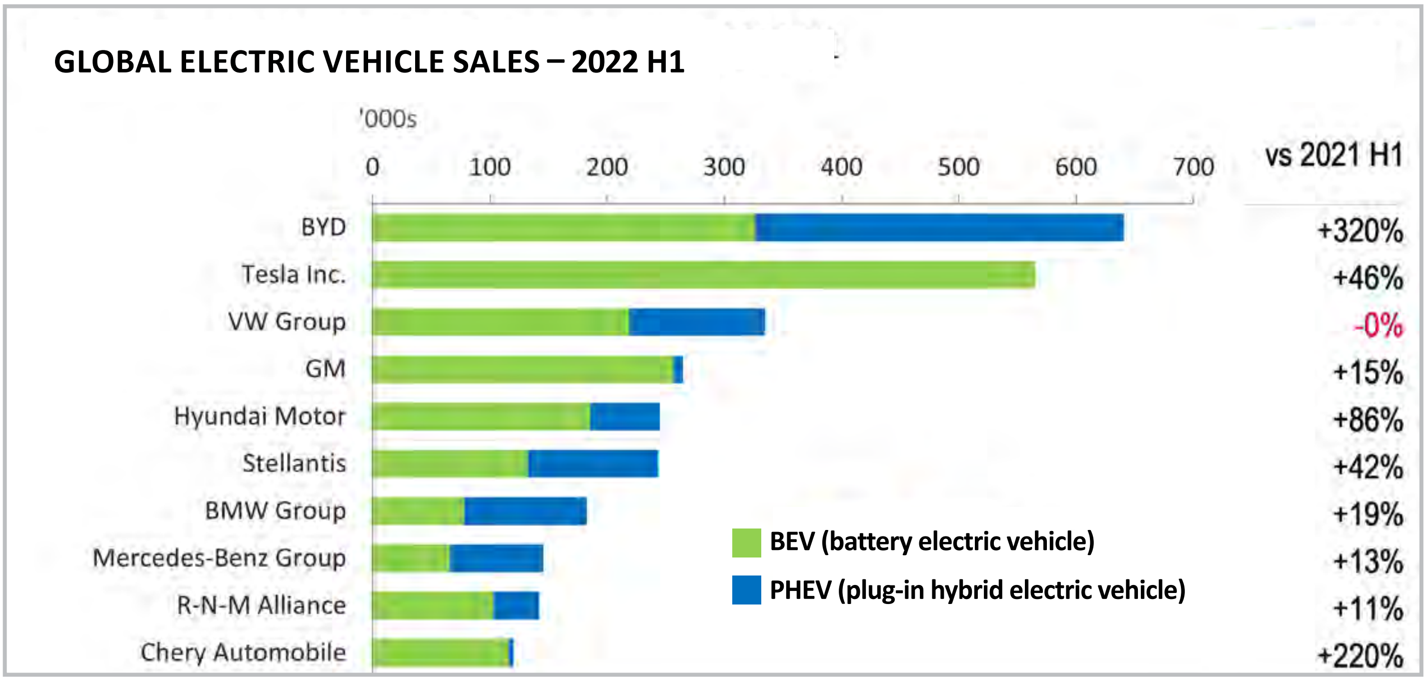
A MARCH INVESTOR DAY COULD BE CRUCIAL

The investor day at the beginning of March could quiet many critics but it won't do much to sweeten the bad taste left in many new Tesla owner's mouths. Nobody likes to miss out on a bargain or find they've paid over the odds for something they could have got much cheaper if they'd just waited a few more weeks.

And a week is a long time on markets with shares in the company still firmly riding the roller coaster.

Can Tesla's pricing strategy mitigate softening consumer demand? Will the company's divisive CEO ultimately be found to be hero or villain? And has future growth already been priced in? We could be closer to some answers by the end of 2023.

TESLA FACES MOUNTING COMPETITION



Source: EV-volumes – Aggregated sales / Registrations by country

Does Royal Mail owner International Distributions Services hold a 'hidden store of value'?

More than one investor sees a brighter future for the group

Being a value manager often means taking a positive view on a stock which seems to be universally unloved and facing plenty of headwinds, which is certainly the true in the case of logistics firm **International Distributions Services (IDS)**.

The FTSE 250 company, which recently changed its name from Royal Mail Group to emphasise its international scale, has delivered a string of profit warnings and is dealing with large-scale industrial action and a cybersecurity attack, so why on earth would investors be interested?

We look at the pros and cons of the business and talk valuation with one of its biggest shareholders.

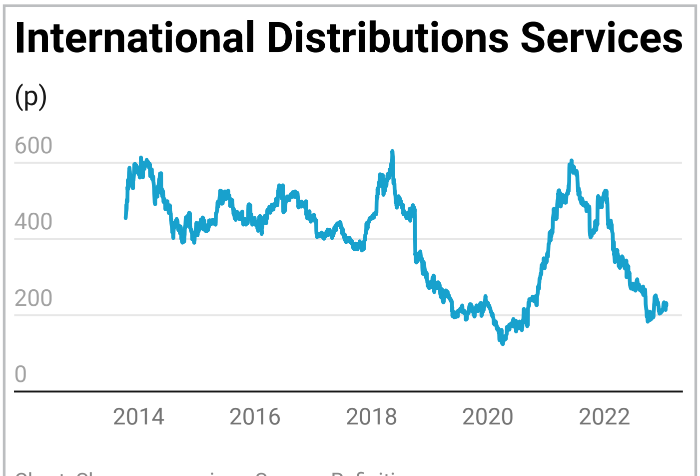


Chart: Shares magazine • Source: Refinitiv

HIGHS AND LOWS

It has been an odd few years for IDS, with revenues and earnings getting a big boost from the shift to e-commerce during the pandemic and the shares more than quadrupling from 124p in March 2020 to more than 600p by June 2021.

The good times didn't last, sadly, and the shares have since lost 75% of their value after a series of earnings downgrades and repeated warnings the firm isn't doing enough to reshape Royal Mail in light of the trend away from traditional UK delivery services, in particular the sending of letters.

