STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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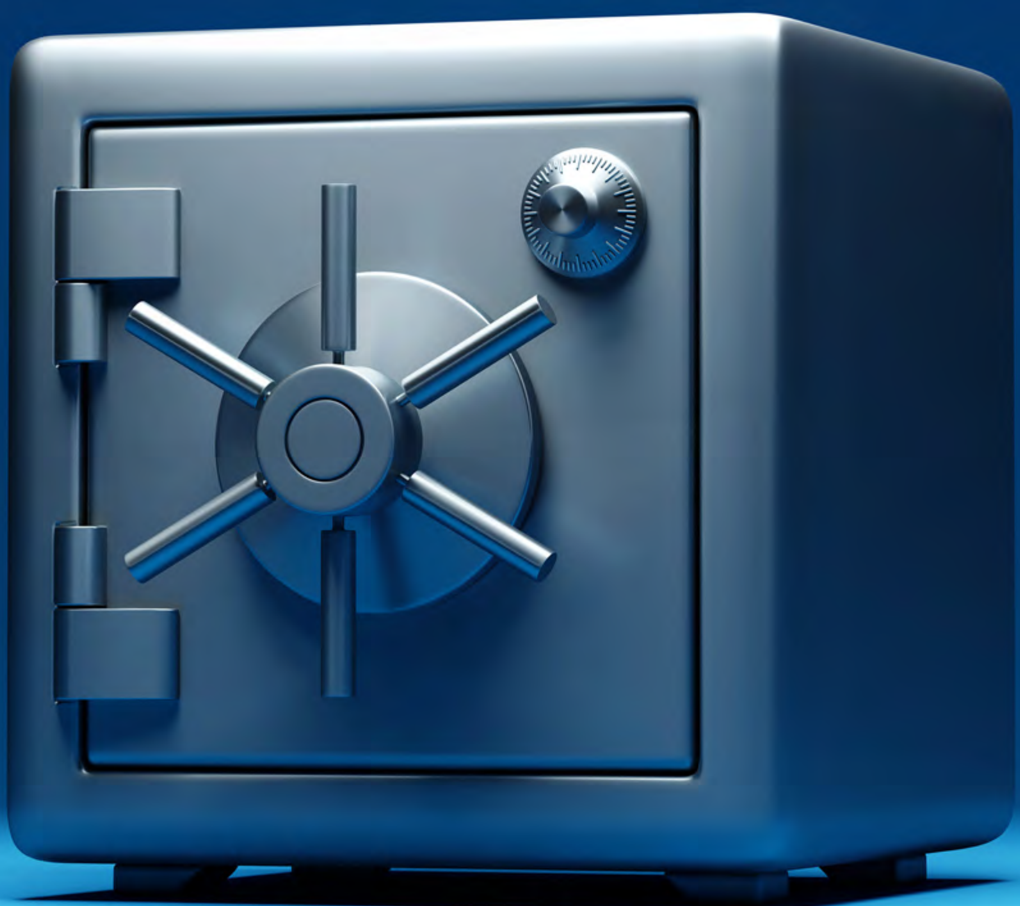
SHARES

WE MAKE INVESTING EASIER

Banking crisis

Should you be worried about investing in this sector?



USING A LIFETIME ISA

Top strategies whether you're saving for a house or retirement

Contents

06	**NEWS**	• Banking crisis: should you be worried about investing in this sector? • The important bits from the Budget for savers and investors
14	**GREAT IDEAS**	**New:** iShares Gold Producers / Just Group **Updates:** Babcock International
19	**FEATURE**	Investing in AIM shares for inheritance tax relief? Don't get caught out by these issues
23	**FEATURE**	How investors can take part in company fundraisings as they dial up again
27	**FEATURE**	Are Harbour Energy and its rivals bluffing about leaving the North Sea behind?
32	**UNDER THE BONNET**	Where do investors stand after Tesla's 57% 2023 share price rally?
35	**FEATURE**	Lifetime ISA: Top investment strategies for your first home or retirement
42	**EDITOR'S VIEW**	Higher rates on cash savings could drive more generous dividends from shares
44	**CASE STUDY**	How I invest: a mix of shares, investment trusts and a growth fund help me save for my family's future
47	**ASK TOM**	How do I top up National Insurance contributions now the deadline has been extended?
50	**DANNI HEWSON**	High street comeback: companies are back in expansion mode again
55	**FEATURE**	Why investing in your 60s doesn't mean the end of investing for capital growth
59	**FUNDS**	Tracker funds are at the top of retail investors' ISA shopping list
62	**INDEX**	Shares, funds, ETFs and investment trusts in this issue

Three important things in this week's magazine

1


News

Banking crisis: should you be worried about investing in this sector?

The biggest US bank collapse in a decade has rocked investor confidence

Shares in the likes of Barclays, HSBC and Lloyds have slumped as investors worry about a new banking sector crisis

We explain what's happened, what might come next and the knock-on impact for interest rates

2


News

Budget 2023: big news on pensions as lifetime allowance is abolished

Chancellor's big reveal was overshadowed by a deepening crisis in the banking sector which rocked markets

There was plenty of good news for investors in the Budget

Discover the most important bits about new pension allowances and other changes to personal finance and tax matters

3


Feature: Investing in AIM

Investing in AIM shares for inheritance tax relief? Don't get caught out by these issues

We explain what happens if a BPR-qualifying company moves to a different market or is taken over

Two of AIM's biggest stocks could soon leave the junior market

If you're holding EMIS and Breedon to qualify for IHT relief, you need to think about your next steps now

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:

Find out which companies in the FTSE 100 have the highest dividend yields

Illumina shares jump 17% after activist Carl Icahn reveals 1.4% stake

Online retailer Virgin Wines launches review following 97% profits plunge

How popular tech fund Allianz Technology Trust is tackling risk after losing 7% to benchmark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Investment world look like a big puzzle?
We've solved it in one fund.
The investment world likes to complicate everything. Our Managed Fund likes to keep it really simple. It's made up of equities, bonds and cash, and we think to generate great returns, that's all you need. The result is a balanced portfolio with low turnover and low fees. Beautifully straightforward, it's been answering questions since 1987.
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Actual Investors

News

Banking crisis: should you be worried about investing in this sector?

The biggest US bank collapse in a decade has rocked investor confidence

By **Ian Conway**
Companies Editor

If a week can be a long time in politics, in financial markets it can make investors feel as though their whole world has been turned upside down.

For years, analysts have consistently peddled the line that higher – or at least rising – interest rates are positive for banks because it means they can generate a bigger margin on their lending.

Instead, last week's collapse of Silicon Valley Bank has shown that rising interest rates have a negative effect on the value of bonds, which in turn can impact a bank's liquidity, especially if its deposits don't match its loans.

Investors have panicked, leading to a sharp decline in share prices around the world, with banking one of the worst hit sectors. While markets in Europe had started to calm down as of Tuesday 14 March, there remain two unanswered questions – are more banks going to get into trouble and will the SVB incident prompt central banks to be less aggressive with interest rate hikes? We don't know the answer to the former, but the latter looks plausible.

WHAT HAPPENED TO SVB?

SVB was a specialist lender with a focus on technology and venture capital companies. At the end of last year, the bank had assets including loans of around $210 billion and customer deposits of around $175 billion.

There are two reasons why SVB got into difficulty, both of which centre on the mismatch between its assets and its deposits. First, the bank had fewer deposits than loans, so to finance some of its investments it had to borrow money at progressively higher rates, just as Northern Rock had to borrow from the UK interbank market, which proved its undoing. Second, the bank was taking in short-term deposits and investing them in long-term assets like loans to companies and US government bonds.

Due to the popularity of venture-capital investing the bank's deposits exploded from $60 billion to almost $200 billion in a short space of time, and it decided to invest a large chunk of this money in US government bonds when yields were very low. However, last year's sharp rise in interest rates drove down the value of the bonds held by SVB and every other bank.

When customers started asking SVB for their money back last week, the bank had to sell some of its long-term bond holdings at a loss to raise the cash to meet the withdrawals. Once the market got wind SVB might be in trouble there was a full-blown 'run' on the bank, leading to a collapse in its share price.

Californian state regulators took over the bank and the US Treasury, the Federal Reserve and the Federal Deposit Insurance Corporation stepped in to guarantee all of SVB's deposits and protect its customers.

COULD MORE BANKS BE IN TROUBLE?

As well as guaranteeing SVB's depositors that their money was safe, in a re-run of measures introduced in the great financial crisis of 2008 US regulators agreed to let banks use the Federal Reserve's 'discount window' to borrow cheaply to finance customer withdrawals if they needed to.

Despite the improvement in banks' capital ratios since 2008, investors still have concerns over the ability of some US specialist and regional lenders to meet customer withdrawals so shares of **First Republic Bank (FRC:NYSE)** and **Western Alliance (WAL:NYSE)** slumped after the SVB debacle.

In the UK, shares of the big high-street banks **Barclays (BARC)**, **HSBC (HSBA)**, **Lloyds (LLOY)** and

NatWest (NWG) have also been under pressure and by the evening of 13 March the FTSE 350 bank index had lost close to 10% of its value in a week.

Shares of smaller, less heavily capitalised firms such as **Bank of Georgia (BGEO)**, **TBC Bank (TBCG)** and **Virgin Money (VMUK)**, which rely on the stability of their deposit base, also fell on the stock market although there is no indication that any of them have any operational difficulties.

Ratings agency Moody's believes the decline in bond values is temporary and most European banks have enough liquidity to meet any potential liability, allowing them to hold their bonds to maturity.

WHY DID HSBC BUY SVB'S UK OPERATIONS?

HSBC paid £1 to rescue the UK arm of SVB and protect its depositors. The company said the acquisition would strengthen its commercial banking arm and enhance its ability to serve 'innovative and fast-growing firms', including in the technology and life-science sectors.

The Bank of England said the deal would ensure 'the continuity of banking services, minimising disruption to the UK technology sector and supporting confidence in the financial system'.

It also stressed no other UK banks were materially affected by the failure of SVB and the wider UK banking system was 'safe, sound and well capitalised'.

WHAT DOES IT ALL MEAN FOR START-UPS?

The immediate effect of the turmoil at SVB is likely to be that banks and other financial firms tighten

5-Day market movements in major indices and banking stocks

INDICES	
S&P 500 (US)	**-4.7%**
FTSE 100 (UK)	**-4.6%**
Dax (Germany)	**-3.1%**
UK BANKS	
Virgin Money	**-14.8%**
Barclays	**-11.1%**
HSBC	**-9.2%**
Lloyds	**-7.4%**
NatWest	**-5.2%**
EUROPEAN BANKS	
Credit Suisse	**-17.8%**
Commerzbank	**-14.7%**
US BANKS	
First Republic Bank	**-74.3%**
Western Alliance	**-65.0%**
KeyCorp	**-36.7%**
Bank of America	**-15.7%**
Citigroup	**-14.0%**

Table: Shares magazine • Source: Google Finance, 14 March 2023

THE EXPERT'S VIEW FROM ALGEBRIS INVESTMENTS

'Assuming the economic impact is relatively contained, we do not see a clear read-across (from SVB), particularly for the larger US and European banks, for several reasons.

Large banks are subject to more comprehensive and thorough regulation. For instance, in Europe, banks are limited in how much rate mismatching they can take on their held-to-maturity bond portfolios, due to Basel 4 regulations. This means that they will not face the same steep negative equity position that SVB found itself in with its deeply underwater securities book.

Hence, the average European bank has losses of just ~5% of tangible equity, compared to the 124% that SVB showed as of year-end.

'Further, European and large US banks must deduct unrealised losses on securities accounted at fair value (i.e., marked to market on a quarterly basis, in contrast to held-to-maturity) from their regulatory capital.'

their lending criteria making it harder for fledgling companies, which are notorious for burning through cash before they generate a profit, to borrow money.

Another effect is investors are likely to want to put a bigger discount on assets held in venture capital funds and potentially on private assets in general to compensate them for what they perceive to be increased risk. That doesn't bode well for investment trusts invested in private markets.

WHAT DOES IT MEAN FOR INTEREST RATES?

As well as prompting a sell-off in bank stocks around the world, the collapse of SVB has spurred frantic buying of government bonds as investors look to reduce their risk exposure in favour of 'safe' assets.

That in turn has led to a steep decline in bond yields and in market expectations for interest rate rises by the Federal Reserve and the Bank of England over the next couple of months.

Whereas traders were worrying last week that Fed chair Jerome Powell was ready to raise interest rates faster than they had anticipated, this week all bets seem to be off.

Instead of a 50 basis-point hike, economists at investment bank Goldman Sachs now expect the Fed to leave interest rates unchanged on the next rate decision day (22 March) despite the bank's primary aim being to rein in inflation, not alleviate strains in the financial sector.

While SVB may well have been an outlier, with investors worried about possible contagion due to unrealised bond losses on banks' balance sheets and potentially a broader financial crisis, many observers are arguing the Fed should take its time to assess the impact of the bank's collapse and allow sentiment to recover.

SHOULD I SELL ALL MY SHARES?

While the news around SVB has caused shockwaves across global stock markets, we do not see a reason to panic and sell shares.

Admittedly there is now a heightened risk of tighter regulation among banks which means investor sentiment could temporarily remain poor towards the sector. That will put pressure on banks to provide reassurance they have strong balance sheets and aren't in trouble.

Most people hold shares in banks for generous dividends and we do not expect payouts to be cut from the UK banking stocks in the wake of the SVB crisis.

THE EXPERT'S VIEW FROM ING

One of the reasons that the Federal Reserve could deliver fast and impactful interest rate increases over the past year is that the system could take it.

Equity markets and bond markets may have crumbled, but as long as the system was intact the Fed could continue to tighten.

The SVB saga as a standalone mutes the ability of the Federal Reserve to over-tighten from here, as there is an implied threat to the system should the Fed be seen to be overdoing it.

Risk barometers like FRA/OIS and the cross-currency basis have spiked, but not dramatically so. This suggests the system has had a wobble but is absolutely not under immediate threat.

The down move in the yield curve points to a material reduction in the likelihood that the Fed overdoes it on rate hikes.

We argue that what equity markets do here is not that relevant. They can come under pressure, but the really important thing to monitor is the financial system. If that were to be materially threatened, the Fed could not hike at all.

We only have to look at the global financial crisis and the pandemic as templates that showed the Fed is single-minded when the system is under threat, and that is to cut rates and ease policy, significantly.

We are not at that point, and we most likely won't get to that point. But if the inflation data refuses to dampen in a material fashion it places pressure on the Fed to make a tough choice. The simplest choice is to stick with a 25 basis point rise and let the market calm down of its own accord in the weeks and months ahead.

Budget 2023: big news on pensions as lifetime allowance is abolished

Chancellor's big reveal was overshadowed by a deepening crisis in the banking sector which rocked markets

Panic in the banking industry overshadowed any big market impact from the Budget on 15 March even if the abolition of the lifetime allowance on pension contributions was a genuine rabbit out of the hat for investors.

Previously the lifetime allowance, which is the maximum you can build up in a pension pot without paying extra tax, stood at a little more than £1 million. The motivation for the change is apparently the fact 80% of NHS doctors retire early due to pension tax charges.

The maximum you can pay into a pension each year tax-free will increase by 50% from £40,000 to £60,000. To put the changes into some perspective, if you were to put away £60,000 per year for 47 years, you would've have achieved a savings pot of £2.82 million (without factoring in interest or investment growth).

Chancellor Jeremy Hunt threw a lifeline to those already in retirement by increasing the Money Purchase Annual Allowance, how much you can pay into a pension once you've started taking money out of it, from £4,000 to £10,000. Yearly allowances of £20,000 for adult ISAs and £9,000 for Junior ISAs were left unchanged.

Forecasts from the Office for Budget Responsibility suggest the UK will avoid a technical recession although the economy will still shrink this year and projections for medium-term growth have fallen. An extension of the energy price guarantee from 1 April could provide a boost to consumer-facing businesses, so could an increase in free childcare hours but that doesn't begin until April 2024.

Pub groups including **JD Wetherspoon (JDW)** bounced off their lows as the chancellor unveiled a 'Brexit pubs guarantee' which means duty on draught products in pubs would be up to 11p below the duty in supermarkets from 1 August – a differential which will be maintained in the future.

There were a couple of announcements to salve any wounds from a looming increase in the headline corporation tax rate from 19% to 25%. Every pound spend on IT equipment, plant or machinery can be deducted in full and immediately from taxable profit for the next three years, with a plan to make this permanent as soon as possible.

News that nuclear energy will qualify for the same investment incentives as renewable energy could be good news for **Rolls-Royce (RR.)** which is working on small modular reactors – a technology which could enable faster and cheaper development of nuclear capacity.

Hunt pledged to lift the budget to repair potholes each year by 40% to £700 million. That creates opportunities for companies which spend time fixing the nation's highways including **Costain (COST)** whose share price moved higher on the news. [TS/SG]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

21 March: Kingfisher, Oxford Nanopore Technologies, Fintel, Ergomed, Alliance Pharma, Zotefoams, Kape Technologies, Tissue Regenix, Luceco, Gamma Communications, Aptitude Software, Quixant, Henry Boot, Equals, Staffline

22 March: Hostelworld, Ten Entertainment, Vistry, Fevertree Drinks, Pendragon, LSL Property Services, Anpario, MPAC, Genel Energy, Judges Scientific, Essentra, BioPharma Credit

23 March: Playtech, Portmeirion, Safestyle, Sopheon, Pollen Street

HALF-YEAR RESULTS

20 March: SCS, YouGov

23 March: Smiths Group

TRADING UPDATES

22 March: Bloomsbury Publishing

Fevertree

Can the posh mixers maker regain some fizz when it posts 2022 results?

After enjoying years of fizzing earnings upgrades and share price gains off the back of its 2014 stock market listing, posh mixers maker **Fevertree (FEVR:AIM)** has gone flat in recent times.

In January the company downgraded 2023 guidance thanks to rising costs – this negative news coming off the back of three profit warnings in 2022.

A key selling point for Fevertree and its premium proposition is its glass bottles (which now account for 80% of its sales mix) but the cost of producing these is heavily tied to volatile energy prices. Supply chain issues have also impacted US sales.