Group results for the half-year to September showed a 4% drop in group revenues to £5.84 billion and an operating loss of £163 million against a profit of £311 million the previous year.

All the damage was due to Royal Mail, which posted a 10.5% decline in revenue to £3.65 billion and operating losses of £219 million against prior-year profits of £235 million 'driven by weak parcel volumes, inability to deliver productivity improvements and impacts from industrial action'.

GLS, the international distribution business, reported a 9.5% increase in turnover to £2.2 billion and a slight drop in profits to £162 million due to rising costs.

In a 26 January trading update there was no change to the firm's full-year profit guidance, which in some ways was a blessing as it meant no further downgrades. It said strikes had cost the business £200 million over nine months.

DAMAGED GOODS?

The reality is the group's future profitability hangs on right-sizing Royal Mail and getting agreement with the unions over pay and working hours.

Repeated strikes over Christmas will undoubtedly have damaged the company's franchise and seen some customers choose rival services to ensure delivery – winning them back will be an uphill task.

At stake is Royal Mail's 30% share by value of the £15 billion a year UK parcel market, which Ibis Research estimates will keep growing at 5% per year between now and the end of 2027.

Challengers such as Evri, formerly Hermes, pitch themselves as 'disruptors', offering a cheaper service with late cut-off times for retailers, making it attractive for e-commerce customers, and contracting out last-mile delivery to 'gig-economy' drivers.

IDS's reputation has been further damaged by a cyber incident which caused 'severe disruption' to Royal Mail's export service meaning it was unable to send letters and parcels to overseas destinations.

The company had to ask customers temporarily to stop submitting export items into the network while it worked to resolve the issue, but the issue raises questions over the level of investment needed in its systems and security.

TAKING A LONG-TERM VIEW

Given the headwinds facing the business, it's reasonable to ask why anyone would even think of buying shares in International Distributions Services.

The company seems to be in a perpetual state of turmoil, unable to satisfy the public or its employees, yet two big investors are prepared to ignore the noise and focus on what they see as the firm's hidden value.

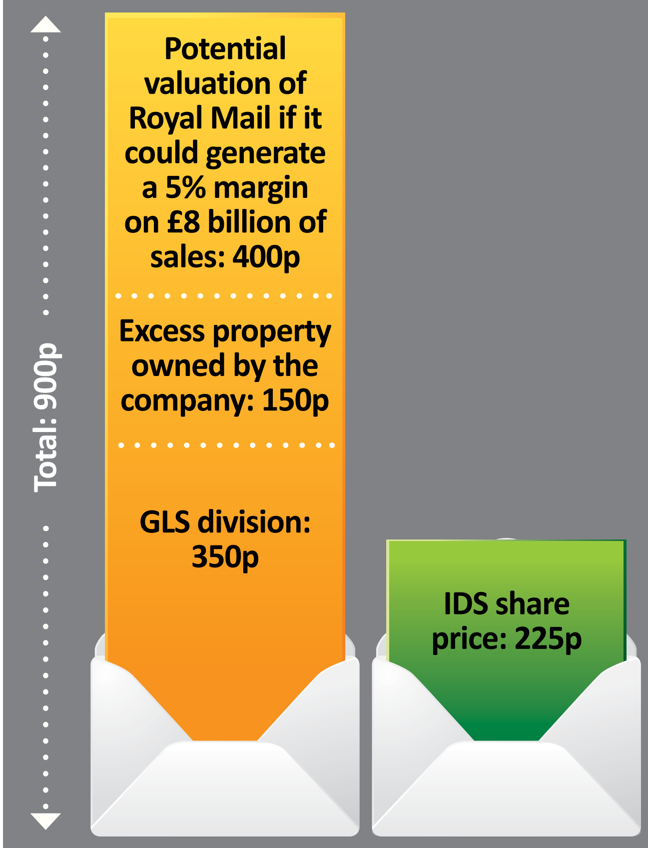
VESA, controlled by Czech investor Daniel Kretinsky, is not only the largest shareholder but has been steadily increasing its holding and now owns a 23.2% stake.

Redwheel, which manages **Temple Bar (TEMPL)** among other funds, owns 9.5% of IDS and shares the same vision for the firm as VESA.

Ian Lance, co-head of the UK Value and Income team at Redwheel and co-manager of Temple Bar, believes the GLS division of IDS is 'as good as any European logistics company'.

For the year to March, GLS is expected to make around £350 million of operating profits, which on a multiple of 10 times would mean a value of £3.5 billion or roughly 350p per share, argues Lance.

INTERNATIONAL DISTRIBUTIONS SERVICES - REDWHEEL VALUATION PER SHARE VS CURRENT SHARE PRICE



Graphic: Shares magazine
Source: Shares magazine, Redwheel, Google Finance, as at 25 January 2022

Royal Mail owns excess property worth another 150p per share, has little debt aside from leases and has a pension surplus, which takes the value of IDS shares to 500p even ascribing zero value to Royal Mail's operations, against a current share price of 225p.

If, and admittedly it is a big if, Royal Mail turned a 5% margin on say £8 billion of annual sales, in theory it could be worth 400p per share.

'The market is only looking at the next quarter, whereas we're looking at the next five to seven years,' says Lance, in which time he expects the company to be broken into two share classes with most investors preferring to own GLS while Royal Mail may offer 'option value'.

By **Ian Conway** Companies Editor

Monster Beverage has been a superstar stock over the past decade

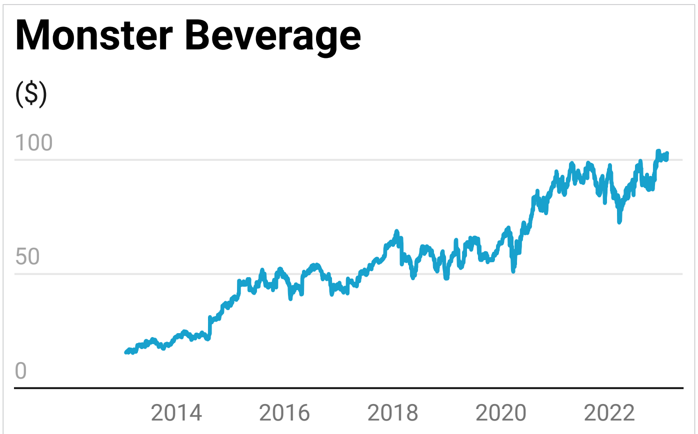
It has helped define the world of energy drinks and continues to grow despite fierce competition

Avid Premier League football fans can't fail to have noticed the promotion of popular Monster Energy drinks on stadium advertising hoardings.