When it reports 2022 results on 22 March, Fevertree needs to demonstrate it is making progress on a plan to bring on stream bottling capacity in the US to help limit logistics costs and disruption. [TS]

Kingfisher

B&Q-owner bemoaned a 'challenging' consumer outlook when downgrading profit guidance in November

Full year results (21 March 2023) from **Kingfisher (KGF)** will reveal if the DIY retailer's sales resilience continued in the final quarter, supported by demand for energy-efficiency products.

The B&Q, Screwfix and Castorama brands owner proved a lockdown winner as spending on home improvement projects surged, but the cost-of-living crisis and housing market downturn represent stiff headwinds for the company.

Kingfisher lowered its full year profit outlook with its third quarter update (24 November 2022) due to the 'challenging' outlook for consumer spending. [JC]

Nike

The sportswear firm is hoping for a boost from China reopening as its main rival struggles

US trainers and sportswear giant **Nike (NKE:NYSE)** posts third quarter numbers on 21 March with investors hoping it can match the strong second quarter update.

In the previous three-month period, earnings per share of $0.85 was comfortably ahead of the $0.64 consensus forecast and the company also raised its outlook, as management flagged progress clearing a chunky inventory pile that arose in large part due to supply chain disruptions.

Key areas of focus for the third quarter will be the impact of China reopening on its sales and whether it has been able to capitalise on the recent travails of its rival **Adidas (ADS:ETR)** which boss Bjørn Gulden, who took over at the start of 2023, is hoping to turn around. [TS]

General Mills

Investors will have much to chew over with the company's Q3 results

Third quarter results (23 March) from **General Mills (GIS:NYSE)** provide an opportunity to see if the cereal maker has sustained the positive momentum engendered by its 'Accelerate' strategy as consumers grapple with cost-of-living pressures. The food multinational behind the Cheerios, Nature Valley and Haagen-Dazs brands recently raised guidance for the financial year to May 2023, citing resilient consumer demand

and the growth opportunities afforded by its brand portfolio, notably dog and cat food brand Blue Buffalo. [JC]

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

17 March: Lithium Americas, Ballard, Orla Mining, Janux Therapeutics
20 March: Cathay Financial, Foot Locker
21 March: Nike
22 March: Tencent, GameStop
23 March: Accenture, General Mills, Cintas, Carnival

EUROPEAN UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

17 March: Vonovia
23 March: Hamburger Hafen

This tracker fund is a cheap way to secure gold's safe haven qualities

With SVB's collapse leading to market volatility this ETF offers exposure to the prized precious metal

With concerns about systemic risk in the banking sector, gold's qualities as a safe haven are once again coming to the fore and we've found an excellent way to play the precious metal.

Gold typically performs well during periods of low growth and sticky inflation and when investors are feeling nervous. Arguably all three of these factors are present and correct right now.

Even aside from the collapse of banking group SVB, the crash seen at several crypto-linked institutions and the ongoing volatility in this part of the market has blown out of the water any claims for bitcoin as an alternative store of value to gold.

One of the things which has held gold back recently has been rising interest rates and the implications for gold's attractiveness relative to assets like cash and bonds which, after all, offer something gold doesn't: an accompanying income stream.

Gold price

($/oz)

Chart: Shares magazine • Source: Refinitiv

However, the collapse of SVB has led to a reduction in rate expectations, at least for the time being, and this should be supportive to gold.

A step back for the dollar, which tends to have an inverse relationship to the metal, is also helpful. On the flipside if rates are higher for longer and if the dollar strengthens these could help dull gold's shine as a defensive asset – something investors should bear in mind.

iSHARES GOLD PRODUCERS UCITS ETF
(SPGP)
Price: £10.46
Net assets: £1.29 billion

Investing in gold miners, while it comes with operational risk, also allows you to typically secure income from dividends and enjoy outsized gains if they can deliver growth.

A diversified fund of gold producers protects you from the risk of being caught out by the failings of individual companies and **iShares Gold Producers (SPGP)** is a low-cost way of achieving this kind of exposure.

The exchange-traded fund has an ongoing charge of 0.55% and has delivered a five-year annualised total return of 9% versus 6.6% from **BlackRock Gold & General (B5ZNJ89)**, the big actively managed gold mining fund which has a much higher ongoing charge of 1.16%.

Dividends are automatically reinvested into the ETF which tracks the S&P Commodity Producers Gold index, a basket of companies engaged in exploration and production of gold. Its largest holding is **Barrick Gold (GOLD:NYSE)**, a $30 billion miner headquartered in Canada which has assets across the globe, including in the Americas, Africa and Asia.

It has a stake in **Franco-Nevada (FNV:NYSE)** which receives royalties on revenue from various third-party mines. It also invests in **Newmont (NEM:NYSE)**, the world's largest gold miner by output, and which last month made a $17 billion takeover bid for Australian rival **Newcrest (NCM:ASX)**. [TS]

Babcock's in recovery mode and its shares are much cheaper than other defence stocks

The engineering support services group is a self-help story with significant rerating potential

BABCOCK INTERNATIONAL
(BAB)
Price: 328.8p
Market cap: £1.66 billion

As volatility returns, one way to protect your portfolio is to tap into returns that aren't reliant on the global economy or the direction of markets.

We think **Babcock International (BAB)** is a good option as it undergoes an internally-driven, multi-year turnaround.

The engineering support services play has had a difficult time. However, *Shares* believes a rebound from October 2022 lows has further to run as Babcock benefits from self-help and a step-up in defence spending over the coming decade.

WHY BUY BABCOCK NOW?

The FTSE 250 constituent is at the start of a major recovery after several turbulent years, having been hit hard by additional costs during the pandemic. A specialist in managing complex assets and infrastructure in safety and mission-critical environments, Babcock swung from a £1.81 billion loss to pre-tax profit of £182.3 million in the year to March 2022.

This was the first year of its turnaround under CEO David Lockwood and chief financial officer David Mellors, who together successfully turned round defence outfit Cobham before its £4 billion sale to US private equity firm Advent in 2020.

Following the conclusion of a disposals programme designed to refocus Babcock on its core capabilities as a critical defence supplier to the UK and international partners whilst strengthening the balance sheet, defence now accounts for roughly two thirds of group revenue, and contract wins are coming through.

The backdrop for defence and security equipment and services providers has visibly improved due to Russia's invasion of Ukraine and tensions between the west and China. This environment is favourable for Babcock, the second largest supplier to the UK Ministry of Defence with a leading position in the UK maritime defence sector.

The company owns and operates complex marine engineering infrastructure in the UK and undertakes 100% of the in-service support and deep maintenance for the UK's nuclear powered submarines fleet, as well as for a high proportion of UK surface warships.

BABCOCK IS CHEAPER THAN OTHER DEFENCE FIRMS

Cost savings are coming through and margins are set to recover, driving positive free cash generation in the year to March 2024.

Based on Shore Capital's 2024 and 2025 earnings estimates of 38.5p and 43.6p, Babcock trades on single digit prospective price-to-earnings ratios of 8.5 and 7.5, a discount to peers such as **BAE Systems (BA.)** and **Qinetiq (QQ.)** on double digit earnings multiples. This suggesting a rerating is overdue, while an imminent return to the dividend list offers an additional catalyst. [JC]

Chart: Shares magazine • Source: Refinitiv

Finding Compelling Opportunities in Japan

AVI Japan Opportunity Trust

Asset Value Investors (AVI) has been finding compelling opportunities in Japan for over three decades. Despite a year filled with challenges and volatility, Japanese equities fared relatively well.

Many investors may be surprised to hear of Japan's resilience during what was a difficult year for global equity markets. After all, Japan has suffered from stagnant growth and an ageing population for a prolonged period of time. However, Japan has a relatively stable economy and the attitude towards corporate governance has improved significantly since the onset of 'Abenomics'. Japan is now the world's second largest activist market. Activist events have risen 110%* over five years, as pressure from shareholders continued to intensify. This was accompanied by a surge in corporate buybacks as cash was returned to investors.

Excess cash is one of the things that the investment team at Asset Value Investors (AVI) look for in Japan. AVI's portfolio of 20-25 stocks are all companies that have been thoroughly examined by the investment team to find value, quality, and an event to realise the upside. Key to the strategy is to build relationships with company management, actively working together to improve shareholder value. While AVI can launch public campaigns, it aims to work behind closed doors with management to find mutually beneficial solutions. The depth of the investment team provides AVI the resources to undertake detailed and targeted research.

In 2022, our engagement was mostly behind the scenes. Over 120 meetings were held with 26 portfolio companies and 24 detailed letters or presentations were sent to these companies. This engagement is well supported by the broader changes in the attitudes of Japanese management as they are encouraged by the Japanese Corporate Governance Code to better allocate capital. The result is long term sustainable improvements in returns for investors.

As anyone who has invested in Japan will know, change takes time. Discovering overlooked and under researched investment opportunities requires a long-term approach. A long-term time horizon aligns AVI with the interests of the management to work together on creating shareholder value.

The companies AVI invests in have cash on their balance sheets and attractive business models with either stable earnings or structural growth trends to ensure corporate value is growing.

In 2018, AVI launched the now c. £149m* AVI Japan Opportunity Trust (AJOT). The strategy's first four years bears witness to the success of this approach, with a strong NAV total return and outperformance of its Japan small-cap benchmark. AVI's aim is to be a constructive, stable partner and to bring our expertise – garnered over three decades of investing in Japan. We are optimistic about the macro environment in Japan. The weak Yen makes Japan highly cost-competitive, both for tourism and manufacturing. Our portfolio includes a variety of sectors, with strong exposure to the domestic Japanese economy. Inflation has returned after a 40-year absence and with wage growth and increased spending, we expect to see better allocation of capital and improved productivity, which would support returns for investors. AVI is well positioned to capture this long-term opportunity with a unique investment approach and established track record.

Just Group remains attractive after strong full year trading update and confident outlook

More pension schemes are expected to bring forward their defined benefit de-risking plans

Just Group (JUST) 86p

Gain to Date: 13%

We highlighted the attraction of annuities and lifetime mortgages specialist **Just Group (JUST)** on 1 December 2022 based on its underappreciated transformation to positive cash generation and predictable cash flows.

With the bulk annuities market predicted to complete more than £600 billion worth of deals over the next decade according to consultant Lane Clark & Peacock, Just Group is well positioned to capture more of the market.

Pleasingly, the shares have moved up nicely, reflecting momentum in the business and stronger than expected trading.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

In early March the company delivered knock-out fiscal 2022 numbers with adjusted operating profit up 41% to £336 million which was way ahead of analysts' expectations.

Chart: Shares magazine • Source: Refinitiv

Higher interest rates have improved pension scheme funding levels 'materially', and strong deal momentum in the back half of 2022 has continued into 2023 with the firm signing its largest transaction to date at £513 million this month.

Strong trading drove organic capital generation of £134 million which Jefferies estimates was three times the consensus expectation and allowed the firm to increase the full year dividend by 15% to 1.73p per share.

The company reiterated confidence in achieving its 15% target growth in operating profits per annum on average over the next three years.

Analysts at JPMorgan Cazenove suggested the firm's £6 billion defined benefit pension pipeline meant there was 'upside risk' to the chief executive's forecast.

WHAT SHOULD INVESTORS DO NEXT?

While the shares have got off to a great start since we highlighted them as attractive, there is arguably more upside to go.

Analysts have increased their 2023 earnings estimates by around 10% since the beginning of the year which should continue to be supportive.

The shares trade on a lowly four times 2023 forecast earnings per share and well below net tangible assets of 170p per share which looks too stingy. We remain positive. [MG]

Investing in AIM shares for inheritance tax relief? Don't get caught out by these issues

We explain what happens if a BPR-qualifying company moves to a different market or is taken over

Investing in certain AIM stocks to obtain inheritance tax relief is a popular strategy, yet the rules can be complicated.

Given that two of AIM's biggest stocks are poised to leave the junior market – **Emis (EMIS:AIM)** in a takeover and **Breedon (BREE:AIM)** which wants to move to London's Main Market – investors might be asking how the rules work if you switch into a different qualifying AIM stock.

THE KEY RULES

Your estate won't have to pay the 40% inheritance tax charge upon your death for any investments in AIM stocks that qualify for business property relief, also known as BPR, and held for at least two years.

If a BPR-qualifying AIM company is taken over, you can passport the time accrued in the stock for IHT relief qualification. For example, let's say you held EMIS for six months. To retain the IHT relief 'time' built up, you would need to sell the shares before the takeover becomes unconditional. You reinvest the proceeds in another BPR-qualifying AIM company and after a further 18 months you will have built up a total of two years in qualifying investments and qualify for IHT relief on that part of your portfolio.

WHAT IF I BOUGHT SHARES IN THE SAME STOCK AT DIFFERENT TIMES?

Let's say you invested in EMIS on two separate occasions, 1,000 shares bought three years ago (which we'll call Parcel A) and 250 shares bought six months ago (Parcel B).

You sell the EMIS shares and reinvest the full proceeds into another BPR-qualifying stock. This is where you will need to have kept accurate records of all transactions.

Parcel A had been held for three years so already qualifies for IHT relief. You work out the amount received from selling those 1,000 shares and wherever you reinvest (it can be in more than one BPR-qualifying stock) that new investment will also qualify for IHT relief.

Parcel B had only been held for six months so you need to work out the value of the 250 shares sold and, wherever you reinvest, those new BPR-qualifying shares bought with the proceeds of Parcel B must be held for a further 18 months before that part of your portfolio qualifies for IHT relief.

Once you've hit the two-year qualifying period, you can sell the shares and have three years to use that cash as you wish. But you must be reinvested in qualifying AIM stocks before the three-year period ends to retain the IHT relief status.

'If the investor dies when still in cash, before replacement stocks have been purchased, the cash would be in the estate and subject to IHT,' notes Chris Boxall from Fundamental Asset Management, a specialist in AIM/IHT. 'Investing in AIM for IHT planning purposes really demands full investment at all times.'

By **Daniel Coatsworth** Editor

Shopping for **discounts**

UK investment trusts are trading at the widest discount seen since the financial crisis, according to recent research from Numis. The share price of the average investment trust was trading 13% below its net asset value in 2022, which suggests that there is value to be found in this well-established and diverse part of the UK investment industry. It could, therefore, be a good time for investors to be considering investment trusts as a buying opportunity.

DISCOUNTS EXPLAINED

Investment trusts are stock market listed companies, so their shares are subject to the forces of demand and supply. A stock market works by setting a price at which demand (the quantity of shares that investors want to buy) and supply (the quantity of shares that investors want to sell) are in equilibrium. As demand and supply change over time, you should expect a share price to move to maintain the balance between these two forces.

This is the same for all quoted companies, but with investment trusts there is an additional measure of actual value, against which the share price can be compared. This is known as 'net asset value' (NAV for short), and it is essentially the value of all the assets held in that investment trust's portfolio at a given point in time expressed on a per share basis. Most investment trusts release their

NAV every day, but some – particularly those that invest in less liquid or private assets – release their NAVs less frequently.

The presence of a NAV calculation means that investors get a regular look at the actual value of that investment trust which they can then compare to the prevailing share price to get a sense of how cheap or expensive it is. This is a key differentiator between investment trusts and other 'open-ended' investment vehicles such as OEICs, ICVCs and unit trusts, where the value at which investors can buy or sell units is determined explicitly by NAV, and supply and demand are instead balanced by changing the number of units in issue on a daily basis.

When the share price of an investment trust is trading below its NAV, it is said to be trading at a

Source: Numis

Illustrating investment trust discounts and premiums

An investment trust's share price is influenced by its NAV but can deviate significantly from it

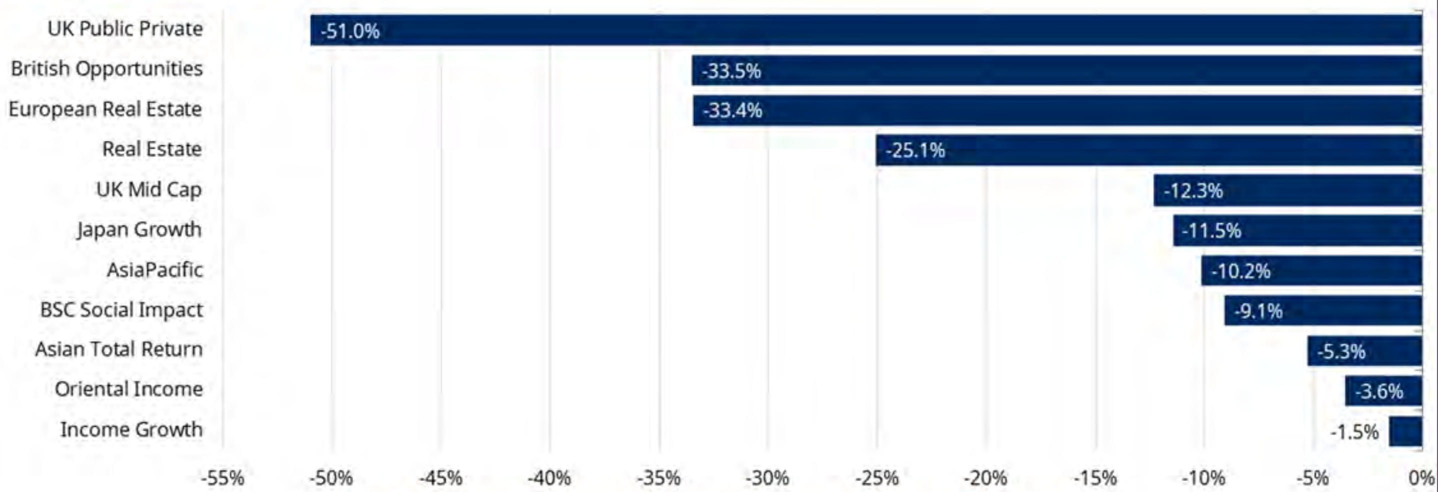
Source: Schroders. Fictional data used for illustrative purposes only.

discount. Conversely, if the investment trust's share price is above its NAV, it is said to be trading at a premium. The chart and table above and on the right should help to illustrate this with a simple example, showing how the share price and NAV of an investment trust interact over time. Put simply, an investment trust's share price will be influenced by its NAV but over time, it can deviate significantly from it in both directions.

	30 April	30 September
Share price	90.5p	115.5p
Net asset value	100.6p	105.0P
Discount / premium calculation	(share price – net asset value) / net asset value	
	= (90.5 – 100.6) / 100.6	= (115.5 – 105.0) / 105.0
	= -10.1 / 100.6	= 10.5 / 105.0
	= -10% discount	= +10% premium

Opportunities to buy Schroders investment trusts at a discount

Discount to NAV (%)



Past performance is not a guide to the future

Source: Schroders as at 28 February 2023.

WHY DO INVESTMENT TRUST SHARE PRICES MOVE AWAY FROM NAV?

Broadly speaking, if an investment trust is trading on a discount, it reflects slightly lower demand than supply. This can happen for a number of reasons, such as uncertainty about the outlook for the asset class the trust is invested in, or a lack of interest or liquidity in a particular market or investment theme. By contrast, an investment trust on a premium tends to reflect high demand as a result of elevated investor enthusiasm for a particular characteristic. Sometimes, however, discounts and premiums can arise simply because stock markets are not always totally efficient.

For investment trusts that release NAV data less frequently, a discount or premium may represent the market trying to estimate the change in the value of its assets since the NAV was last released. So, it is always important to try to understand why an investment trust share price has deviated from its NAV before making an investment decision. Nevertheless, a discount does effectively mean that investors have the potential opportunity to buy an asset for less than it is estimated to be worth. It's bargain hunting time!

WHICH SCHRODERS INVESTMENT TRUSTS ARE CURRENTLY AVAILABLE TO BUY AT A DISCOUNT?

As the chart on the previous page illustrates, all Schroders investment trusts are currently available to buy at a share price below NAV. Discounts (as at 28 February 2023) range from -1.5% on **Schroder Income Growth Fund plc**, through to -51.0% for **Schroder UK Public Private Trust plc**.

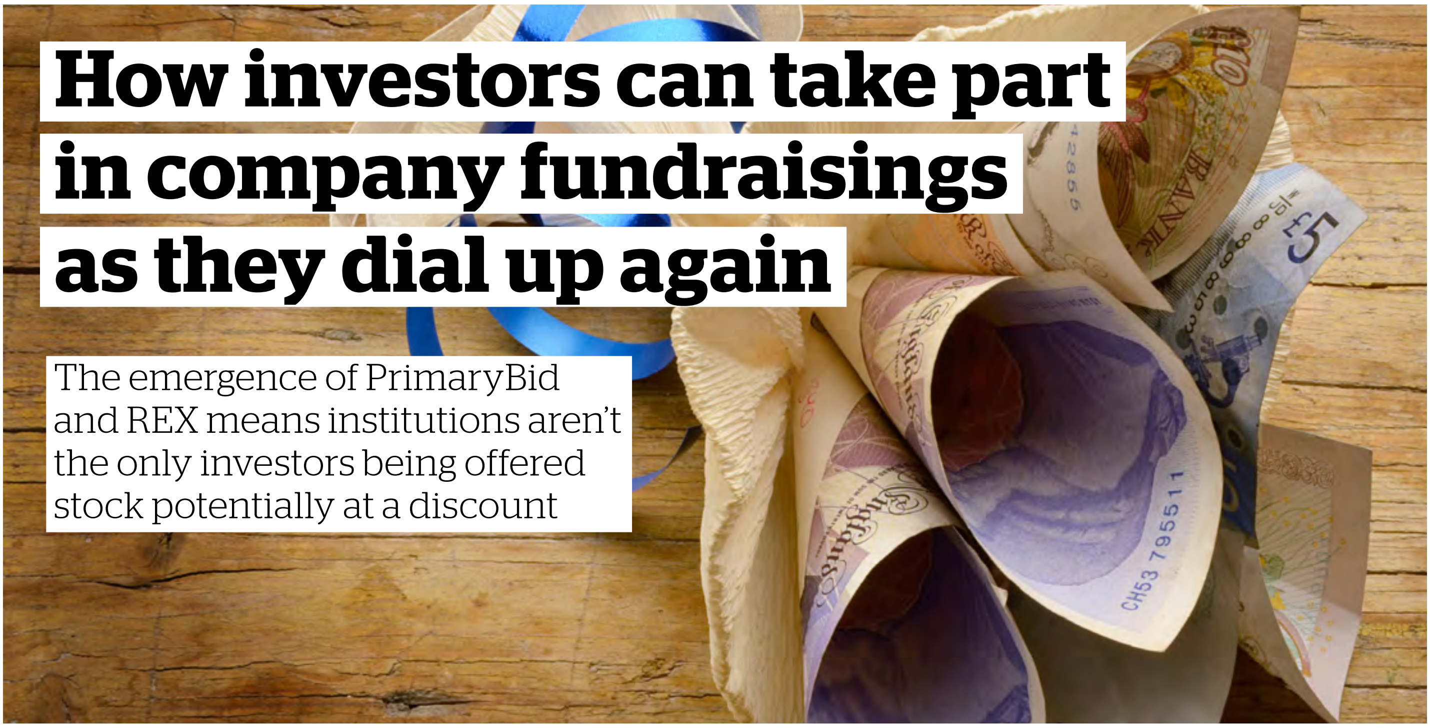
CONCLUSION

The fact that UK investment trusts have been trading at their widest discount for fifteen years suggests there are currently bargains to be found if investors look carefully. Due diligence is, as always, vital, and investors should do their research before committing to an investment.

We are confident in the investment proposition of each of Schroders investment trusts and would encourage investors to find out more to understand the individual attractions of the Schroders range.

The long-term chart at the beginning of this article suggests that the broad level of discount currently seen on UK investment trusts won't remain this wide forever. Happy shopping!

Find out more about Schroders Investment Trusts



How investors can take part in company fundraisings as they dial up again

The emergence of PrimaryBid and REX means institutions aren't the only investors being offered stock potentially at a discount

This year has brought some tentative optimism from investors linked to easing inflation and Chinese reopening. Corporate confidence is gradually recovering after the invasion of Ukraine brought fundraisings to a halt, with businesses beginning to tap the market for growth capital again.

In this article, we outline why the year ahead should see a rebound in equity fundraisings and explain how retail investors can get involved, often at attractive share price discounts.

SHARE-BASED FUNDRAISINGS ARE BACK

2020 and 2021 were bumper years for fundraisings on the London Stock Exchange; 2020 because the onset of the pandemic and lockdowns meant companies needed cash to shore-up balance sheets, 2021 as companies sought fresh funds to capitalise on an anticipated post-Covid recovery that was derailed by inflation and the Ukraine conflict.

After a subdued 2022, investment bankers are sharpening their pencils for an uptick in fundraisings this year. And given higher interest rates, companies are looking to raise equity rather than borrow to fund growth.

Oliver Brown is manager of **IFSL RC Brown UK Primary Opportunities (B905T77)**, a multi-cap fund that seeks to buy quality, typically dividend-paying companies when they raise money through placings or initial public offerings (IPOs). He recalls there were no big IPOs in 2022 and the last quarter was 'as quiet as it has probably ever been in my career'.

Yet he sees 'more positivity on the outlook' this year and believes there are 'plenty of good companies out there that will be seeking fresh capital in order to expand', with a smaller contingent wanting to protect and repair balance sheets. 'I would expect fundraising to grow throughout the year,' he adds.

'I think it will be back to a more normal year, over the £20 billion mark,' he explains.

London-listed fundraisings

Year	Proceeds ($m)	Number of issues
2020	$58,586	496
2021	$60,798	466
2022	$13,538	273
2023	$601	44

Table: Shares magazine • Source: Refinitiv

WHY EQUITY TRUMPS DEBT

RC Brown UK Primary Opportunities has invested in placings this year by US natural gas producer **Diversified Energy (DEC)**, which raised £134.9 million at 105p, a 5.2% discount to the prevailing market price and **3i Infrastructure (3IN)**, the investment trust which raked in £100 million at 330p, a 3.4% discount.

The fund has also supported quarried materials group **SigmaRoc (SRC:AIM)**, which raised £30 million at 54p, a 1.8% premium to the 53p market price, which it will use to acquire quarries and fund organic growth and carbon footprint reduction projects. Oliver Brown believes it is significant that SigmaRoc raised £30 million in equity and £10 million in debt for acquisitions.

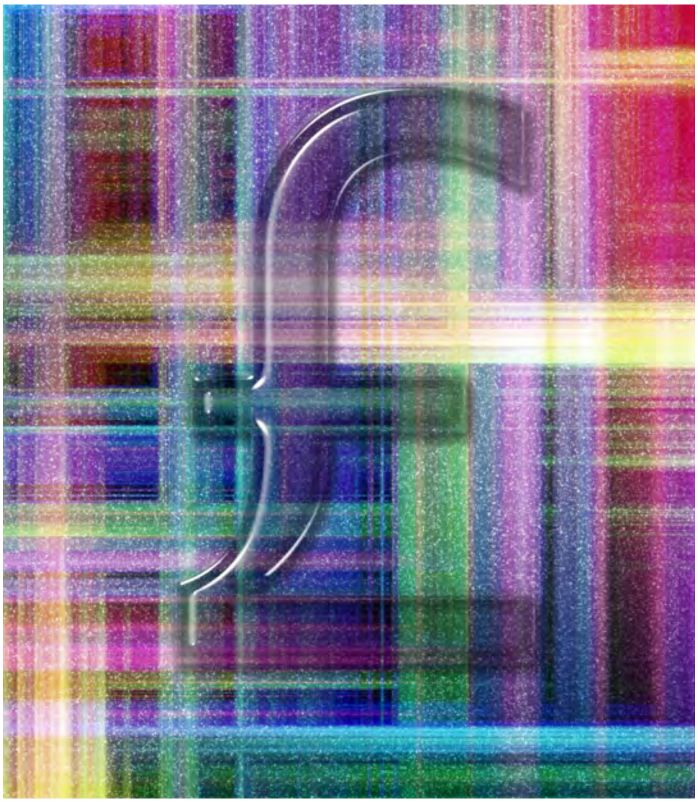
'Because the cost of debt has gone up, issuing equity is now more attractive than it was. More than ever, investors are very hot on how much debt a company has,' says Brown. 'We tend to buy into companies at the stage when they are raising money, so the fact that debt is reasonably more expensive and equity has become reasonably more attractive, and investors are less prepared to tolerate as much debt in businesses, means you are going to see equity raises.'

TRYING TO CREATE A LEVEL PLAYING FIELD

Public markets were created to allow everyone to invest in companies they believe in, but retail investors have been missing out on valuable share offers for decades as the technology wasn't available to enable retail inclusion at scale. Increasingly however, retail investors are being offered a chance to buy shares when companies raise money through IPOs or at a discount through share placings.

This level playing field has long been desired by smaller investors, who now have a regulatory tailwind at their back following the UK Government's Secondary Capital Raising Review (July 2022), which recommended that companies should give due consideration to including their retail shareholders in all capital raises as fully as possible.

Fundraising platform PrimaryBid enables individuals to invest in IPOs, placings and other deals, while the similar REX platform owned by broker Peel Hunt allows retail investors to participate in IPOs and fundraisings conducted as accelerated book-builds. REX is set to become a standalone business branded 'RetailBook' in the second half of this year.



WHAT ARE PLACINGS, RIGHTS ISSUES AND OPEN OFFERS?

A share placing is when new shares are issued to institutional investors, or small groups of investors for capital. This increases the amount of shares in issue and dilutes existing shareholders by spreading a company's profit over a larger number of shares, which decreases earnings per share. Usually new or 'primary' shares are only offered to institutions, which differentiates a placing to a rights issue.

The latter involves the issue of rights to existing shareholders that entitles them to buy additional shares in proportion to their existing holdings, within a fixed period and at a specified price. If a holder takes up their entitlement in full, they will own the same percentage of the company as they held previously.

Rights issues can be an effective way for companies to raise new money for acquisitions or to strengthen balance sheets and this fundraising method is often employed at times of crisis. **Lloyds Banking (LLOY)** used a rights issue to raise £13.5 billion in the wake of the global financial crisis

in 2009, for example, while the pandemic saw **International Consolidated Airlines (IAG)** and **Rolls-Royce (RR.)** announce multi-billion-pound rights issues to shore-up their balance sheets after the aviation sector was effectively grounded.

Rights issues aren't always welcomed by shareholders, as their discounted price tends to pull down the market price of a stock. But many companies would argue that's the price to pay to allow their business to grow – and that the longer-term benefits will more than compensate for the short-term pain.

An open offer gives existing shareholders the right to buy new shares in a company at a discount to the market price. You might also hear an open offer referred to as an entitlement issue. For example, if you owned 500 shares in a company, and an open offer is announced giving you the right to buy one share for every five you own, you could buy up to 100 new shares in total. Open offers and rights issues are similar, but one key difference is that with an open offer, you can't sell your rights in the market.

PROS & CONS OF TAKING PART

The key benefit of taking part in placings and other fundraisings is that you are typically able to buy shares at a discount to the prevailing price, and you don't pay stamp duty. Rarely is a placing done at a premium because then the investors could just buy the shares more cheaply in the market.

On PrimaryBid, retail investors have had an average discount of just under 10% across more than 170 deals since 2020, while in the year the platform completed its most deals – 2021 with 91 fundraisings – the average discount was still attractive at 9.1%.

James Deal, head of UK and co-founder of PrimaryBid, says shareholders deserve to have the opportunity to participate in public company fundraisings, especially when they are dilutive or at a price discount.

'Rewarding investors for their long-standing support is obvious and part of pre-emption. So too is broadening the register with new investors of the same type, i.e. retail interests. With technology, we can facilitate such inclusion for issuers with ease.'

PrimaryBid number of deals

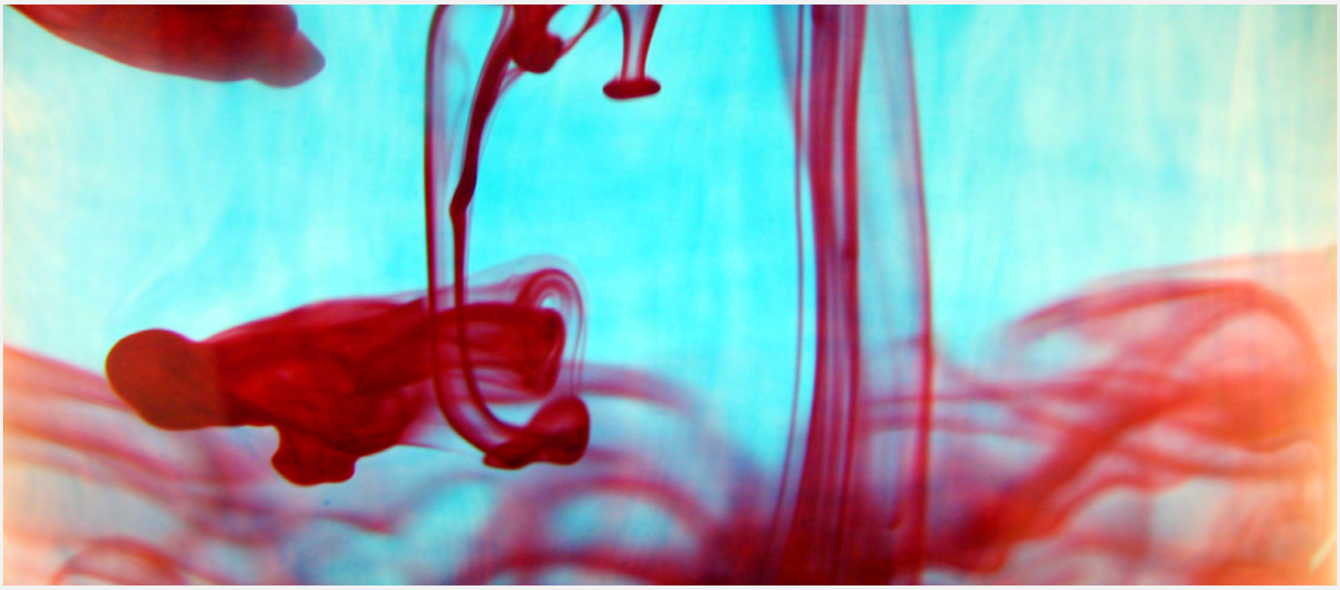
Year	Deals
2020	52
2021	91
2022	29
2023	1
Total	**173**

Table: Shares magazine • Source: PrimaryBid

PrimaryBid's average fundraising discounts

Year	Average discount
2020	−12.3%
2021	−9.1%
2022	−8.0%
2023	−5.1%
Total	**−9.9%**

Table: Shares magazine • Source: PrimaryBid



DILUTION & DIVIDENDS

Dilution through placings, rights issues and open offers affects the value of retail investors' holdings depending on the number of additional shares issued in the fundraising and the number of shares held by retail investors. Increasing the number of shares in issue means both earnings and dividends per share are stretched more thinly.

Here's an example using a hypothetical logistics firm, 'Cheetah FastFreight', which has a market capitalisation of £50 million with five million shares in issue. Let's say it has allocated £1 million to pay out in dividends or 20p a share out of earnings of £2 million or 40p per share. If it issued one million new shares the dividend per share would reduce to 16.7p and the EPS would be 33.3p. In other words, if retail investors don't participate in the placing, their share of earnings and dividends goes down materially.

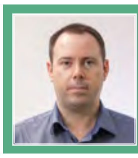
Aaqib Mirza, CTO of Peel Hunt who will become part of the RetailBook leadership, says that discounts through REX can vary, but the point to take away is 'retail investors are being treated the same as institutions, so it is a level playing field'. Traditionally, institutions were the beneficiaries of these fundraising discounts, but now everyone is being treated the same.

'We had a deal a week or two ago where the actual transaction was done at a premium to the close, so it is deal specific,' he explains. Since launch in 2015 more than 50 deals have completed on the REX platform, generating demand of more than £450 million from retail investors.

Participating in a fundraising also means you are investing in the growth of the business unless it is a company in distress. On the flipside, if you don't subscribe to the new shares being offered in a placing or open offer or take up your rights, your overall holding in the company will be diluted and you will suffer a decline in voting rights.

Also keep in mind that most of these placings happen after the stock market is closed for the day, so any retail investor without cash in their ISA or SIPP cannot sell an existing position in a different stock to raise money to fund their share placing application.

If you are not paying attention to messages from your investment platform provider, or studying the stock market announcements like a hawk, you might miss the placing opportunity. Investors typically have a short period – often just an hour – to apply for shares in the placing.