The Monster Energy logo, a vibrant green 'M' composed of three lines on a field of black which suggests it was created by the claws of a monster ripping through the can, continually pops up pitch-side. The campaign is likely to add extra sales fizz in a period in the calendar when consumers are feeling their way into the New Year and seeking beverages which can pep them up and provide a physical boost.

But does the investment case stack up at the innovative company behind the brand, namely **Monster Beverage (MNST:NASDAQ)**? In this article we explain how the $53 billion business makes money and consider if it can continue to generate strong growth for investors who buy into the story today.

Monster Beverage has generated a 562% total return for investors over the past 10 years, significantly outperforming the tech-focused Nasdaq Composite index which delivered a 260% return over the same period. That's impressive for a beverages business and reflects Monster's delivery of strong volume and revenue growth.



MONSTER'S GROWTH INGREDIENTS

Monster Beverage is a developer and marketer of energy drinks including Monster Energy, Relentless and Burn which as of 2020, spoke for almost 40% of what was then a $5.7 billion US energy drink market, the second highest share after Red Bull.

The company was originally founded as humble juice products seller Hansen's in 1935 in California before an eventual expansion into alternative beverages including energy drinks, then a name-change in 2012 from Hansen to Monster Beverage.

In 2015 Monster signed a long-term strategic partnership deal with **Coca-Cola (KO:NYSE)** which included asset swaps. Coca-Cola transferred ownership of its worldwide energy drinks business to Monster, while Monster transferred its non-energy drinks business to Coca-Cola.

As a result of the transaction which also involved changes to distribution and a $2.15 billion payment, Coca-Cola obtained a 16.7% stake in the energy drinks company, which has since grown to 19.57% thanks to Monster's share buybacks.

MONSTER BRANDS

Guided by co-CEOs Hilton Schlosberg and Rodney Sacks, modern-day Monster develops, sells and

COMPETITIVE THREATS

Subject to rising regulation, the drinks industry is fiercely competitive and Monster locks horns with myriad rivals besides Red Bull, many of them boasting financial, marketing and distribution clout. Yet despite an influx of competition, Monster is more than holding its own by launching new products, entering new markets and establishing money-spinning sponsorship partnerships.

While Monster's partnership helped Coca-Cola establish its presence in the energy drinks market, this didn't prevent the soft drinks powerhouse branching out to offer an energy drink of its own, 'Coca-Cola Energy', though the tipple failed to gain significant market traction.

Nevertheless, Coca-Cola does own sports drink maker Bodyarmor, while **PepsiCo (PEP:NYSE)** owns Rockstar and other competitors span everyone from Lucozade-owner **Suntory (2587:TYO)** to **Starbucks (SBUX:NASDAQ)**, **Keurig Dr. Pepper (KDP:NASDAQ)** and smaller rival **Celsius (CELH:NASDAQ)**, a specialist in 'healthier' sugar-free energy drinks made from natural ingredients.

UK competition comes from the likes of **Britvic (BVIC)**, the soft drinks group behind fast-growing energy brand Purdey's. Irn-Bru maker **AG Barr (BAG)** recently acquired energy drinks business Boost.

distributes energy drinks and concentrates under an array of brand names including its flagship Monster Energy, NOS, Full Throttle and Reign.

The group's divisions include Monster Energy Drinks, which primarily includes the iconic fizzy Monster Energy drinks now sold in over 140 countries as well as Reign Total Body Fuel high performance energy drinks and True North Pure Energy Seltzer energy drinks, a line of plant-based and zero sugar energy tipples 'with an immunity boost'.

Monster's Strategic Brands segment mainly includes various energy drink brands acquired from Coca-Cola as well as affordable energy brands. Other parts of the business include Alcohol Brands, which features various craft beers and hard seltzers bought as part of 2022's $330 million acquisition of CANarchy Craft Brewery Collective, while the 'Other' division includes certain products from Monster's American Fruits and Flavors subsidiary sold to independent third-party customers.

Durable competitive advantages include Monster's brands and the thousands of registered trademarks it already has around the world, as well as the ever-expanding distribution of its products.

Monster Beverage is an asset-light business since it doesn't operate its own manufacturing facilities for finished goods. Instead, it buys the ingredients, concentrates, bottles and cans which are then delivered to third-party bottlers and contract packers. This business model enables the company to generate high returns – operating margins north of 30% and return on capital employed for 2019, 2020 and 2021 of 31.3%, 30% and 26.3% respectively – and copious amounts of cash.

DOES MONSTER STILL HAVE MOMENTUM?

The company has yet to publish its results for 2022, but 2021 was the firm's 29th consecutive record year of rising sales, despite the impact of Covid on supply chains and retail customers, with net sales increasing by 20% to $5.5 billion.

Its last reported set of figures were good. Third quarter 2022 sales hit $1.62 billion, up 15.2% year-on-year despite a strong US dollar headwind, with revenue growth driven by the Monster Energy Drinks segment, where sales fizzed 13% higher to $1.5 billion.

Sales in the Strategic Brands segment bubbled up 19.3% to $88.8 million, while sales to

Monster's biggest shareholders

Coca-Cola	19.57%
Brandon Limited Partnerships	8.03%
Vanguard	5.92%
Fidelity	4.90%
AllianceBernstein	3.87%
State Street Global Advisors	3.25%
BlackRock	3.18%
Loomis, Sayles & Co	3.17%
Capital World Investors	2.51%
T.Rowe Price Associates	2.21%

Table: Shares magazine • Source: Stockopedia

customers outside the US shot up 15.8% to $610.6 million amid expanding brand distribution in international markets.

On the negative side of the ledger, gross margins softened from 55.9% to 51.3% as Monster absorbed higher ingredient, packaging, aluminium can, transport and warehousing costs. However, the impact of elevated input costs was partially mitigated as Monster flexed its muscles and raised prices.

Schlosberg stressed that gross margins increased on a sequential quarterly basis thanks to price hikes and easing supply challenges. 'While aluminium pricing is easing, cost inflation, including increases in ingredient and other input costs, freight and fuel costs and co-packing fees, remain challenging,' he conceded, though he believes that some of the increased costs are likely to be transitory.

As a growth-focused stock, Monster doesn't pay dividends at the moment, though the company has a robust balance sheet with $1.3 billion in

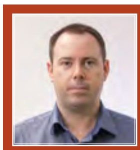
cash and cash equivalents, $1.35 billion in short-term investments and $72.4 million in long-term investments at the end of September. This liquidity and the company's cash generation is supporting capital returns to shareholders by way of earnings-enhancing share buybacks.

WHAT DO ANALYSTS THINK?

Management believes Monster Beverage is well positioned to profit from the expansion of the global energy drinks market and according to Stockopedia, analysts agree, being overwhelmingly bullish with four 'strong buy' ratings and 12 'buy' recommendations versus nine with 'hold' ratings. There isn't a single 'sell' rating, which might surprise given Monster Beverage commands a premium rating.

Consensus calls for net profits of $1.22 billion and earnings per share of $2.3 for 2022, bubbling up to $1.58 billion and $3 respectively in fiscal 2023. Based on those estimates, Monster trades on 44.4 times estimated 2022 earnings, falling to 34 times current year earnings, though this does represent a derating from 50 times-plus as recently as 2016.

'Our innovation pipeline of both alcoholic and non-alcoholic beverages continues to be robust and exciting,' said Sacks at the recent results, pointing to the (January 2023) launch of Monster Energy Zero Sugar into US retail and the launch of a first flavoured malt beverage alcohol product in the first quarter of 2023, namely 'The Beast Unleashed'.



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

Why bonds are back, how to invest in them and our best pick

This asset class has become more attractive as a lower risk source of income again

With interest rates moving up rapidly over the last year bonds now offer equity-like returns with far less risk. They are also likely to provide ballast to portfolios if recession strikes over the coming months.

This article explains the reasons behind the change in fortunes for bonds and provides some ideas on where to get exposure to different parts of the market.

Investing in individual bonds requires specialist knowledge and deep pockets which means for most investors funds are a good choice as they make this market more accessible and provide ready-made diversification.

WHAT HAS CHANGED?

Bonds or fixed income securities are IOUs from governments and companies and they used to be boring but reliable. They haven't been either in the last two years.

iShares Core Global Aggregate Bond ETF

Chart: Shares magazine • Source: Refinitiv

Bonds failed to provide their customary protection against stock market turmoil in 2022 with the Bloomberg Global Aggregate Bond index falling 14%, the second consecutive year of losses.

This was bad news for 60-40 portfolios which rely on bonds to provide a positive return in times of market stress. The poor price performance (prices move inversely to yield) means that for the first time in two decades bonds now provide a decent income with UK 10-year government bonds yielding around 3.3%, albeit they did reach 4% in October 2022.

In other words, the outlook for bonds has changed dramatically. In its 2023 outlook, asset manager Fidelity argued higher bond yields will enable bonds to be a good source of reliable low-risk income once again.

HOW TO INVEST IN THE BOND MARKETS

There are a hierarchy of risk levels associated with investing in different parts of the bond market. The safest part is short-dated government bonds, also known as sovereign bonds.

Shorter dated bonds usually pay a lower rate of interest than longer dated ones. Today that isn't the case because central banks have been rapidly increasing interest rates to slow the economy and bring down inflation. This means shorter dated bond yields are higher.

For example, UK two-year bonds currently yield 3.4% which is above the 10-year, but below the 3.7% offered on 30-year bonds.

Shorter dated bond prices are less sensitive to changes in interest rates than longer dated bonds and therefore more defensive than longer dated bonds.

Investors who believed inflation and interest rates have peaked may prefer the longer end of the government bond market.

The **Lxyor FTSE Actuaries UK Gilts ETF (GILS)** invests across the entire bond market and has a trailing yield of 2.4% and an ongoing charge of 0.05% a year.

A product which tracks the shorter end of the UK government bond market is **Lxyor FTSE Actuaries UK Gilts 0-5-year ETF (GIL5)** which has an ongoing charge of 0.05% a year.

INVESTMENT GRADE CORPORATE DEBT

Moving one step along the risk spectrum, corporate bonds offer a higher yield or 'spread' over government bonds. This reflects the credit risk (corporations with weak balance sheets may not pay back their loans in full) investors are taking on in this part of the market.

Investment grade refers to the highest quality part of the market and these companies have stronger balance sheets which should make them more resilient in an economic downturn.

The consensus view is that investment grade bonds are currently the sweet part of the market. In late 2022 investors could pick up 6% yields without taking on much risk. These yields have not been seen since the early 2000s.

A strong start to 2023 has seen investment grade bond prices increase by around a tenth and yields drop to around 5%, but many investors still see this as attractive. If the US economy falters there is the prospect of interest rates falling which could give investment grade bond prices a further boost.

Morgan Stanley argues that US corporate earnings estimates are too high and will lead to falling revisions as companies update the market. Chief strategist Michael Wilson says: 'The consensus might be right directionally, but wrong in terms of magnitude… We think it's in the magnitude of the move lower led by much weaker earnings and a Fed committed to fighting inflation.'

With the UK in a weaker economic position than the US, the case for owning high quality corporate bonds also stacks up.