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

Are Harbour Energy and its rivals bluffing about leaving the North Sea behind?

Claims that the windfall tax wiped out profit do not tell the whole story

There was little doubt about the part of its latest results which **Harbour Energy (HBR)** wanted the market to focus on.

Whereas companies often look to flatter their headline profit numbers, the opposite seemed to be true when Harbour, previously known as Premier Oil, reported full-year results on 9 March. Pre-tax profit of $2.46 billion had effectively been wiped out by the energy profits levy with just $8 million left over.

Scratch below the surface and pleas of poverty do not stand up. The company generated free cash flow of $2.1 billion from which it was able to pay off more than half of its net debt and return $553 million to shareholders.

Harbour made what looked like a calculated accounting decision to book the impact of the energy profits levy all the way out to 2028 in its 2022 results.

The company, which has made it clear it will reduce headcount in the UK and could prioritise investments elsewhere, is not the only operator to decry the impact of the energy profits levy which effectively creates a headline tax rate of 75%.

Another major independent producer in the North Sea, **Enquest (ENQ)** is on record as saying it has deferred drilling on the Kraken field thanks to the windfall tax which it says will have an impact on its 'capital allocation strategy and UK production growth ambitions'. AIM-quoted **Serica Energy (SQZ:AIM)** has made it clear it is looking elsewhere for opportunities, even though it still believes in the 'importance' of UK oil and gas.

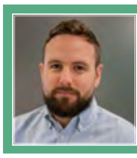
Their concerns matter as these independents will have to play a central role if the UK's remaining reserves of oil and gas are going to be exploited, with the big oil companies having already exited large parts of the North Sea.

When the levy was first announced in May 2022 Shore Capital analyst Craig Howie observed: 'The chancellor has actually handled it reasonably sensibly and pragmatically – particularly through implementation of a significant investment allowance.'

The problem is an 80% investment allowance was effectively reduced to 29% on everything except 'decarbonisation expenditure' six months later and the period over which the tax applies was extended by two-and-a-bit years.

It is the constant tinkering with the tax set-up in the UK which is arguably the biggest problem for North Sea producers and the one most likely to drive investment elsewhere. Developing an oil or natural gas field is a multi-year commitment and you need to have certainty to be able to budget and plan effectively.

More than once over the years this author has heard oil executives compare the UK's fiscal set-up and its instability unfavourably with locations you would think would be much more fraught with political risk. Food for thought.



By **Tom Sieber** Deputy Editor

Janus Henderson INVESTORS

Anatomy of a Good Company: **Hermes**

Jamie Ross, Portfolio Manager of Henderson EuroTrust, provides a snapshot of the typical analysis undertaken on every company considered for the portfolio. In this case, he explains the rationale behind the inclusion of one of the most prestigious luxury brands - Hermes.

There tend to be many features that most good companies have in common, but there are myriad characteristics and features to analyse that will be unique to each and every business. By undertaking a detailed analysis of the 50 or 60 companies we have on our radar (a portfolio of ~40 positions and a watch list of 10-20 names), we try to ascertain whether a business is a good business and if so, whether now is the right time to be invested or not.

In 1984, on a late-night flight from Paris to London, a chance encounter between Jane Birkin, the actress, singer and model, and Jean-Louis Dumas, the CEO of Hermes, resulted in a moment of inspiration that created the Birkin Bag. Nearly 40 years later, The Birkin is well established as Hermes' most iconic and desirable handbag. Demand for these bags significantly exceeds their carefully managed supply and even second-hand prices can be stratospheric. The Birkin is a wonderful example of the power of human desire for beautifully made, scarce items and it is this longstanding desire that drives powerful, resilient economics for a company like Hermes.

The history and heritage of the brand is a crucial driver of desirability for any branded goods company. The history of Hermes goes back a long time before the iconic Birkin was dreamt up. In 1837, Thierry Hermes opened his first workshop in Paris, specialising in harnesses. Made-to-measure saddles followed, with the establishment of a broader leather goods offering during the interwar period. Today, Hermes has grown into a global company employing nearly 20,000 people and generating revenues of over €11bn.[1] The power of the business today stems from the history and heritage of the brand.

You can't create heritage, you can't invent a history, but brand desirability is inextricably linked to the past. This gives companies like

KEY TAKEAWAYS

- Hermes carefully manages the volume of products it manufactures, tightly controls the distribution chain, and ensures that demand growth exceeds supply growth year-after-year. This helps drive brand desirability and pricing power.
- High gross margins enable Hermes to invest heavily behind the brand whilst also generating high levels of profitability. Meanwhile, long-term wealth creation and the growth of aspirational, middle-class consumers in emerging markets continues to drive growth.
- We take a long-term view when judging the merits of a particular company and this aligns with family owners who tend to care about the long-term wealth creation that comes from their stake in the company, rather than being concerned with short term profitability.

Hermes a huge competitive advantage and creates a powerful moat around their business. Hermes is a great example of a company with a carefully protected brand heritage – this drives attractive and durable economics for shareholders. We have owned Hermes since 2014 and continue to see attraction in the long-term investment case, the key pillars of which are laid out below.

Desirability, brand heritage, and limited supply drive attractive gross margin dynamics…

Heritage and history are extremely important elements of brand desirability. However, brands can lose their desirability over time. Hermes has consistently invested in its brand and has maintained exceptional manufacturing quality, with every Hermes bag handmade, and hand stitched in an artisanal workshop.

Another risk to a brand comes from the supply side. A desirable, aspirational brand loses its appeal the minute that supply exceeds demand – humans desire things that they can't have! Hermes carefully manages the volume of products which they manufacture, tightly controls the distribution chain, and ensures that demand growth exceeds supply growth year-after-year. Waiting lists are the norm for their most desirable products. This has helped drive brand desirability and, with it, Hermes' ability to charge prices significantly ahead of the cost of the raw materials used to make a particular product.

These factors – amongst many others – contribute to high (~70%) gross margins for Hermes.[1] These exceptional gross margins are a key element of the overall strong economics delivered by the company.

High gross margins enable Hermes to invest heavily behind the brand whilst also generating high levels of profitability…

High gross margins mean that for every unit of revenue that Hermes receives, they simply generate more profit and cash than a lower gross margin company would. This is extremely important and acts as a significant competitive advantage. It provides Hermes with the firepower they need to consistently invest in the brand and to grow the business. They spend less than you might imagine on Advertising & Promotion (circa. 5% of sales versus some peers at 10% of sales), but that is the beauty of operating such a well-known brand with such a long history behind it.[1] The strong presence of flagship stores helps build their brand presence as well as acting as a core sales channel; most of their operating costs are focused on investments behind their retail stores.

With 70% gross margins, Hermes is able to invest around 30% of sales in operating costs (advertising, costs associated with the stores etc) whilst still generating extremely healthy operating margins of around 40%.[1]

Low capital intensity and working capital needs combine with high margins to drive an attractive return on invested capital…

Though Hermes is a vertically integrated business, it is operating in an industry where capital intensity is not high. This factor combines powerfully with the high margin structure to ensure that Hermes generates a very attractive return on invested capital. In 2022, Hermes generated €4.7bn of operating income, and with a 29% tax rate, this resulted in net operating profit after tax of around €3.3bn.[1] From my calculation, its average invested capital for 2022 was around €5.1bn, meaning Hermes is currently generating a return on invested capital of around 65%.[2] This is exceptional when compared to the wider market. There are not many companies in Europe that can match this kind of economic performance.

Long term wealth creation and the growth of aspirational, middle-class consumers in emerging markets continues to drive significant growth…

For any potential investment, growth in revenues and earnings are not necessarily attractive or desirable. It all depends on how much capital is required to fund that growth and what return on capital the company is able to generate. As I have shown above, Hermes is able to generate very attractive returns on capital. Therefore, this is a company that we want to grow – we love it when they are able to deploy capital for further growth. Growth is a significant part of the attraction for us with a business like this.

In 2012, Hermes generated €3,484m in sales, by 2022, revenues have expanded to €11,602m.[1] Clearly, part of this strong growth (12.8% compound annual growth rate) is related to the strong desirability that Hermes has and their success in expanding to new customer groups in new regions.[3] However, an important reason for why we like Hermes simply relates to the industry in which they operate. The luxury goods industry has experienced significant growth over the past 20 years, driven by powerful structural themes, whilst Hermes has managed to consistently outgrow the sector; from 1999-2019, the sector has grown at a 7-8% CAGR, whilst Hermes has grown at an 11% CAGR.[4]

Global wealth creation is the most powerful sector driver. Over the past 20 years, global wealth has grown by 7% per annum and this is set to continue. The wealthy are getting wealthier, and the growth of the middle classes in China, India and other regions is helping to support global wealth creation. This is a major growth driver for the sector.[5]

Family ownership and control drives long term behaviour…

A final point worth discussing is the fact that Hermes is a family-controlled company. Different investors view family ownership in different ways. As a general rule, we like to invest alongside families that have been longstanding owners of a business. We take a long-term view when judging the merits of a particular company and this aligns with family owners who tend to care about the long-term wealth creation that comes from their stake in the company, rather than being concerned with short term profitability. Thus, family control allows the management team to think and act in a long-term way without being worried about whether they might be judged on shorter term metrics. This fosters the perfect environment for maintaining the power of a heritage brand; the long-term health of the brand should trump concerns over short-term profitability every time. With Hermes, we truly believe this to be the case and the family ownership plays a significant role in this.

Recently, the family behind Hermes have committed to maintaining their controlling stake in the until 2041 at the earliest. We see this as very good news.[6]

[1]Source: https://assets-finance.hermes.com/s3fs-public/node/pdf_file/2023-02/1676618361/slides-fy-2022-va-vdef.pdf

[2]Source: Henderson EuroTrust, 2023

[3]Source: https://finance.hermes.com/en/publications#

[4]Source: Citi Research – The Power of a 183-year-old icon, 26 June 2020

[5]Source: Credit Suisse – EMEA Luxury Goods: Entering a new dawn – 50 key questions for luxury investors, 8 November 2022

[6]Source: https://www.voguebusiness.com/companies/hermes-family-signals-plan-to-retain-majority-stake-until-at-least-2041#:~:text=The%20family%20members%20own%2054,through%20the%20holding%20company%20H51

Important information

Before investing in an investment trust referred to in this document, you should satisfy yourself as to its suitability and the risks involved, you may wish to consult a financial adviser. This is a marketing communication. Please refer to the AIFMD Disclosure document and Annual Report of the AIF before making any final investment decisions.

- If a Company's portfolio is concentrated towards a particular country or geographical region, the investment carries greater risk than a portfolio diversified across more countries.
- Some of the investments in this portfolio are in smaller companies shares. They may be more difficult to buy and sell and their share price may fluctuate more than that of larger companies.
- This Company is suitable to be used as one component in several in a diversified investment portfolio. Investors should consider carefully the proportion of their portfolio invested into this Company.
- Active management techniques that have worked well in normal market conditions could prove ineffective or detrimental at other times.
- The Company could lose money if a counterparty with which it trades becomes unwilling or unable to meet its obligations to the Company.
- Shares can lose value rapidly, and typically involve higher risks than bonds or money market instruments. The value of your investment may fall as a result.
- The return on your investment is directly related to the prevailing market price of the Company's shares, which will trade at a varying discount (or premium) relative to the value of the underlying assets of the Company. As a result losses (or gains) may be higher or lower than those of the Company's assets.
- The Company may use gearing as part of its investment strategy. If the Company utilises its ability to gear, the profits and losses incured by the Company can be greater than those of a Company that does not use gearing.

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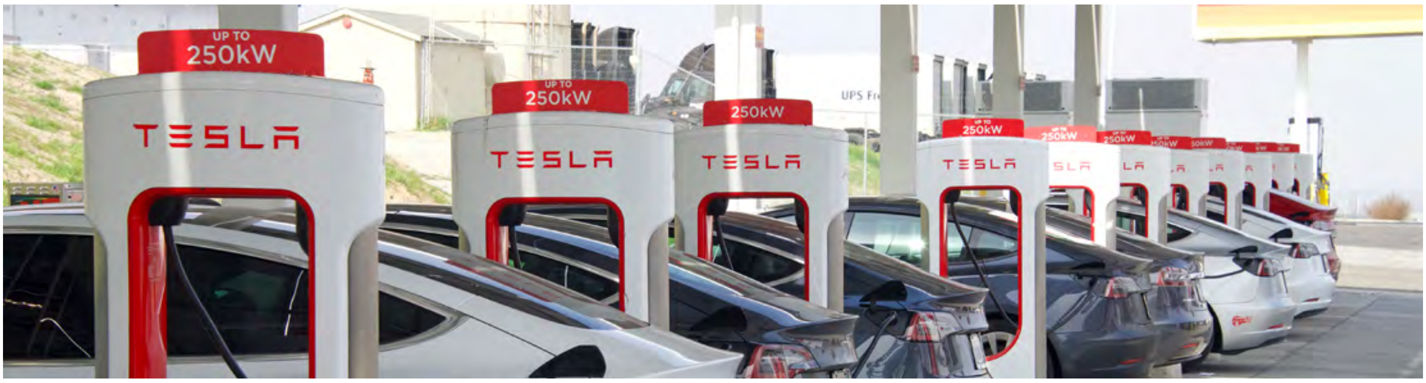

Where do investors stand after Tesla's 57% 2023 share price rally?

We look at how the electric vehicle company makes money and its plans for rapid growth in the energy space

The story of **Tesla (TSLA:NASDAQ)** continues to astonish investors, both fans and sceptics. In the early part of 2023, the share price had all but doubled (from the start of the year to 15 Feb), followed by sharp falls from that $214.24 peak a month ago. As it stands, the stock is about 57% up year-to date at $169.98.

It's a far cry from its pariah status of 2022 when shares in the electric cars-to-energy lost nearly 70% of their value.

The question is, what next?

A key part of Tesla's share price advance this year has been its price cuts. In January, the company lowered the prices of two of its most popular vehicles, the Model Y and Model 3, across US and European markets by up to 20%. The company cut prices again at the start of March.

'Our focus on continuous product improvement through original engineering and manufacturing processes have further optimised our ability to make the best product for an industry-leading cost,' is what Tesla said in a statement at the time.

'As we exit what has been a turbulent year of supply chain disruptions, we have observed a normalisation of some of the cost inflation, giving us the confidence to pass these through to our customers.'

As is so often the case with Tesla, investors have found themselves split over EV (electric vehicle) prices.

ARE PRICE CUTS A SIGN OF STRENGTH OR WEAKNESS?

'How do bulls like Dan Ives or Gary Black justify improving margins when the company is cutting selling prices and inventory is up?' asked Markets.com analyst Neil Wilson rhetorically. Dan Ives is an analyst at US broker Wedbush. Gary Black is a Future Fund managing partner and co-founder. Both are long-run champions of Tesla shares.

For the time being, investors seem willing to buy into the idea that price cuts across a number of models are not necessarily a terrible thing, if they can successfully lure Chinese buyers. The flipside is pressure on industry-leading margins which is yet to be fully reflected in Tesla's numbers.

How analysts rate Tesla shares

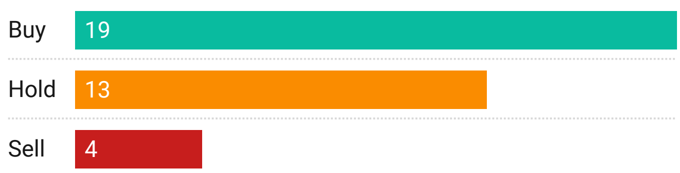

Chart: Shares magazine • Source: Koyfin

Investment bank Berenberg recently (8 March) downgraded its Tesla recommendation to clients from 'buy' to 'hold', admitting that Tesla's vehicle price cuts will hit gross margins in the short run, but still sees high margins long term.

'We see less upside in the shares after a 21% rise since our upgrade, putting them on a 1.3% free cash flow yield on our 2025 forecast,' it said.

Interestingly, however, Berenberg's Adrian Yanoshik increased his target price on the shares to $210, up from $200. That's more than 20% above the $173.44 where they closed on 10 March.

Tesla

Share price change (%)

Chart: Shares magazine • Source: FE Analytics

The Berenberg analyst wrote that 'misplaced fears of a price war' appear to have been accepted by the market and that volume opportunities will increase when Tesla releases its cheaper next generation vehicle. The analyst also says Tesla's valuation 'now leaves less room for disappointment'.

Price cuts in the auto industry are nothing new, but they are for Tesla. The company, which historically has been unable to keep up with demand, has seen its order backlog shrink from 476,000 units in July 2022 to 74,000 in December 2022. This has been attributed to Tesla's robust production growth, which saw 2022 production increase 41% over 2021 (from 930,422 to 1,313,851 units).

With the days of endless demand over, Tesla is going on the offensive by reducing prices, a move that puts pressure on competitors, but has also angered existing owners. Tesla's price cuts are an attempt to protect its market share, but they're not exactly the desperation move some media outlets have claimed them to be.

Recent data compiled by *Reuters* shows that Tesla's margins are significantly higher than those of its rivals, both in terms of gross and net profit.

CHEAPER CAR PLAN WAS LIGHT ON DETAIL

The four-hour Tesla presentations marathon at its investor day on 1 March was meant to get investors excited but many were left disappointed, lots of talk but little detail. We know Tesla wants to drastically reduce manufacturing cost and complexity to create cheaper cars, which it would do at the new manufacturing facility planned for Mexico.

That process would involve designing a new generation of power train that would eliminate the need for rare earth materials, cut silicon carbide

Tesla's market-leading profit margins

Company	Gross profit per EV	Net profit per EV
Tesla	15,653	$9,574
GM	3,818	$2,150
BYD	5,456	$1,550
Toyota	3,925	$1,197
VW	6,034	$973
Hyundai	5,362	$927
Ford	3,115	−$762
Xpeng	4,565	−$11,735
Nio	8,036	−$19,141

Table: Shares magazine • Source: Reuters, Visual Capitalist, Q3 2022. EV = Electric vehicle supply needs by 75%, shrink factory footprints by half, and be compatible with any type of battery chemistry.

But the new car rumoured to be attached to the more efficient power train was under wraps at the presentation (it was literally shown under a sheet in the slide deck) and Tesla said it wasn't going to share any new vehicle plans yet.

HOW DOES TESLA MAKE MONEY?