SHARES' TOP PICK

Allianz Strategic Bond Fund (BYT2QW8)
Even the professionals are divided on which part of the bond market looks like the best bet, although there are clear attractions of corporate investment grade credit. That's why we highlight the Allianz fund which has an unconstrained mandate to invest what the managers believe are the best opportunities.

Headed by Mike Riddell we like the team's discipline which ensures it behaves like a bond fund. This means it should provide ballast against falling share prices. The team recently increased exposure to government bonds which means it is positioned for a recession and lower interest rates. The fund has a trailing yield of 3.7% and an ongoing charge of 0.43% a year.

An example of an actively managed global fund is **Artemis Corporate Bond (BFZ91W59)** which has a trailing yield of 3.24% and an annual ongoing charge of 0.37%. The fund uses a combination of long-term strategic positions with shorter term tactical positions to take advantage of opportunities.

The **iShares GBP Corporate Bond ETF (SLXX)** has a trailing yield of 2.77% and an ongoing charge of 0.2% a year.

For the US market the **iShares Broad USD Investment Grade Corporate Bond ETF (USIG)** provides exposure to a wide set of US corporate bonds. The ETF holds bonds of well-known companies such as **Apple (APPL:NASDAQ), JPMorgan Chase (JPM:NASDAQ)** and **Goldman Sachs (GS:NYSE)**.

Examples of bonds funds and ETFs

Fund Name	Code	Ongoing charge (%)
Lxyor FTSE Actuaries UK Gilts ETF	GILS	0.05%
Lxyor FTSE Actuaries UK Gilts 0-5-year ETF	GIL5	0.05%
iShares GBP Corporate Bond ETF	SLXX	0.20%
Artemis Corporate Bond	BFZ91W59	0.37%
iShares Broad USD Investment Grade Corporate Bond ETF	USIG	0.04%
XTrackers XT USD High Yield Corporate Bond ETF	XUHG	0.20%
Vanguard USD Emerging Market Government Bond ETF	VEMT	0.25%
Allianz Strategic Bond Fund	BYT2QW8	0.43%

Table: Shares magazine • Source: AJ Bell, Morningstar

HIGH YIELD CORPORATE BONDS

High yield corporate bonds are the riskiest part of the bond market because they are considered the most likely to default during economic downturns. Investors may not get their capital back in full when this happens although the effect is mitigated by the diversification offered by funds.

Bond fund managers consider high yield bonds similar in terms of risk to owning equities which is reflected in the higher yields. With yields around 8% some investors believe the risk to return ratio is attractive. That said, high yield corporate bonds are only suitable for investors willing and able to take a lot of risk.

XTrackers XT USD High Yield Corporate Bond ETF (XUHG) aims to track a very liquid part of the Bloomberg US Corporate high yield index. It has a trailing yield of 6.13% and an ongoing charge of 0.2% a year.

EMERGING MARKET BONDS

Emerging government debt markets offer higher yields than developed markets, currently at around 5.5%. They are further along the rate hiking cycle than the US and Europe according to US financial services firm Capital Group because they started earlier.

Asset manager BlackRock points out that the fundamentals of emerging market debt are better

than you might think. For example, more than 55% of emerging market debt is considered investment grade and governments are far less indebted than their developed markets counterparts.

While these managers make a good case for investing in emerging markets, it is considered risker than developed market sovereign debt. Political risk and currency devaluations complicate the pure investment considerations.

One example of a tracker fund in this space is **Vanguard USD Emerging Market Government Bond ETF (VEMT)** which tracks bonds issued by emerging market governments. It has a trailing yield of 5.02% and an ongoing charge of 0.25%.

By **Martin Gamble** Education Editor

How much money can I make from investing in stocks and bonds?

A football team needs defenders and strikers and a well balanced portfolio needs safer and riskier investments

Investing is never easy but for investors just starting out it can appear particularly intimidating. This article demystifies the process and helps explain risk and return. It will focus on the three broad asset classes of cash, bonds, and shares.

The whole point of investing is to lay out cash today to end up with more cash in the future. This cannot be done without taking some risk along the way. (Cash stashed under the bed doesn't grow) In other words, risk and return cannot be separated.

Research by **Barclays (BARC)** based on 122 years of data shows that the odds of stocks beating cash increases from 74% over five years to 91% if stocks are held for 10 consecutive years.

The same can be seen in stocks versus bonds. The message is clear, the longer an investor

Chances of stocks beating cash

	Over five years	Over 10 years
Chance of outperforming	74%	91%

Chances of stocks beating bonds

	Over five years	Over 10 years
Chance of outperforming	72%	77%

Table: Shares magazine • Source: Barclays Equity Gilt Study 2022. Note: based on data over 118 years for five-year period and 113 years for 10-year period. Calculated by dividing the years stocks have outperformed cash by total number of years.

Annualised total returns by asset class since 1899

Stocks	9%
Bonds	5%
Cash	4%

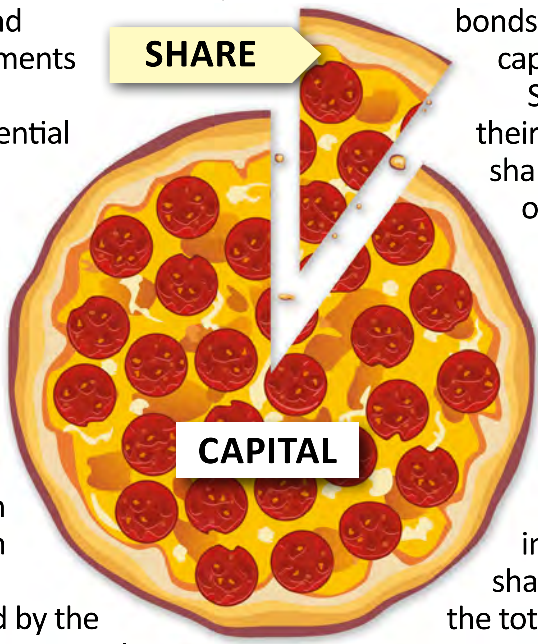
Table: Shares magazine • Source: Barclays Equity Gilt Study 2022

A RISK LADDER

Source: Shares magazine

holds stocks, the better the chances of earning superior returns.