In 2022 the company derived $69.7 billion of its revenue from automotive sales and leasing and $1.8 billion from regulatory credits. In a push to reduce carbon emissions, governments globally offer credits as an incentive for carmakers to develop electric vehicles. Given this is Tesla's sole focus in terms of cars it automatically receives these credits and can sell them at an effective 100% bottom line to rivals who must have a certain level of regulatory credits each year.

While the company doesn't explicitly spell out the contribution of these credits to its profit, if we assume it is genuinely 100% profit, it represents around 9% of the adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) for 2022 of $19.2 billion.

Tesla revenue breakdown 2022

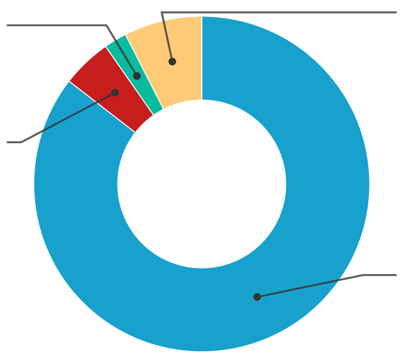

Chart: Shares magazine • Source: Tesla

That leaves some $10 billion of revenue derived from the other parts of its business: Energy plus Services & Other (repair and maintenance, service plans and sales of used Tesla vehicles). Energy is the part of the business that is often overlooked, but that's starting to change. Tesla's 'path to a fully renewable energy future' is a set of ambitious goals around solar energy and power storage.

'There is a clear path to a sustainable energy earth. It doesn't require destroying natural habitats, or for us to be austere,' Musk said. 'We could support a civilisation much bigger than earth's sustainably on earth, and I'm shocked by how few people realise this.'

The company's slide deck, as shared on Twitter, claims that only a third of the dirty energy generated on earth ends up being consumed in a useful manner. Tesla estimates that transitioning to green energy would require an additional 240 TWh (terawatt hours) of energy storage, 30 TW of new solar or wind generation, and an additional $10 trillion to break free of fossil fuels.

If investors believe Musk's presumptions, 2022 will not be Tesla's Energy arm's last record year.

Tesla Solar had a good fourth quarter with 100 MW (megawatts) deployed, but the company really shined with its energy storage deployment: Powerwalls and Megapacks. Tesla confirmed that it deployed a record 2.4 GWh (gigawatt hours) of energy storage in Q4, up 152% year-on-year and 300 MW more than the previous quarter, which was also a record.

It brings Tesla's total deployment for the entire year to 6.5 GWh, up 64% versus 2021.

A new factory in California did contribute to the record in Q4, but the ramp-up started in the middle of the quarter, which means that the impact will be felt more in 2023 as it takes time from the production of the Megapacks to their deployments at energy storage projects.

TESLA ENERGY HITS $1 BILLION MILESTONE

Tesla Energy revenues are running at more than $1 billion a quarter for the first time, and expectations are for this to rise rapidly, much faster than costs, which will help drive gross margins way beyond the 13% to 14% earned from Energy & Storage in Q4.

Tesla shares change hands today for around 27-times last year's $17.4 billion EBITDA. If the business is valued similarly on 2025 Berenberg EBITDA forecasts of nearly $36 billion, it would imply a market valuation of more than $1 trillion compared with around $550 billion today.

By **Steven Frazer** News Editor

LIFETIME ISA

Top investment strategies for your first home or retirement

By **Ian Conway** and **Tom Sieber**

Putting aside some of your disposable income on a regular basis to build up a deposit on a first home and take that initial step onto the property ladder is something everyone strives for, but did you know the government will give you thousands of pounds for free to do it?

Launched in April 2017, the Lifetime ISA is one of the less well-publicised savings products, but it can get you to that deposit target much quicker than you think.

You don't have to use it for a deposit – if you hold onto it until you are 60 you can take your money out and supplement your income or your pension.

WHAT IS THE LIFETIME ISA?

The Lifetime ISA is designed to encourage home buyers to build up a deposit for their first flat or house.

To open an account, you must be 18 or over but under 40, and you can pay in up to £4,000 per year as part of your £20,000 annual ISA limit until you are 50.

The government will add a 25% bonus to your savings, up to a maximum of £1,000 per year.

In theory, therefore, if you pay in £4,000 every year from age 18 to age 50 you could get a 'free' £32,000 from the government on top of your original savings of £128,000.

Once you turn 50, you can't pay into your Lifetime ISA or earn the 25% government bonus but your account stays open and earns interest or investment returns. You can hold cash, shares, or a mixture of them, and you get all the usual ISA benefits such as no tax on income and capital gains but there are strict rules on withdrawals.

You can only withdraw money if you are:

- Buying your first home;
- Aged 60 or over;
- Terminally ill with less than 12 months to live.

If you withdraw cash or assets for any other reason, you must pay a 25% charge based on your total pot.

There are also conditions on buying your first home, such as:

- The property must cost £450,000 or less;
- You can't buy a property until at least 12 months after you make your first payment;
- You must use a conveyancer or solicitor to act for you in the purchase – the ISA provider will pay the funds directly to them;
- You must apply for a mortgage.

If you're buying together with someone else who also has a Lifetime ISA and it's a first property for both of you, they can use their savings and government bonus too.

WHY SHOULD I OPEN ONE?

According to the Land Registry, which tracks all housing transactions in the UK, the average price of a house in December last year was £294,000, up 10% on the previous year, so getting on the property ladder is harder for many people.

However, it's worth pointing out the average is made up of everything from flats, which cost an average of £233,000, to detached houses, which cost an average £463,000.

Also, the data is a mix of prices for first-time buyers and owner-occupiers who are moving home, with the average price for a first-time buyer – who the Lifetime ISA is aimed at – averaging £245,000 against an average of £345,000 for people moving from one house to another.

According to the Nationwide, which tends to be more conservative in its calculations, the average UK house now costs six and a half times the average salary compared with around three times back in the early 1990s and a long-run average of four and a half times.

For first-time buyers, the UK average is about five and a half times their salary, ranging from just over three times in Scotland and the north of England to nine times in London.

In terms of how long it would take the average first-time buyer to get together a 20% deposit, assuming they set aside 15% of their take-home pay each month, those in Scotland and the north of England could have the money ready within six years, but for those wanting to buy in London it could take over 15 years.

10% deposit as percentage of gross income

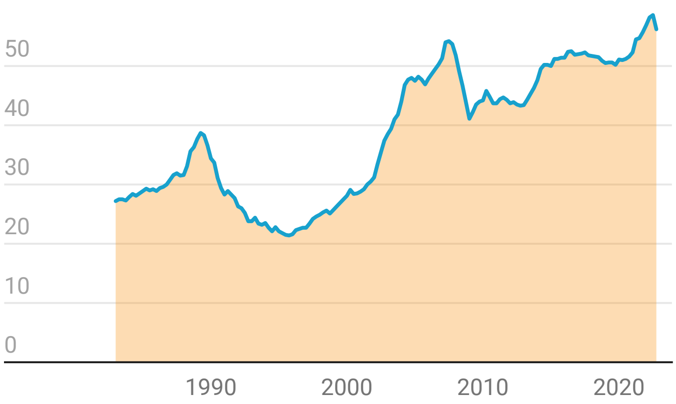

Chart: Shares magazine • Source: Shares magazine

In London, the average price of a property was £530,000 in January, around £250,000 above the UK national average and around 18% above the

UK house price earnings ratio (HPER)

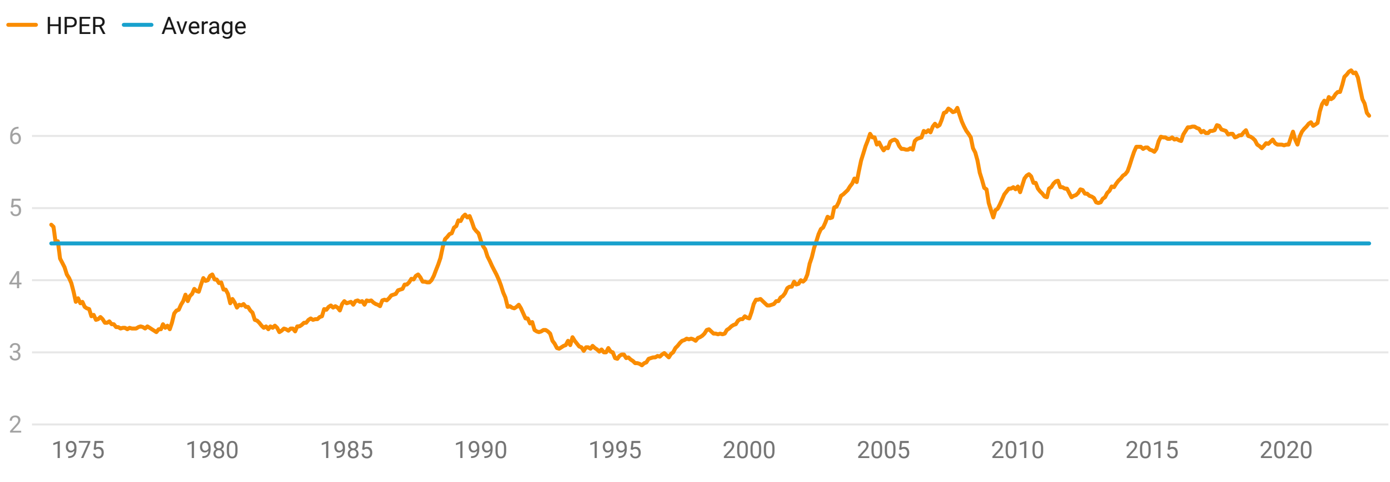

Chart: Shares magazine • Source: Nationwide upper limit for purchases using the Lifetime ISA, but that figure includes super-prime properties.

Most housing transactions each month, including in London, are for properties worth £300,000 or less, suggesting there is a liquid market for flats and smaller houses which are likely to appeal to first-time buyers.

For those who have their heart set on living in the capital, prices and deposits will be steep so it makes even more sense to start contributing to a Lifetime ISA and taking advantage of the government bonus as early as possible.

CAN YOU SHOW ME SOME EXAMPLES?

Let's use the hypothetical example of siblings John and Joanna, who are both 35, and have both been saving £4,000 a year for the last 15 years to put down a deposit on a house.

John has paid £4,000 a year into his ISA, which has grown at 5% per year, while Joanna has paid £4,000 a year into her Lifetime ISA and collected an extra £1,000 free each year, while her capital also grows at 5%.

For illustrative purposes, our calculation assume the Lifetime ISA has been available for 15 years even though it was only launched in 2017.

Thanks to the 25% government bonus, Joanna's savings have compounded at a higher rate than John's, giving her a deposit of more than £113,000 after 15 years against John's £90,000.

The difference is much more than the £15,000 extra 'free' money which Joanna received and demonstrates why starting early and choosing a Lifetime ISA over a standard ISA makes sense for those saving up for their first home.

WHAT IF I DON'T WANT TO BUY A HOUSE?

One of the great misconceptions about Lifetime ISA's is they are 'use it or lose it' product, like life insurance, and if you don't buy a house then you are somehow missing out.

Lifetime ISAs are perfect for someone who doesn't have a lot of disposable income but who wants to save for retirement and is happy to tie their money up for the long term.

You don't have to start at 18 but you still get the 25% government bonus on whatever you pay in up to £4,000.

For this example, we've taken cousins Sophie and Steve, who are both 50 and have been paying £4,000 into their savings every year for the last 15 years. For illustrative purposes we have assumed the Lifetime ISA has been around for more than a decade and the pair opened their accounts before they turned 40.

Steve has paid his £4,000 into a stocks and shares ISA which has grown at 5% per year, while Sophie has paid her £4,000 per year into a Lifetime ISA which has also grown at 5% per year.

As in the previous example, after 15 years Steve has a pot of £90,000 and Sophie has a pot of £113,000 thanks to her government bonus.

Steve's savings have grown to an impressive £147,000 by the time he is 60, but Sophie has done even better with her savings just topping £184,000. This is thanks to the fact she contributed to her

John and Joanna each invest £4,000 per year from age 20 to buy a flat

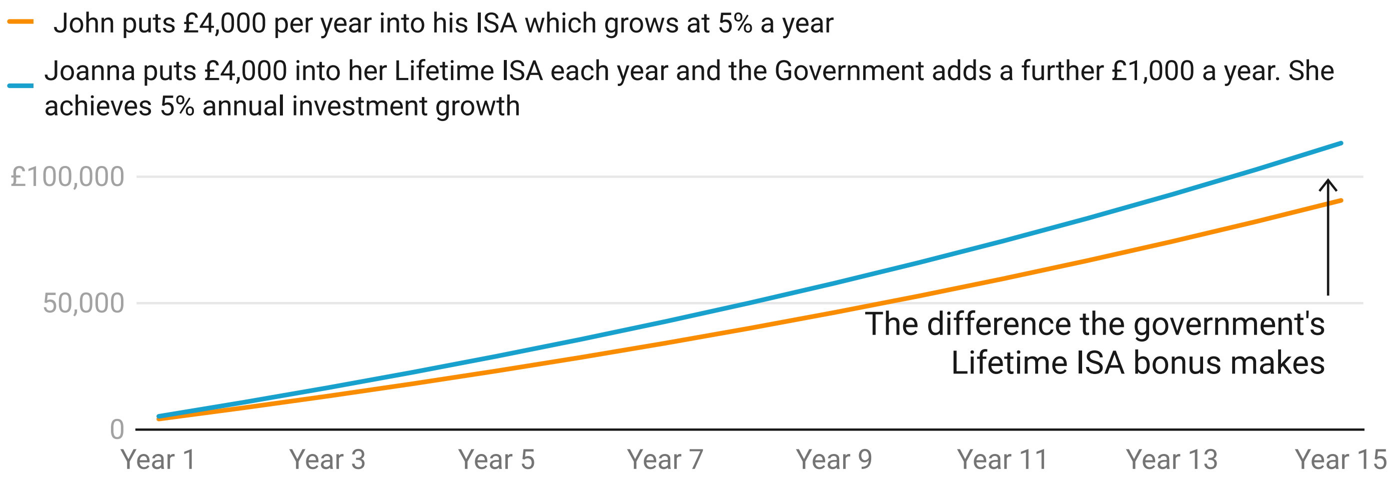

Chart: Shares magazine • Source: Shares magazine

Steve and Sophie each invest £4,000 per year from age 35 for their retirement and stop paying in aged 50

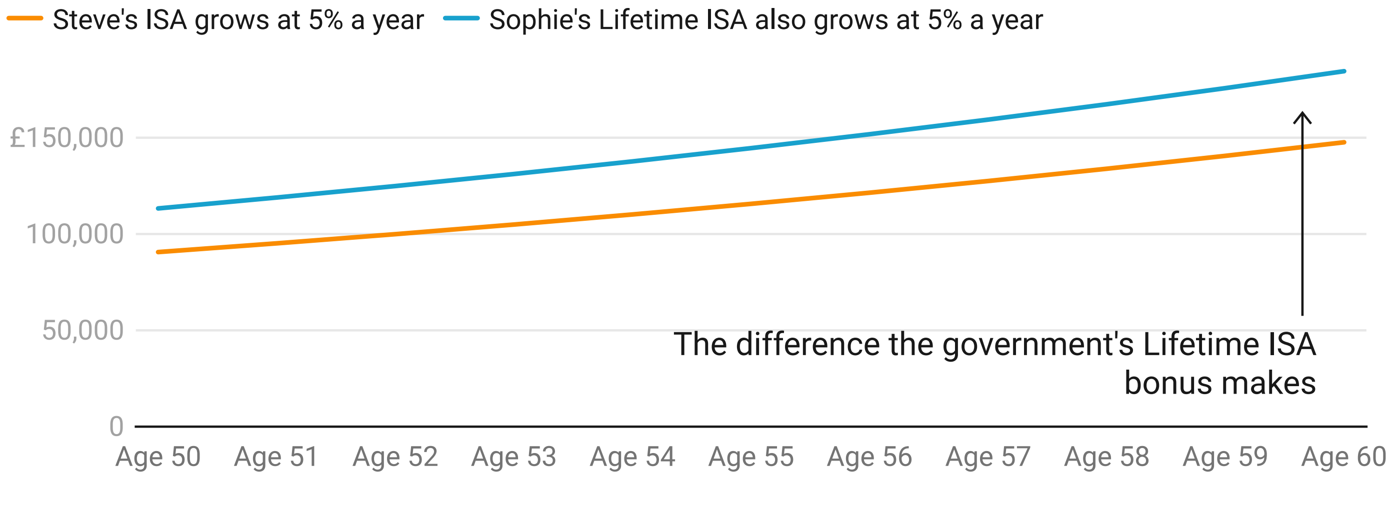

Chart: Shares magazine • Source: Shares magazine

Lifetime ISA for 15 years early in the process and received that bump of £1,000 per year.

The usual vehicle for retirement savings is a pension which comes with its own tax benefits attached and a much higher annual contribution limit of £40,000 or 100% of your qualifying earnings, whichever is lower.

For basic rate taxpayers the 25% upfront tax relief is akin to the Lifetime ISA government bonus payment, though additional and higher rate taxpayers can claim more relief on top for pension contributions through their tax return.

Even if a Lifetime ISA does not contain your main retirement pot it could be a useful ringfenced option for money you might want to use for a holiday of a lifetime when you retire, for example. Or for someone worried about breaching the lifetime allowance for pension contributions a Lifetime ISA could be a useful alternative for their retirement savings.

WHAT SHOULD YOU INVEST IN?

It is worth splitting this into three parts based on your investment horizon which will determine how much risk you can afford to take on.

FIVE YEARS OR LESS UNTIL YOU WANT TO BUY A HOUSE

In this situation, your best option is to keep your Lifetime ISA in cash. If you invest the money in the market and are caught out by short-term volatility you could end being without the full amount you need to lay down a deposit and your dream of a first home could be dashed. The Moneybox Lifetime ISA has a rate of 3.5% with a 12-month 0.75% bonus.

FIVE TO 10 YEARS UNTIL YOU WANT TO BUY A HOUSE

Having between five years and a decade before you want to purchase your first home gives you scope to take on a little more risk with the aim of making your money work a bit harder.

You could consider a multi-asset fund whose inherent diversification should help even out ups and downs in the market, and two solid investment trusts with a sensible approach to risk.

Offering global exposure to stocks, the investment manager of **Securities Trust of Scotland (STS)**, Troy Asset Management has a cautious approach which might suit someone using a

Lifetime ISA to buy a house within five to 10 years' time.

Steered by James Harries and Tomasz Boniek, Securities Trust of Scotland is an investment trust with a portfolio of what the managers consider to be solid and reliable businesses which do not require lots of money to grow and therefore have a steady stream of cash which they can return to shareholders.

Among the 33 holdings are **British American Tobacco (BATS)**, soft drinks and snacks firm **PepsiCo (PEP:NASDAQ)** and consumer goods firm **Unilever (ULVR)**. It trades at a discount to net asset value of 2.1% and has an ongoing charge of 0.93%.

Another investment trust to consider is UK-focused **City of London (CTY)** which has an explicit income focus. Again, there is a bias towards being conservative with investors' money. The trust targets income and capital growth from high-quality large companies with strong balance sheets. It holds defence firm **BAE Systems (BA.)** and publishing firm **RELX (REL)**, among others. It trades at a slight premium to net asset value, offers a 4.7% yield and has a low ongoing charge of 0.37%.

When it comes to multi-asset funds **Royal London Sustainable World Trust C Acc (B882H24)** has one of the best records over the last five years and offers an ethical focus for those for whom that is an important consideration.

As at the end of January 83% of its assets were in stocks and shares with 15% in bonds and the remainder in cash. This version of the fund automatically reinvests dividends for you. The ongoing charge is 0.77%.

10 YEARS OR MORE UNTIL YOU ACCESS THE CASH

If you have a decade or more before you need to access the cash, either because you're already on the property ladder and are going to use the Lifetime ISA as a retirement vehicle or you're young and have started very early with the aim of purchasing a property down the line, then you can afford take on more risk.

You have quite a lot of flexibility in terms of potential investments. We would suggest **Fidelity Global Special Situations W Acc (B8HT715)**, **Jupiter Asian Income (BZ2YMT7)** and **Henderson Smaller Companies (HSL)** as good starting points.

Managed by Jamie Harvey and Jeremy Podger, Fidelity Global Special Situations focuses on three distinct categories of company.

Those undergoing corporate change through restructuring, M&A or spinning off businesses; those with the ability to deliver higher-than-expected earnings growth; and unique businesses with a dominant market position, robust growth, cash flow and pricing power.

This approach has helped deliver annualised returns of 12% over the last decade. The ongoing charge is 0.92%. Holdings include **Alphabet (GOOGL:NASDAQ)**, **JPMorgan Chase (JPM:NYSE)** and **UnitedHealth (UNH:NYSE)**.

Managed by the experienced Jason Pidcock, Jupiter Asian Income is unusual in having no exposure to China, where growth has slowed, and geopolitical concerns have started to mount. A healthy weighting in Australian stocks means it is less exposed to emerging market risks than peers.

Over five years it has generated annualised returns of 8.7%. Holdings include **Woodside Energy (WDS:ASX)**, **Samsung Electronics (005930:KRX)** and **Singapore Telecommuncations (Z74:SGX)**. The ongoing charge is 1.01%.

A good small cap stock picker can often outperform the wider markets given their greater growth potential (which comes with an extra helping of risk), so Henderson Smaller Companies makes sense for someone with time on their side to invest.

Included in the portfolio are environmentally focused investment manager **Impax Asset Management (IPX:AIM)** and gaming firm **Team17 (TM17:AIM)**. The ongoing charge is 0.42% and the trust trades at a 10% discount to net asset value. The 10-year annualised return is 10.1%.

Orbis
Invest Differently

Four Principles for Choosing the Right Active Manager

The active versus passive debate has raged for years and has its supporters on both sides. However, most investors would generally accept that in the uncertain environment of the past few years their portfolio should be diversified. This includes the option of blending together the usually lower cost, market-hugging returns of passive funds with higher cost, active funds that offer the potential for higher returns in the long term.

However, that is easier said than done. For passive options there are many things to consider, but the key question remains price. Meanwhile, for active managers, the dilemma for investors and their advisers is in identifying skilled managers for the long-term.

This is especially important, given that data from S&P Dow Jones Indices shows that in the 10 years to 30 June 2022, 92% of sterling-denominated Global Equity funds underperformed the S&P Global 1200 index[1]. With similar figures for active managers in the US and elsewhere in Europe, some investors may question whether active managers are worth it at all.

Making the right choice

Of course, that doesn't mean investors should give up on investing altogether and keep their money under a mattress. It's just that instead of striving for the impossible – perfect performance – they should understand that even modest outperformance can make a big difference to their portfolios over the longer term.

But to achieve that modest outperformance, investors need to identify managers that have a particular set of skills. We believe there are four principles that can help narrow down the field that are typically overlooked by investors.

1. UNDERSTAND THE INCENTIVES

Incentives are strong drivers of human behaviour. Are the manager's interests are aligned with those of the end investor?

Key things to look for that show a manager is closely aligned with their investors:

- **Ownership structure –** Is the manager privately-owned, or are there external shareholders driving behaviour and focusing on shorter-term results? Also co-investment shows the manager has 'skin in the game'. It is worth asking your manager if they put their money where their mouth is.
- **Performance fees –** Do fees benefit the manager no matter whether they underperform or outperform or are they dependent on actual results?
- **Activism –** Does the manager make use of opportunities to potentially influence companies towards shareholders' best interests? Examples could include managers engaging on remuneration and corporate governance.

2. FOCUS ON THE LONG-TERM

Buying shares means investing in a business, so the manager needs to act like a long-term business owner.

This is sometimes ignored, as is evidenced by the fact that the average holding period for shares listed on the New York Stock Exchange in June 2020 was only 5.5 months. In which case, is the manager making decisions based on the long-term fundamentals, or on short-term noise?

[1]SPIVA® Europe Scorecard - Source: S&P Dow Jones Indices LLC, Morningstar. Data for periods ending 30 June 2022. Outperformance is based on equal-weighted fund counts. Index performance based on total return.
www.spglobal.com/spdji/en/research-insights/spiva/#europe

3. BE SCEPTICAL OF OVERCONFIDENCE – ESPECIALLY ABOUT THE FUTURE

The future is more uncertain than people believe, and many investors are prone to overconfidence in their assumptions and their ability to interpret information.

Though it is tempting to think that we can accurately predict the future, history tells us a different story.

The key is to accept no-one can predict the future, instead consistency of process is key. A manager who is focused on the long-term and has the conviction and ability to stick to their investment approach regardless of the market is more valuable than one who changes their approach based on the current market trends.

4. EMBRACE CREATIVITY

Your active manager should not oppose consensus for the sake of it, but rather be an independent thinker who evaluates arguments against commonly held views.

Humans like to stick with the herd and look at what other people have done, but this does not always produce good results, particularly in investing. This is because share prices aren't driven purely by the outcome of a particular event. Instead moves can be exacerbated by the difference between the outcome and what the market and other investors expected the outcome to be.

So, for contrarian investors it comes down to finding opportunities where the outcomes are likely to be better than the expectations.

Thinking differently
The more successful investors over the years are those that look at the wider picture, and many active managers have evolved to do just that.

At Orbis, we try to only invest in a company once we have a strong view of what it's worth (its intrinsic value) and aim to buy its shares at a price that is below that. But to do so, you have to understand the reasons why the seller is selling at a cheaper price.

Once the shares of a company go past our estimate of its intrinsic value, then we are happy to sell that on to other investors who may think there is further to go, as this allows us to invest those proceeds into something else that we think is undervalued.

Sometimes people say that contrarian investing, opposing the consensus, comes with more risk. But our view is that this approach can avoid the risk of overpaying for shares that are very overpriced.

Both active and passive investing approaches have their pros and cons. This is why it makes sense to have a blended portfolio, utilising the strengths of both to create a truly diversified and balanced portfolio. However, keeping in mind some simple principles when choosing the active element and looking at the situation from a different perspective can hopefully help make the decision a little less complex.

Higher rates on cash savings could drive more generous dividends from shares

Company directors and fund managers need to find a new way to encourage people to take the risk of investing

There is a powerful headwind for company directors and fund managers. It's an issue causing all kinds of a stir behind closed doors.

I'm talking about how you can get more than 4% on cash without taking any investment risks. Even the one-year gilt (UK government bond) is yielding 4.1%. That's very appealing for some people who can't stomach the ups and downs of the stock market. These figures are in line with the equivalent rate of interest from the FTSE 100, currently yielding 4%.

Many people are now saying 'why bother with equities?' and that's why company directors and fund managers are going to have to work harder to promote the benefits of buying shares or investing in an equity fund. Key to that argument will be greater focus on dividends.

Cash and gilts are deemed to be risk-free ways to make money whereas stocks and share-based funds come with the risk of your investment going down in value as well as up. Over the long-term, history has shown us that shares do best.

Why should someone take the risk now? The key argument is that a share or share-based fund can provide capital growth and income growth – something you won't get with cash. The market decides whether a share price goes up or down, and that's influenced by company success and external factors including sentiment, economics and politics. But the income portion is controlled by management deciding how much spare cash they can afford to return to shareholders.

> **"The income portion is controlled by management deciding how much spare cash they can afford to return to shareholders"**

I believe we could see companies become more generous with dividends to make their shares more appealing against cash. That in turn gives an asset manager holding these shares a better story by which to market their funds.

We've seen small caps go down the dividend carrot route in the past, such as when the commodity sector was in a decline and miners needed to attract investors so they started paying out more cash to shareholders. This time round, mid and large caps could be the areas of focus and we've already seen signs of more generous dividends over the past few months.

One might ask if a backdrop of high inflation and uncertain economic conditions is the time for companies to start paying out more cash.

David Cumming, head of UK equities at Newton Investment Management, argues that in some cases such as the banking sector, they can easily afford to pay out more dividends. He also sees little risk of companies over-distributing, which was the case pre-Covid in areas like oil and gas.

'The good thing about the UK market is that the cover ratio is about 50%. The free cash flow yield is about 7% to 8%, and you've got a 4% yield so you're two times covered. So, the quality of the dividend cover is quite good at the moment.

'Having stable dividends and a decent yield in an environment where you've got a bit more uncertainty, a bit less growth and a higher cost of debt, then those dynamics become a bit more attractive.'

While more dividends are good news for investors, just watch out for any company that is ratcheting up payments to shareholders while also juggling large debts and avoiding investment in its business. Getting more cash today is good but never at the cost of letting the business suffer.

How I invest: a mix of shares, investment trusts and a growth fund help me save for my family's future

Gordon uses his scrutiny of a company's management, leadership and strategy to make his investment choices

Gordon retired in his late 50s after a successful career in media planning including a period working for *The Sunday Times*. He is a big fan of investing and calls his SIPP (self-invested personal pension) 'my family's future'.

Dividing his time between a rented flat in Mexico City and a house in the UK, Gordon's investment journey stems from his interest in the general management of companies, their growth and productivity.

'I try to identify exceptional managers and boards which tend to speak out against the rest. I enjoy research and analysis; however, I'm not obsessed. I mostly own shares, one growth fund and several investment trusts. I don't buy ETFs.

'I have a balance of short, medium and long-term growth investments. I don't do bonds.'

INTERESTED IN GREEN ENERGY

Gordon is positive about the long-term future of alternative green energy source, hydrogen. He says: 'As a kid I read a piece in a national newspaper about experiments in developing hydrides as an aviation fuel. I think hydrogen makes the best sense long term particularly in the areas of aviation, shipping, and long-haul trucking. I see an amazing future for alternative combustible fuels, especially hydrogen.

'I have my eye on US-based electrical equipment manufacturing company **Plug Power (PLUG:NASDAQ)** as the company is ahead in hydrogen fuel for light industrial vehicles. I also have a watch-list of US infrastructure companies, but most are too expensive for me at present.'

ITM Power (ITM:AIM) – a hydrogen economy company – has also caught Gordon's eye as the company has a new CEO. 'I believe it has a solid long-term future making economic green hydrogen. I am convinced about the long-term future of green hydrogen as a significant part of the UK's energy integrity and security.'

Other sectors of interest to the investor include insurance where he has been impressed by Amanda Blanc, chief executive of **Aviva (AV.)**. 'Blanc has a keep it simple portfolio strategy, as well as personal honesty.'

The defence sector has also caught his eye as he believes NATO will continue to increase spending in the long-term. Gordon invested in defence, security and aerospace company **BAE Systems**

(BA.) two years before the Ukraine war and has also invested in defence and nuclear engineering services company **Babcock International (BAB)**.

STAYING INFORMED

Gordon invests every month and checks the value of his investments every week. He watches *Bloomberg* every morning to stay on top of the latest financial news but he doesn't belong to any investment clubs.

'I prefer my own counsel. I don't regret not having informed friends to discuss stuff, but I gather a lot of information from reading. I pick bits and pieces from the financial press, and I try and corroborate this with other sources.

'I try to look to change and to the future – the world, Europe, Asia. But I'm increasingly pessimistic about the UK and China. I make use of analyst notes, but some differ wildly in the forecasts. I don't spend too much time analysing company accounts or financial statements.'

Gordon says he avoids Latin America 'because I know the levels of corruption are endemic'. He adds: 'It seems to me that the emerging economies I looked at four to five decades ago are still emerging. I've never been tempted by investing in Russia and Eastern Europe. India has clearly been on the rise for some time, but I don't trust its politics. Brexit was an enormous mistake. There's more opportunity in the US, Europe, and the Association of South-East Asian Nations.'

PUTTING MONEY INTO INVESTMENT TRUSTS

Gordon's portfolio features a range of investment trusts including **JPMorgan Global Growth and Income (JGGI)**, **Murray International (MYI)**, **JPMorgan Claverhouse (JCH)**, **City of London Investment Trust (CTY)** and **Scottish Mortgage (SMT)**.

'I still place a lot of faith in their structures and managements who do all the heavy lifting in complex sectors and geographies and who are mainly, atypically in the finance world, decent folk.

'Baillie Gifford's strategy for Scottish Mortgage Investment Trust is brave, which is why I bought this long-term growth stock. Only disruptors can join the portfolio. I admired Clayton Christensen, the (now deceased) Harvard professor who created the concept of industrial disruption. Baillie Gifford, I believe, follows this principle even if unwittingly.

'However, I don't agree with the view that **Tesla (TSLA)** and the likes of **Tencent (0700:HKG)** justify such a large individual attention in Scottish Mortgage's portfolio. There are new disruptors appearing.'

TURNAROUND FAN

Gordon invests in **Rolls-Royce (RR)**, the aircraft engine specialist whose share price has doubled over the past six months. He says he has been impressed by the company's research and development capabilities and likes new chief

Rolls-Royce

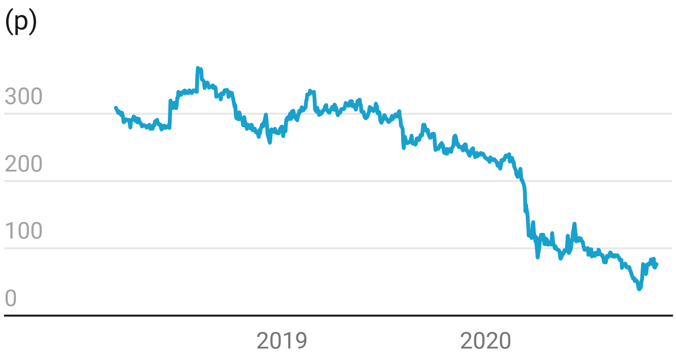

Chart: Shares magazine • Source: Refinitiv

executive Tufan Erginbilgic, albeit recognising that former boss Warren East planted the seeds of the company's turnaround plan.

He has put money into telecoms companies **BT (BT.A)** and **Vodafone (VOD)** as regular investments but 'on not much research'. He bought Vodafone when it sold a large stake in US network Verizon Wireless.

> **"I'm hoping Tullow Oil is a takeover target"**

Other shares passing muster with Gordon can be found in the financial sector. **Lloyds (LLOY)** is one of his legacy investments bought long before the global financial crisis of 2008 which triggered a big sell-off in banking shares.

He invested in insurance group **Prudential (PRU)** because of management change, international strategy – focusing on Asia and Africa – and divestments. 'It's going to be too exposed to China, Hong Kong is not independent anymore, so I'll sell if my investment appreciates by 30%.'

From the construction sector he holds housebuilders **Taylor Wimpey (TW.)** and **Vistry (VTY)**. The former he says has a large land portfolio and the latter has a hedge in its social housing commitments.

Gordon owns shares in oil and gas exploration company **Tullow Oil (TLW)**. He says: 'I'm hoping it's a takeover target or one day it will find water or gold instead of low-grade oil in Africa or Guyana. I took a risk on sensible governments in Africa not embracing Chinese or Russian investments.'

He also invests in energy giant **Shell (SHEL)** as he has faith in the people running the company. 'I believe its management is realistic about the need to continue with fossil fuel development in the medium-term. It also has a parallel strategy of investing in future technology. I'll probably take some profit when this phase's present rate of increase slows.'

FUTURE INVESTMENT PLANS

Gordon says he has a long-term strategy for decades; however, he has recently become 'more focused' after converting one of his pensions into a SIPP. By running his own pension scheme, a SIPP provides much greater investment choice than can be found with a typical pension found in the workplace or offered by one of the large life insurance companies.

'Over the past year, I've shifted the balance more to identifying long-term growth – such as Vietnam rather than China. A couple of years ago my portfolio was skewed towards growth with medium risk and with a balance of UK, European and global.'

DISCLAIMER: Please note, we do not provide financial advice in case study articles, and we are unable to comment on the suitability of the subject's investments. Individuals who are unsure about the suitability of investments should consult a suitably qualified financial adviser. Past performance is not a guide to future performance and some investments need to be held for the long term. Tax treatment depends on your individual circumstances and rules may change. ISA and pension rules apply.

By **Sabuhi Gard** Investment Writer

How do I top up National Insurance contributions now the deadline has been extended?

Act now to help boost state pension payments when you retire

I understand that the deadline for topping up your state pension National Insurance has been extended from 5 April to 31 July – is this correct?

As a mother who raised children and only worked for a limited number of years, I have many 'missed' years. I have just turned 60 and understand that I can pay all the years' National Insurance contributions until 2030 now to go from a state pension of £105 per week to £145 but topping up the missed years' National Insurance contributions could raise this to £185. How do I do it?