It is useful to think about investment risk as a 'ladder'. At the bottom of the ladder are relatively safe investments such as cash and government bonds. Safer investments offer lower returns. As investors move up the risk ladder, the potential returns increase.



CASH AND BONDS ARE LOWERRISK BUT OFFER LOWER RETURNS

Cash earns more today than a year ago as interest rates have risen, but typical instant access cash accounts pay less than 1% per year. Higher cash returns can be achieved by 'locking' the cash away for longer.

Cash in the bank is guaranteed by the government up to £85,000. Always consider using tax efficient accounts such as Cash ISAs (individual savings account) or premium bonds.

Bonds are IOUs issued by governments and companies to pay for their spending. Government bonds are considered almost risk free and pay a higher level of interest than cash. Bonds in general carry a fixed rate of interest over a fixed period, say five or 10 years, and pay annual or semi-annual 'coupons' or interest payments.

Because both these variables are usually fixed, bonds are often described as 'fixed-income' securities. Usually, bonds which are due to be repaid longer into the future pay a higher rate of interest than those which mature sooner but their price is also more sensitive to changes in interest rates.

Bonds provide a stable income, but limited growth. Investors can grow their original investment by reinvesting interest payments into new bonds.

It is worth pointing out that although bonds are more stable than shares, they can still lose money, 2022 is a good example with bond prices falling by double-digit percentages reflecting rising interest rates (price moves in the opposite direction to yield).

INDIVIDUAL SHARES ARE HIGHER RISK

Shares are further up the risk ladder and are also known as stocks or equities. Unlike cash and bonds shares are held primarily for capital growth and income.

Shares represent exactly what their name suggests – they are a share of a company's capital (or in other words its cash and assets) and, importantly, they make you a part owner of the business. Think of the capital as a giant pizza and the shares as individual pieces.

Let's take healthcare company **GSK (GSK)** as an example. It has divided its capital into 4.1 billion shares. With the shares priced at £14.33 per share, the total market value of the company is approximately £59 billion or £14.33 multiplied by 4.1 billion.

Companies which can expand their business and grow profits over time will usually see their share price increase to reflect the growing value of the business.

> **"It is important to understand that the stock market reflects future expectations and not past or current results"**

It is important to understand that the stock market reflects future expectations and not past or current results. GSK's market value of £59 billion is what investors believe the company is worth based on future profits.

Companies also pay dividends to shareholders which can be reinvested or taken as income. For investors who do not need the income it is important to reinvest the dividend. The current dividend yield on the FTSE 100 index, representing the 100 largest companies on the UK stock market, is around 3.5%. A dividend yield on an individual share is calculated by dividing the dividend per share by the share price.

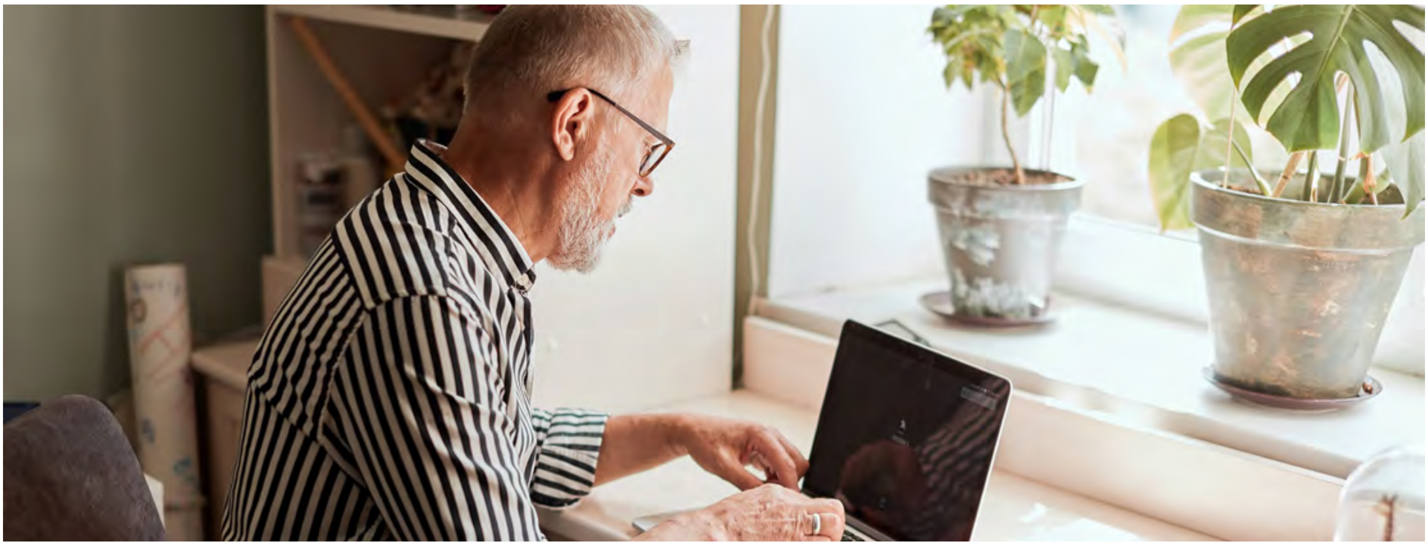
Stock picking can be risky and when things go wrong, it can result in significant losses. Share prices move around far more than bond prices. This higher variability in returns is what makes stocks riskier than bonds.

You should not put all your eggs in one basket. It is important to build a balanced portfolio to protect against losses. For beginners it can make sense to invest in shares through an exchange traded fund that tracks a major index such as the FTSE 100 or an actively managed fund while you build your confidence and knowledge.

By **Martin Gamble** Education Editor

INVESTING FOR BEGINNERS

This is the first in a series of articles aimed at demystifying the markets for anyone just starting out with their investing. Look out for the next part of the series in a future issue of *Shares.*



What can I do if I'm forced to wait for the state pension?