Karen

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

Two weeks ago, I answered a question about paying voluntary National Insurance ('NI') contributions to boost state pension entitlement.

At the time I wrote that article, the deadline for making the most of transitional arrangements which allow you to go all the way back to 2006 to fill any NI gaps and potentially boost your state pension entitlement was 5 April. Usually, you can only pay voluntary NI for the previous six years.

However, things have shifted quickly. Publicity around the deadline led to government phone lines becoming overwhelmed. This in turn created the risk people who could benefit from paying voluntary NI might struggle to do so because they were stuck in a phone queue.

In light of this, the government has extended the deadline to 31 July. Anyone who thinks they might benefit from paying voluntary NI should still aim to speak to the Future Pension Centre as soon as possible, rather than putting it off and risk being caught in another telephone logjam when the new deadline comes closer.

The Future Pension Centre should be able to tell you whether paying voluntary NI will increase your state pension entitlement. This article has more information about paying voluntary NI to boost your state pension entitlement and what you need to consider.

One thing to note: you can only fill historic NI gaps – it is not possible to buy NI for future years. This link has more information.

If you have spoken to the Future Pension Centre and decided you want to pay voluntary NI, you can contact HMRC to find out how much topping up will cost and get an 18-digit reference number. This link has the details.

Once you have your reference number, you can pay HMRC directly through your bank or building society, online or in branch, or you can pay by cheque.

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.

BlackRock

THE ART OF PICKING A GOOD STOCK

Finding resilient companies becomes particularly important at times of weak economic growth. At BlackRock, our analyst team are looking for certain key characteristics to identify companies that can thrive even in tough times.

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Picking the strongest companies is always important, but it is particularly important in the difficult economic environment that faces investors as they make their ISA choices this year. While weaker companies might be able to limp on in more robust economic conditions, they will be exposed in a tougher climate. What are the key criteria for a company that can thrive across different market conditions?

There are important differences between a strong and weak economic environment that can have a real impact for companies' profitability. Interest rates, for example, will make a significant difference. If interest rates are low, it allows companies with high debt to stay in business. The cost of repaying that debt is lower.

As interest rates rise, that debt becomes more expensive and takes up a larger share of the company's costs. This is often one of the biggest risks factors for companies in a weaker economic environment. Their profits drop, they cannot pay their debts and eventually, they go bankrupt. As Warren Buffet said: "With long-term debt, increases in interest rates can drastically affect company profits and make future cash flows less predictable."

PRICING POWER

It is a similar situation with pricing power. Pricing power is the ability for companies to raise prices of their products and services. They may be able to do this because they have a strong brand, or their products are in high demand, or, as in the case of areas such as healthcare, their product is unique. Pricing power is always important, but it becomes particularly important at a time of rising costs.

A lot of companies are facing this problem today. Energy costs are rising, alongside higher agricultural prices. Rental costs may also be increasing and staff are demanding salary rises to match inflation. If they can't pass those additional costs onto consumers, it will hurt their profitability. Equally, during tough economic conditions, the pie gets smaller. If customers don't have a compelling reason to buy a product, they won't. Against this backdrop, pricing power becoming more and more important.

CAPITALISING ON TOUGH TIMES

Companies that go into a tough climate in a strong financial position can capitalise. Their indebted, weaker competitors may go bust. This may allow them to build market share, buy their competitors or the assets they leave behind, at a cheaper price. Good companies will often emerge from difficult conditions in a stronger position than they went in.

This is also where a strong management team can be vitally important. A good, experienced management team will understand how to adapt the business to changing conditions, to make strategic acquisitions or sales, which areas to prioritise and where to cut back. They will understand how to put the company in prime position for the recovery when it arrives.

[1] 12/12/22 - https://www.azquotes.com/quote/709461

BlackRock.

The problem for investors is that these strong, well-run companies can be expensive. Investors see their qualities and the share price may be bid higher. No matter how good a company, if investors pay too much for it, it won't be a good investment. However, in turbulent market conditions, share prices will often be lower. This can make it a good moment to buy into strong companies at a lower cost.

OUR APPROACH

A strong analytical team is a significant asset in a difficult environment. Fund managers need to have the resources to look at a company from all sides, talk to its competitors, its suppliers and its management team. The fund managers across BlackRock's range of investment trusts can call on a deep global analyst team, with specialists across every sector and in every region.

Competition for capital is a feature of all our portfolio. We run high conviction portfolios and are not swayed by the benchmark weighting of an individual stock. The bar for entry into the BlackRock portfolios is high.

In building these high conviction, stock-picking portfolios, the investment trust structure is helpful. The closed-ended structure of an investment trust means the underlying portfolio isn't skewed by the need to manage inflows and outflows. The portfolio will always reflect the fund managers' best ideas, rather than being constrained by the need to buy or sell in a hurry. This can be particularly important in holding the shape of a portfolio in the face of difficult markets.

The final consideration is risk management. Again, this is particularly important at a time of weaker economic conditions when companies may be vulnerable to specific threats. We strive to understand where our risk positions are at any given time – exposure to interest rates, to the oil price, to volatility – and have significant risk resources at our disposal.

Although there may be concerns about the outlook for 2023 – and a temptation to play it as safe as possible with this year's ISA choices - good companies can thrive in all market conditions. The key is finding them. At BlackRock, we have built the infrastructure to find those opportunities wherever they may lie.

For more information on BlackRock's range of investment trusts, please visit www.blackrock.com/its

TO INVEST IN THIS TRUST CLICK HERE

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Danni Hewson: Insightful commentary on market issues

High street comeback: companies are back in expansion mode again

Forget recession fears, many businesses are preparing for the future with new store openings

Despite obvious concerns about a depressed consumer, eye wateringly high energy bills and increased labour costs there are more than a few verdant green shoots springing up on UK high streets and retail parks. A whole host of names, household and less well-known, have announced expansion plans as some businesses continue their post-Covid rebound.

From **Starbucks (SBUX:NASDAQ)**, **Greggs (GRG)** and **Marks & Spencer (MKS)** to Aldi, Wagamama and the brilliantly named Boom Battle Bar, all have put new premises on the drawing board for 2023.

Some investment comes at the cost of other closures. Marks & Spencer is planning 20 new, full line stores in prime locations whilst shutting more than 60 lower productivity sites. Wagamama owner **Restaurant Group (RTN)** is trying to get investors back on side with plans to open five of the popular Asian eateries a year while closing down 35 underperforming casual dining restaurants from its other, more tired brands.

It seems the consumer is still prepared to spend some cash but it's more particular than ever about where, when and what it spends that cash on.

Reimagining store estates is nothing new but in the past where the focus has been about cost-cutting, today's moves have a lot to do with cost opportunities.

Landlords have been through the Covid wringer too, and even before that, the shift to online shopping had started a rush away from bricks and mortar leaving huge holes at the centre of some communities. Not all those holes will prove tempting, companies are using complex data programmes to ensure they're picking the right spots to invest in.

It's not just about footfall or even about the patchwork quilt of stores that surrounds them but about the quality of the consumer that's regularly attracted to a particular area.

BOOMING TRENDS

The ongoing shift to homeworking has meant bars can't assume robust trade will spring from the post-work-crowd fleeing offices at 5pm on Friday. Instead, they've got to think more creatively with some like Boom Battle Bar-owner **XP Factory (XPF:AIM)** creating destinations with an experience that can't be found in many other places.

XP Factory's revenue increased by a rather extraordinary 300% last year as it responded to demand for venues that delivered a unique night out, pairing augmented reality axe throwing and beer pong with cocktails and reasonably priced food. The business achieved early success with its escape room format, but the new model seems to have captured the mood of post-lockdown revellers.

In what could be seen as a remarkable 180-degree mindset shift, coffee chain Starbucks has announced huge expansion plans in the UK –

Consumer card spending growth in 2022

Bars Pubs & Clubs	53.6%
Hospitality & Leisure	45.1%
Restaurants	37.1%
Non Essentials	12.9%
Clothing	11.2%
Essentials	6.3%
Grocery	−0.1%
Retail	−0.8%

Table: Shares magazine • Source: Barclays

only last summer press reports suggested it might sell its UK operations entirely.

A 37% increase in revenues last year might have had some sway in the company's decision-making process. Posh coffee has become one of life's staples and an affordable treat at a time many people are being forced to cut back on bigger purchases.

DRIVING GROWTH

Crucially, Starbucks is thinking about the user, how people want to buy their coffee and in 2022 it reported further investment in its drive-thru outlets as demand went from 'strength to strength'.

That limited contact purchasing came to the fore during lockdowns when enterprising businesses flipped their operations on their heads and used the click and collect model to allow them to keep making money.

Social distancing might be a phrase resigned to the history books, but it was the mother of invention and with people back on the road savvy businesses are choosing to keep and even expand that method of delivery.

And it's a trend that's picked out in the latest update from real estate investor **Custodian Property Income REIT (CREI)** which constantly seeks to refurbish or redevelop its portfolio to achieve maximum return for its investors. With business sentiment pretty ropey over the past year it's had to work hard to maintain the right mix of property in the right places.

Drive-thru options add value, not just for the traditional burger joints but also luring in smaller independents looking to grab as much of the market as possible.

Again, it's back to those metrics and technology isn't just useful for picking locations, it's an integral part of the economic landscape and with huge leaps forward in AI technology businesses need to keep investing to stay ahead of the curve.

Inflation, interest rates and the squeeze on budgets might make headlines but investors are looking to the future.

Inbound travel is back, employment levels are holding up and there is the little matter of a May bank holiday bonanza which is likely to give a boost to travel, retail and hospitality sectors.

There will be losers but there will also be winners, sometimes in the most unlikely places. No one thought sausage rolls on t-shirts would be a best-seller, but Greggs' merchandise tie-up with Primark made it work, and its cafes can now even be found in a number of the fashion retailer's stores. It's clear that innovation and investment are creating fresh excitement on the once-beleaguered high streets.

ADVERTISING FEATURE

Elephants Can’t Gallop

Initially coined by Rudyard Kipling, the adage that “Elephants can’t gallop” was adopted by famous UK small cap investor Jim Slater in the early 1990’s, when he observed that “for management to double the value of a £10bn company takes many years of hard work, whereas to double the value of a smaller company is an easier task”.

The managers of Scottish Oriental Smaller Companies Trust would agree that the scale of the opportunity of investing in smaller companies is exceptionally attractive. The challenges of picking the right smaller companies are different from their larger peers, and the trust has a track record of almost three decades of dealing with these challenges successfully.

Scottish Oriental Smaller Companies Trust plc was initially listed in 1995, raising £23.7 million with a mandate to invest in smaller Asian companies. Over the following 27 years, the Company has navigated dramatic changes in its operating environment. The large markets of the time, such as Malaysia, Singapore and Hong Kong, have been eclipsed by the emergence of China and India. Scottish Oriental has evolved with market dynamics; the definition of what constitutes a smaller company has also evolved to reflect the impact of inflation, from US$ 500 million in 1995 to US$ 5 billion today. The NAV of the trust has increased to £337m.

Over its entire history, Scottish Oriental has been managed by four different lead portfolio managers. Through all of these changes, the Trust has been anchored by the investment philosophy set out in the first Annual Report. Its key tenets, shown below, still hold true today.

THE SCOTTISH ORIENTAL SMALLER COMPANIES TRUST PLC

Manager’s Review

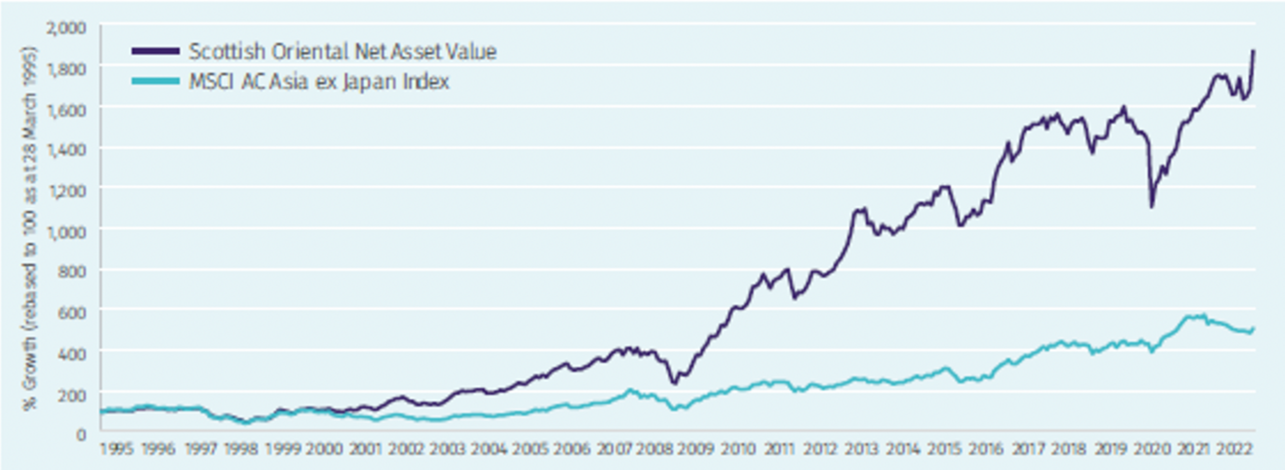
INVESTMENT PHILOSOPHY

- We aim to maximise the rate of return with due regard to risk. Risk is contained by focusing on soundly managed and financially strong companies, and by ensuring that the portfolio is well diversified geographically and sectorally at all times.
- Whilst, cultural, political, economic and sectoral influences play an important part in the decision-making process, the availability of reasonably-priced companies with solid long-term growth prospects is the major determinant of investment policy.
- Our country weightings bear no relationship to regional stock market indices. Regardless of index significance, we do not consider ourselves obliged to hold investments in any individual market.
- Although considerable attention is paid to "value" , we are primarily "growth" investors. As most regional companies are family controlled, value on its own (ie. unless associated with assets per share, sales, cash flow and/or earnings growth) is generally ignored by the market.
- Existing holdings are scrutinised constantly to ensure that our corporate performance expectations are likely to be met, and that market conditions are not excessive. Where otherwise, disposals are made.
- Strong emphasis is placed on frequent visits to countries of the region and on meeting the management of those companies in which we are invested, or might invest.

Growth in initial investment

Growth in an initial investment of £1,000 at launch	As at 31 December 2022
Scottish Oriental Net Asset Value	£18,448
MSCI AC Asia ex Japan Index[1]	£4,775

1 The MSCI AC Asia ex Japan Index is used as a comparison as the MSCI AC Asia ex Japan Small-Cap Index was not available at the time of Scottish Oriental's inception.



This investment philosophy has held the Trust in good stead. An investment of £1,000 made at the inception of Scottish Oriental would have returned a net asset value of £18,448 today, compared with £4,775 if the same sum had been invested in the MSCI AC Asia ex Japan Index[1].

The Trust is no stranger to operating in uncertain economic environments. At the time of its inception in 1995, there were fears of rising interest rates, substantial currency depreciation in Asian economies and worries about the fallout from the collapse of Barings Bank. Bottom-up investors like us also faced challenges of smaller companies in Asia having short listed track records and the regulations protecting minority shareholders being at their early stages of evolution. Despite all of these risks, being a shareholder of Scottish Oriental since inception would have been a rewarding experience.

While the characters are different today, the story has many similarities. The lockdowns in China and the worries about rising inflation, interest rates and weakening currencies create a comparable investing environment. The market leading businesses in which Scottish Oriental invests have faced several crises during this period and have emerged stronger from each of them. The universe of smaller companies in Asia is much larger, their listed track records are longer and the regulations protecting minority shareholders are also well established. Bottom-up stock pickers like us have a more favourable hunting ground than we have had in the past.

This is reflected in the Trust's portfolio, which is more consolidated among its highest conviction holdings than it has been historically. The earnings growth expected for the portfolio is high as companies recover from the Covid-19 disruption, while returns on equity (ROE) is also strong. Despite the higher growth and ROEs, the portfolio's valuations are cheaper than in past years. With this portfolio of market leading businesses poised to emerge as the large companies of the future, we are excited about the Trust's prospects in the coming years.

If you would like to hear more about Scottish Oriental and the management team, Sree Agarwal, the deputy portfolio manager is presenting an AJ Bell Webinar on March 21st at 18.00 UK time, click here for more details and to register.

[1] The MSCI AC Asia ex Japan Index is used as a comparison as the MSCI AC Asia ex Japan Small-Cap Index was not available at the time of Scottish Oriental's inception.

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Why investing in your 60s doesn't mean the end of investing for capital growth

With an investment horizon which could still run to more than two decades, stocks can remain a part of your retirement plan

Everyone's circumstances are unique but for most people entering their 60s thoughts gravitate towards spending less time working and more time living.

This article looks at this age bracket and how different age-related circumstances can alter your investment choices.

Assuming average health and decent genes a women aged 60 today can expect to live to 87 years of age according to the Office for National Statistics. However, the average says nothing about the spectrum of possibilities.

There is a 25% chance (one in four) of reaching 94 years and just under a one in 20 chance of getting a birthday card from the King at the grand old age of 100.

For men average life expectancy is 84 years with a 25% chance of reaching 92 years and a one in 30 chance of living to 100 years. In other words, at age 60 men can expect to live a further 24 years and women a further 27 years on average.

Six decades ago, average life expectancy for men was 69 and for women 74 which means men are now living an extra 15 years and women an extra 13 years. This represents both good and bad news. It is great that people are living longer but it also implies a bigger savings pot might be needed to prevent people running out of money in retirement.

Back in 1963, an average man would typically survive four years after retiring (retirement age was 65) which is too short to consider investing in shares. Today, those considering retiring in their 60s have a much longer runway which means they can opt to maintain exposure to shares; assuming they enter drawdown rather than buying an annuity to get a guaranteed income for life.

Seeking capital growth makes a lot of sense for investors in this age cohort. That said, it is understandable why some investors may wish to dial down their risk appetite, especially if they consider they have already built up adequate capital. Life circumstances are so varied it is impossible to run through all scenarios. But here are a few considerations.

HIGHER MEDICAL COSTS

Ageing brings the increased likelihood of having to fork out to pay for medical treatments and possibly care costs further into the future. At age 60, a case can be made for increasing the portfolio weighting towards bonds and cash at the expense of shares because the timing of medical costs cannot be known with any confidence.