Our expert looks at the various proposals from the Government and what might happen next

I've just turned 60 and was expecting to receive my state pension at age 67. I'm now worried that the Government is going to change the timetable and leave me high and dry. Is there anything I can do?
Colin

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

While there are stories about the Government potentially accelerating a planned increase in the state pension age to 68, nothing has been formally announced. Secondly, based on previous statements it is unlikely any change in the timetable would impact your state pension age.

The current UK state pension age is 66. Those who build up an entitlement to the full flat-rate state pension receive £185.15 per week, or just shy of £10,000 a year. Because this new system was only introduced in 2016 and your entitlement is based on several factors including your National Insurance record, it is possible you will receive more or less than this amount.

Plans set out by previous Governments mean the state pension age will increase to 67 between 2026 and 2028, and it is expected to then rise again to 68 between 2044 and 2046. During those two-year transition periods, some people would have a state pension age between 66 and 67, and 67 and 68.

A review of the state pension age is ongoing and there are rumours the proposed increase to age 68 could be brought forward to the 2030s.

While this would likely impact millions of people's retirement plans, the Government has previously said any shift in the state pension age timetable would give people at least a decade of notice. As you are within seven years of your state pension age, you should not be affected – although it's worth keeping track just in case that position changes.

The impact of an accelerated state pension age increase to 68 would depend on the timing of that rise.

If the increase to 68 is **brought forward by seven years to 2037-39** – a proposal previously set out by the Government in 2017 – this could mean:

- Anyone born on or before 5 April 1970 would have a state pension age of 67;

- Anyone born from 6 April 1970 – 5 April 1971 would have a state pension age between 67 and 68;

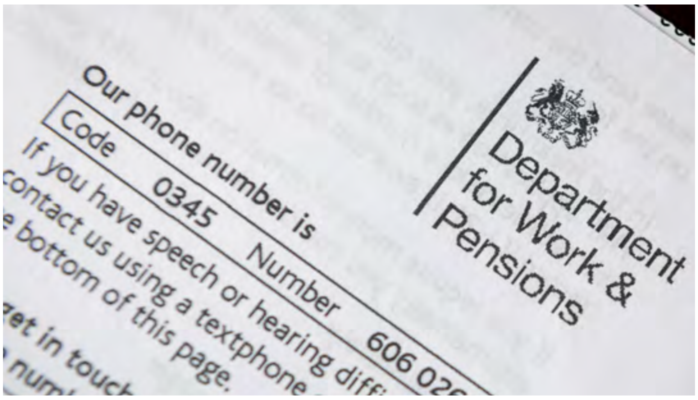
- Anyone born from 6 April 1971 onwards would have a state pension age of 68.

If the increase to 68 is **brought forward to 2035-37**, this could mean:

- Anyone born on or before 5 April 1968 would have a state pension age of 67;
- Anyone born from 6 April 1968 to 5 April 1969 would have a state pension age between 67 and 68;
- Anyone born from 6 April 1969 onwards would have a state pension age of 68.

If the Government goes for the nuclear option and the increase to 68 is **brought forward to 2033-35**, this could mean:

- Anyone born on or before 5 April 1966 would have a state pension age of 67;
- Anyone born from 6 April 1966 to 5 April 1967 would have a state pension age between 67 and 68;
- Anyone born from 6 April 1967 onwards would have a state pension age of 68;

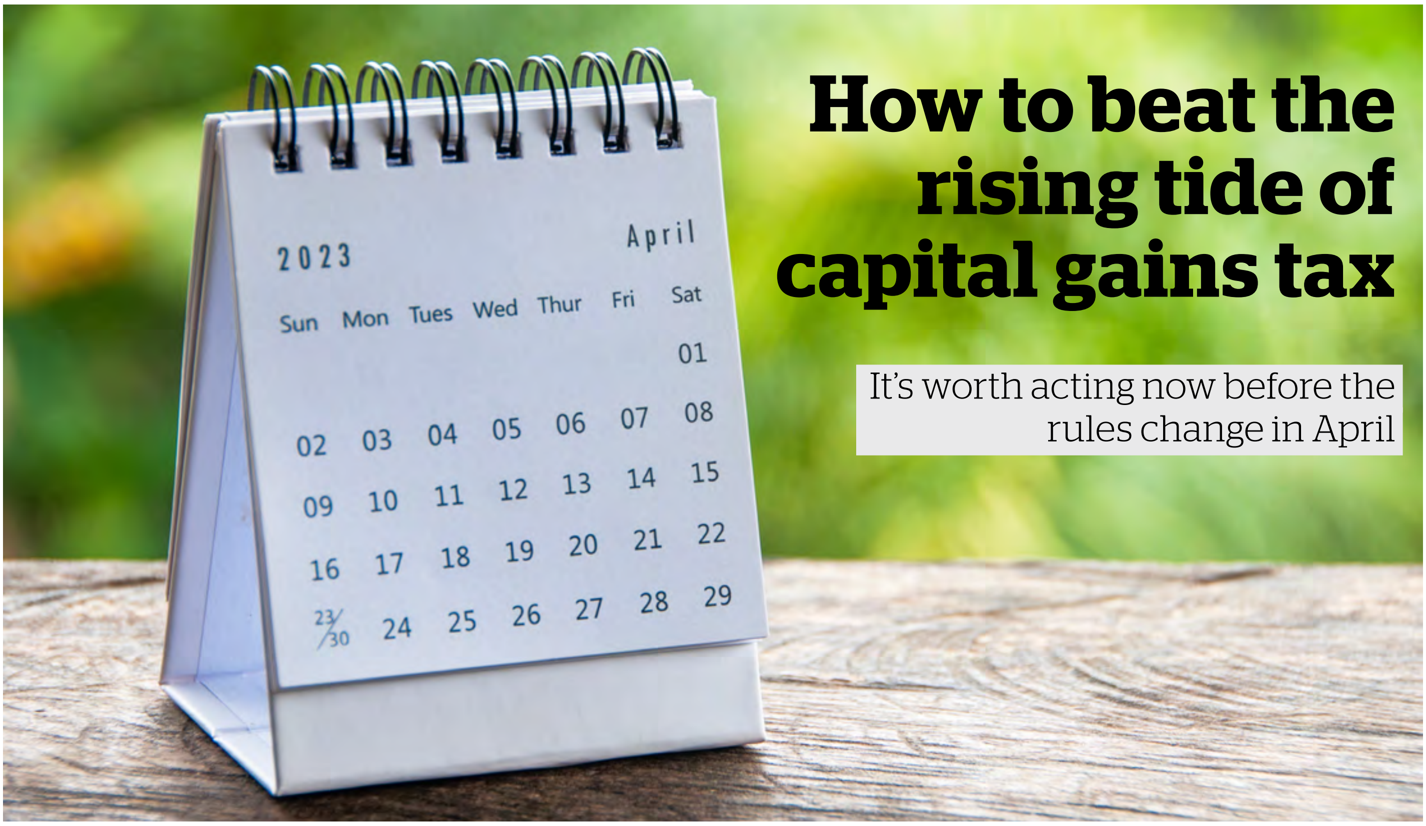


But it's important to note none of this is set in stone yet. Once the Government sets out detailed plans, we'll make sure you know exactly what will happen and how you might be affected.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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



How to beat the rising tide of capital gains tax

It's worth acting now before the rules change in April

Capital gains tax is about to become a big headache for many more investors. Under current rules, individuals have a relatively generous £12,300 of investment gains which they can realise each tax year without being subject to tax.

However, the Chancellor has announced that from April 2023, this allowance will fall to £6,000, and then from April 2024, it will be cut to just £3,000 a year. Any gains above these levels are taxable at 10% or 20% for basic and higher rate taxpayers respectively, with an additional 8% tax on residential property sales.

This is going to cause problems for investors on two counts. First, they now face a higher tax bill when selling investments. Second, more investors are going to find themselves caught up in capital gains tax calculations, which can be beastly to say the least.

HOW CAN I REDUCE OR AVOID CAPITAL GAINS TAX?

There are a range of options open to investors who wish to mitigate the capital gains tax they are going to pay on their investments.

The most obvious is to make appropriate use of pension and ISA allowances, as gains made within these shelters are free from capital gains tax. They protect you from income tax along the way too.

You can even move investments you hold outside a SIPP or ISA inside the wrappers by performing a 'bed and ISA' or a 'bed and SIPP', whereby you sell shares or funds and buy them back within the tax shelter.

This does crystallise any gains, which may be liable to capital gains tax, but seeing as the CGT allowance is £12,300 this year, and £6,000 next year that still gives you scope to tuck away a decent chunk of investments from the ravages of capital gains tax.

There are other tax shelters, such as VCTs and EIS's which also offer growth free from capital gains tax, but these funds invest in early-stage companies, which means they come with high risks and low liquidity.

USING A PARTNER'S ALLOWANCE

There is a manoeuvre rather curiously called a 'bed and spouse', though it's perhaps not quite as romantic as it sounds. The annual capital gains allowance applies to an individual, and so it makes sense for a couple to share their assets out between them, to maximise the allowance of each partner.

The good news is that if they're not evenly

spread currently, transfers of assets between spouses or civil partners are free from capital gains tax, so you can conduct a 'bed and spouse' by re-registering investments from one partner to the other.

By doing a bit of shuffling, you may therefore be able to arrange your investment affairs a little bit more efficiently as far as capital gains tax is concerned.

As part of any redistribution of assets, you should also give some consideration to the income tax band each partner sits in too. Those in higher rate tax brackets would pay a higher rate of capital gains tax on any gains that are realised above the annual CGT allowance, and they will also likely pay higher income tax rates on any interest or dividends received from investments too.

So, there may be some trade-offs and judgements which need to be exercised in getting the right balance, depending on your tax bands and whether you hold investments that produce an income.

WORKING OUT YOUR TAX LIABILITY

In a way, protecting your investments from capital gains tax is the easy bit, compared to working out your capital gains tax liability if you do exceed the annual threshold.

For some holdings this may be straightforward because you can easily find out what you paid for them, and you know what the proceeds are when you sell them.

But it can quickly get more complicated. What if you aren't selling an entire holding? Or if you have bought and sold shares along the way, at different prices? For instance, maybe you have a regular monthly investment into a fund or have simply traded in and out of a share depending on prevailing conditions. There are more complicated rules applying in these circumstances.

If you hold accumulation units in a fund (outside of an ISA or SIPP), you could be in for some testing times with a spreadsheet too. These units reinvest any dividends along the way, and those dividends are liable to income tax.

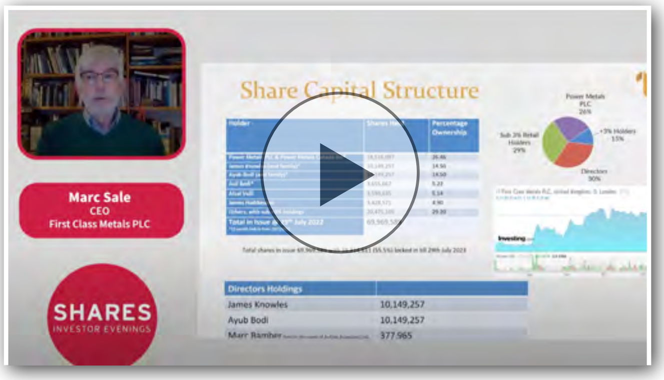
To avoid paying capital gains tax on these dividends too, the government allows you to use them to reduce your capital gain when you sell, but you will need to have your paperwork in good order to be able to tot them up over the years.

The complexity involved is itself a compelling reason to avoid capital gains tax through tax shelters and tax planning, if possible, let alone the actual financial saving you make.

If you find you have exhausted all the possible avenues and do end up paying capital gains tax, perhaps you can console yourself that at least there are gains to be taxed, so in that sense, it's a nice problem to have.

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

WATCH RECENT PRESENTATIONS



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Marc Sale, CEO

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