But a case can also be made, assuming decent health, for maintaining the prior weighting in shares to continue growing the amount of money in your retirement pot – providing more financial flexibility.

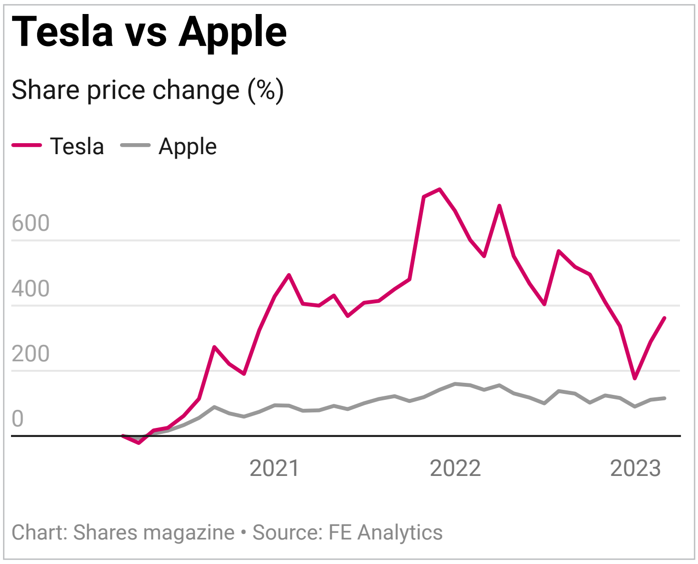
There are similarities with investing to cover university fees which are not needed immediately but years down the line. And remember, not all the expenses need to be drawn down at the start but can be phased as required. Therefore, unless there is an immediate need to cover medical costs, a contingency plan could include investing in shares as well as bonds and cash.

DESIRE FOR MORE STABLE GROWTH

Another reality of growing old is that attitudes change and people become more risk averse. While a 25-year-old may find it thrilling to ride the ups and downs of investing in cutting-edge industries like artificial intelligence and autonomous cars, a 60-year-old may prefer a slower but steadier growth trajectory.

For some people a phased retirement plan may be preferable which allows them to keep working but putting in fewer hours. In this situation rather than increasing bond exposure, it makes more sense to tilt existing stock market exposure towards stable income-paying shares.

It has the added benefit of removing the stress which comes with owning high growth shares which tend to be more volatile as can be seen in the chart comparing **Apple (APPL:NASDAQ)** and **Tesla (TSLA:NASDAQ)**.



One strategy is to focus on high quality companies which tend to throw off lots of cash, often more than is needed to grow earnings. These companies can be rewarding as often dividends increase at a faster pace than earnings.

This is an important consideration when inflation is elevated as it is today. They also possess strong balance sheets which means they are unlikely to go out of business anytime soon.

One final thing to consider is the economic backdrop which has changed significantly since the end of the pandemic. Sticky inflation is forcing central banks to ratchet up interest rates to levels not seen in decades.

Asset manager Guinness Global Investors points out the combination is reminiscent of prior periods of sluggish growth and sticky inflation such as the 1940s and 60s. During these decades dividends accounted for over 75% of the total returns of the S&P 500.

The ideas outlined below are intended to give you a starting point, though you would want a balanced and diversified portfolio made up of several holdings to sustain you through retirement.

TOP FUND PICK

GUINNESS GLOBAL EQUITY INCOME (FUND: BVYPNY2) £23.32

This fund is a great choice for investors looking for sustainable income and capital growth as it provides diversified access to some of the best quality companies across the globe.

This fund is focused on companies which can sustainably grow their dividend rather than ones with a high yield. Fund managers Ian Mortimer and Matthew Page have steered the fund since launch in 2010 and have built an impressive track record.

The fund has delivered a compound annual growth rate of 13.2%, 10.8% and 11.3% over the last three, five and 10 years respectively, easily beating the Morningstar Global Equity Income benchmark.

The managers start by identifying companies which have consistently achieved a return on capital greater than 10% in each year of the last decade.

This tends to screen out highly cyclical businesses with volatile earnings. It is a tough threshold and only 3% of global listed companies pass the test. The resulting pool is scrutinised to assess those companies with the best potential for delivering sustained dividend growth.

The fund is comprised of 35 names equally weighted with the aim of creating a well-diversified portfolio with a reasonable dividend yield (2.3% historic) and a growing income stream at an attractive relative valuation to the market.

The team have a disciplined sell process which weeds out companies which fail to meet several criteria including a stretched valuation and a worsening dividend outlook. The fund has an ongoing charge of 0.81% a year. Other costs to consider are platform custody and dealing charges and the fund manager's transaction charges.

STEADY GROWERS WITH SUSTAINABLE DIVIDENDS

Using Stockopedia software we have screened for companies which are high quality, have demonstrated consistent dividend and earnings growth and are receiving better than average earnings revisions.

The criteria used were five-year average return on equity greater than 15%, 10-year CAGR in earnings per share greater than 6%, 10-year CAGR in dividends per share greater than 10%, and top quartile (25%) earnings revisions in the last three months.

Consistent dividend growers

Company	Return on equity five-year average (%)	Dividend per share 10-year CAGR (%)
Impax Asset Management	33.1	42.7
Dunelm	60.6	25.4
Plus500	85.0	21.7
Renew	24.9	21.4
Judges Scientific	29.9	20.0
3i	20.1	17.7
Howden Joinery	34.3	17.3
Record	23.7	14.8
Hilton Food	21.9	12.8

Table: Shares magazine • Source: Stockopedia, Refinitiv.
CAGR=compound annual growth rate

TOP STOCK PICK

HILTON FOOD (HFG) 723p
Market cap: £651.6 million

Hilton Food is a high-quality supplier of meat, seafood, vegan and vegetarian foods to retail titans ranging from **Tesco (TSCO)** and **Ahold Delhaize (AD:VIE)** to Australia's **Woolworths (WOW:ASX)** under long-term contracts. The business is well placed to cater to burgeoning global demand for affordable protein products.

The company has increased its dividend at a CAGR of 13% a year over the last decade and has a forecast dividend yield of 3.6%. After a 'perfect storm' in 2022 brought about by rising costs and consumer headwinds the business seems back on track to delivering sustained growth.

The company recently flagged progress on recovering input costs and strong top line growth from its three facilities in Australia. It also announced its entry into South-East Asia through a strategic collaboration with Country Foods, Singapore's leading meat importer and distributor.

The deal marks another step forward in management's plan to diversify the business across Asia and internationally. The depressed share price offers investors an opportunity to get onboard at an attractive dividend yield with potential for steady capital growth.

By **Martin Gamble** Education Editor

A unique investment philosophy

AGT
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Nearly four decades of bottom-up fundamental investing.

Asset Value Investors (AVI) has managed the c.£1.1* bn AVI Global Trust since 1985. Our strategy has remained consistent for this period: to buy quality companies held through unconventional structures, trading at a discount. The strategy is global in scope, and we believe that attractive risk-adjusted returns can be earned through detailed research with a long-term mind-set.

The world is filled with challenges and volatility, with a war on European soil and rising interest rates alongside high levels of inflation. Despite the challenging market conditions, we continue to find good investment opportunities.

Our proprietary research process with a focus on mispriced assets that trade at a discount to net asset value enables us to filter through the numerous companies, to distil the market down to a more manageable universe.

AVI's well-defined, robust investment philosophy helps to guide investment decisions. An emphasis is placed on three key factors: (1) companies with attractive assets, where there is potential for growth in value over time; (2) a sum-of-the-parts discount to a fair net asset value; and (3) an identifiable catalyst for value realisation. A concentrated high conviction core portfolio of c. 30± investments allows for detailed, in-depth research which forms the cornerstone of our active approach.

Once an investment has been made, we seek to establish a good relationship and actively engage with the managers, board directors and, often, other key shareholders. Our aim is to be a constructive, stable partner and to bring our expertise - garnered over almost four decades of investing in asset backed companies - for the benefit of all. The approach is benchmark-agnostic, with no preference for a particular geography or sector which allows us to seek out the best opportunities anywhere in the world.

AGT's long-term track record bears witness to the success of this approach, with a NAV total return well in excess of its benchmark. We believe that this strategy remains as appealing as ever and continue to find plenty of exciting opportunities in which to deploy the trust's capital.

Discover AGT at www.aviglobal.co.uk

'Gross Assets at 31 January 2023
±As at 31 January 2023, holdings >1% of NAV
Past performance should not be seen as an indication of future performance. The value of your investment may go down as well as up and you may not get back the full amount invested. Issued by Asset Value Investors Ltd who are authorised and regulated by the Financial Conduct Authority.

AVI
Asset Value Investors

Tracker funds are at the top of retail investors' ISA shopping list

Investors appear to be losing interest in fund managers and are shifting their portfolios to passive vehicles that track an index

It's shaping up to be the ISA season of the tracker fund, if retail investor activity in January and February is anything to go by.

Eight of the 10 most popular funds bought by DIY investors so far this year have been trackers. That's a complete reversal from last year when active funds ruled the roost, with only one passive fund making it into the top 10.

What's driving this trend is less clear. It may be that investors are simply keen to get their money to work in the market. Rather than spending time researching active funds, they might be plumping for a passive placeholder, with a plan to revisit their investments when they have a bit more headspace.

The poor recent performance of some hitherto high-flying global growth funds, most notably from the Baillie Gifford stable, may have caused investor confidence in active funds to falter. Nonetheless, **Fundsmith Equity (B41YBW7)** and **Scottish Mortgage (SMT)** remain popular, despite also suffering weak performance in the last year or so.

IMPORTANT CHOICES

While trackers are simple by nature, there are some active choices which passive investors need to broach. For example, investors looking to gain passive exposure to international stock markets need to consider how much of their portfolio to invest in each region as performance can vary.

Over the last 10 years the S&P 500 index of US shares has returned 272%, while a FTSE 100 tracker of UK shares has returned 81%. Last year the tables turned, with the S&P 500 returning 3% and the FTSE 100 returning 12%.

Picking a regional allocation for your passive portfolio isn't entirely straightforward, and there are no hard and fast rules, but there are a few different approaches.

The first is you simply track just one country's headline index, like the **iShares Core FTSE 100 ETF (ISF)** in the UK or the **iShares Core S&P 500 ETF (CSP1)** in the US.

The benefit of this approach is its simplicity, though by investing in just one market you're missing out on quite a lot of potential opportunities out there in the world. There's nothing wrong with that per se. After all, you can't invest in absolutely everything. But it may mean you go through periods of poor performance which more regionally diversified investors avoid.

You also might find yourself with quite high exposure to certain sectors because of the characteristics of the index you're tracking, for instance a lot of technology in the S&P 500, or a lot of mining and oil and gas exposure in the FTSE 100.

A second approach is to simply invest in a global tracker fund, like **Fidelity Index World (BJS8SJ3)**, which tracks stock price movements across 23 developed markets, weighted according to the size of each company.

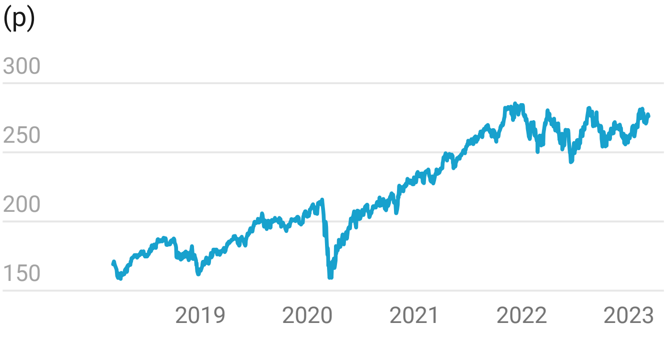

Chart: Shares magazine • Source: Refinitiv

Again, this is a simple solution, and it means you get a very broad investment portfolio which largely replicates the performance of the global market as a whole. This makes it quite a good approach for novice investors.

The one drawback would be you can still end up with high exposure to one area. For instance, at the moment, around two thirds of a global tracker fund will be invested in the US, because of the huge size of companies like **Apple (AAPL:NASDAQ)**, **Amazon (AMZN:NASDAQ)** and **Microsoft (MSFT:NASDAQ)**. That feels like quite a lot of a portfolio to be invested in one market.

Nonetheless this approach is good enough for many active managers, who often broadly follow the geographical exposure of the MSCI World index, which is probably the most well-known global stock market benchmark.

Investing in this way also means the performance of your portfolio won't differ greatly from that of the opportunity set available in developed international markets.

IS THERE ANOTHER STRATEGY?

A third approach is to apply a more active strategy to regional market allocation, picking areas you think will do well and dropping those you think are duds.

If this approach appeals to you, it might be best to start off with a portfolio of index trackers which you feel achieves diversification across geographies, and adjust this tactically, depending on where you see opportunities and threats.

For instance, you could start off from a neutral position of 20% invested in a tracker fund in each of the US, Europe, the UK, Japan, and emerging markets. You can then dial up and down exposures to these markets depending on your prevailing view. This at least gives you a bit of a baseline from which to actively manage your portfolio.

The emergence of very cheap tracker funds has been a revelation for investors in the last 10 years, especially those who are new to investing, and even for old hands who don't want the bother of selecting active funds.

Not all tracker funds are created equal, however, and investors do need to be wary of falling foul of some poorly priced funds. For example, the most expensive UK tracker fund is an eye-popping 21 times more expensive than the cheapest, in terms of the annual fund charge. So even though passive investing is generally a simple endeavour, it still pays to have your wits about you.

DISCLAIMER: Daniel Coatsworth who edited this article has a personal investment in Fidelity Index World and Fundsmith Equity

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

Most popular funds with DIY investors on the AJ Bell platform

Jan & Feb 2023	Jan & Feb 2022
Fundsmith Equity	Fundsmith Equity
Vanguard S&P 500 ETF	Fidelity Index World
Fidelity Index World	Fidelity Global Special Situations
iShares Core FTSE 100 ETF	Baillie Gifford American
Vanguard LifeStrategy	Baillie Gifford Positive Change
Vanguard Global All Cap Index	Liontrust Sustainable Future Global Growth
Fidelity Global Special Situations	Standard Life Global Smaller Companies
Vanguard FTSE All-World ETF	Jupiter UK Special Situations
UBS S&P 500 Index	Rathbone Global Opportunities
iShares S&P 500 ETF	LF Blue Whale Growth

Table: Shares magazine • Source: AJ Bell

ADVERTISING PROMOTION

Fidelity Special Values PLC
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Portfolio manager Alex Wright's contrarian approach to the trust thrives on volatile and uncertain markets, when he believes stocks are most likely to be misjudged and undervalued.

Investing mainly in the UK, and supported by Fidelity's extensive research team, Alex looks to invest in out-of-favour companies, having spotted a potential trigger for positive change that he believes has been missed by others.

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Equity markets at both home and abroad have experienced significant volatility in recent months. While lower valuations could represent a great buying opportunity, it's also essential to recognise that not every undervalued situation is special. Some unloved stocks are cheap for good reason.

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Past performance

	Feb 2018 - Feb 2019	Feb 2019 - Feb 2020	Feb 2020 - Feb 2021	Feb 2021 - Feb 2022	Feb 2022 - Feb 2023
Net Asset Value	0.3%	−3.9%	8.9%	21.2%	11.6%
Share Price	2.7%	−6.0%	10.2%	22.6%	3.7%
FTSE All Share Index	1.7%	−1.4%	3.5%	16.0%	7.3%

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 28.02.2023, bid-bid, net income reinvested. ©2023 Morningstar Inc. All rights reserved.
The FTSE All Share Index is a comparative index of the investment trust.

Important information

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The Trust can use financial derivative instruments for investment purposes, which may expose it to a higher degree of risk and can cause investments to experience larger than average price fluctuations. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. The trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies and the securities are often less liquid. This information is not a personal recommendation for any particular investment. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser..

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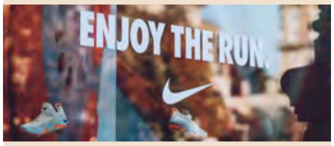
Index

Main Market	
Aviva	44
Babcock	16, 45
BAE Systems	16, 39, 45
Bank of Georgia	7
Barclays	6
British American Tobacco	39
BT	46
Diversified Energy	24
Enquest	27
Greggs	50

Harbour Energy	27
Hilton Food	57
HSBC	6
International Consolidated Airlines	25
Just Group	18
Kingfisher	11
Lloyds Banking	24, 46
Marks & Spencer	50
NatWest	7
Prudential	46
Qinetiq	16
RELX	39
Restaurant Group	50
Rolls-Royce	25, 46
Shell	46
Taylor Wimpey	46
TBC Bank	7
Tullow Oil	46
Unilever	39
Virgin Money	7
Vistry	46
Vodafone	46

Overseas shares	
Alphabet	39
Amazon	60
Apple	56, 60
Barrick Gold	14
First Republic Bank	6
Franco-Nevada	14
General Mills	12
JPMorgan Chase	39
Microsoft	60
Newcrest	14
Newmont	14
Nike	12



PepsiCo	39
Plug Power	44
Samsung Electronics	39
Singapore Telecommunications	39
Starbucks	50
Tencent	45
Tesla	32, 56
UnitedHealth	39
Western Alliance	6
Woodside Energy	39

Funds	
BlackRock Gold & General	14
Fidelity Global Special Situations	39
Fidelity Index World	59
Fundsmith Equity Fund	59
Guinness Global Equity Income	56
IFSL RC Brown UK Primary Opportunties	23
Jupiter Asian Income	39
Royal London Sustainable World Trust	39

ETFs	
iShares Core FTSE 100 ETF	59
iShares Core S&P 500 ETF	59
iShares Gold Producers ETF	14
WisdomTree Cybersecurity ETF	30

AIM	
Breedon	19
EMIS	19
Fevertree Drinks	11
Impax Asset Management	39
ITM Power	44
Serica Energy	27
SigmaRoc	24
Team17	39
XP Factory	50

Investment Trusts	
3i Infrastructure	24
City of London Investment Trust	39, 45
Custodian Property Income	51
Henderson Smaller Companies	39
JPMorgan Claverhouse	45
JPMorgan Global Growth and Income	45
Murray International	45
Scottish Mortgage	59, 45
Securities Trust of Scotland	38

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