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VOL 25 / ISSUE 11 / 23 MARCH 2023 / £4.49

SHARES

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INVESTING IN A WORLD OF HIGHER RATES

FEATURE What the banking crisis means for markets


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Contents

Three important things in this week's magazine

1


News

Wild moves in markets after SVB collapse and Credit Suisse rescue

Calm has been restored for now as the debate over the impact on interest rates cranks into gear

Forced Credit Suisse merger with UBS and SVB collapse as crisis engulfs banking sector

What's been happening to markets and why Swiss regulators upset bank bond holders

2


INVESTING IN A WORLD OF HIGHER RATES

Despite recent volatility you shouldn't panic and instead remain patient and diversified say experts

S&P 500 versus FTSE 100 rebased to 100

Investing in a world of higher rates

Volatility has followed in the wake of interest rate hikes with significant implications for markets

3


Feature: Company longevity

Why a company's longevity is important to some of the best fund managers

Businesses often stand the test of time for a good reason

Some of the UK's oldest companies

Why some of the best fund managers care about longevity

Several big funds quantify the average age of companies in their portfolio as they look for businesses which have stood the test of time

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:


DIY seller Kingfisher promises higher returns after year of no growth


Water utilities to link dividends to performance and financial resilience


Deal-hungry Diploma buys TIE and raises £236 million for further takeovers


Rentokil profits rise 28% uplifted by Terminix deal, hikes dividend by 18%

Wild moves in markets after SVB collapse and Credit Suisse rescue

Calm has been restored for now as the debate over the impact on interest rates cranks into gear

The evolving banking crisis sparked by the unravelling of Silicon Valley Bank is creating consequences that seemed unimaginable only a few weeks ago.

While a run on a bank is nothing new the speed of the SVB's demise was something which speaks to the increasing power of social media.

Chief economist at wealth manager Kingswood Rupert Thompson says: 'The problems at Silicon Valley Bank have certainly spread faster and further than we and most commentators were expecting.

'This is in part down to the internet and social media which mean deposit runs on banks can occur far faster these days than in the past.'

The most startling market reaction to the crisis has been the sharp reversal of US two-year treasury yields. Shorter term yields reflect the expected path of official interest rates and so are closely watched by investors.

At the beginning of March, the two-year yield was above 5% and heading higher as the Federal Reserve seemed determined to stay on its hiking path to stamp out sticky inflation.

Yields have since dropped below 4%, representing a drop of 22% one of sharpest on record, wrong-footing hedge funds and other institutions which had expected interest rates to keep move higher. Futures markets are now pricing in cuts to interest rates later in 2023.

Meanwhile, volatility in the US bond markets reached its highest since 2008 in the week ended 17 March according to the ICE BofA Move index as trading volumes more than doubled.

WHAT WILL HAPPEN TO RATES NOW?

This article went to press before the key interest rate decisions from the Federal Reserve on 22 March and the Bank of England on the following day.

On 16 March the ECB (European Central Bank) increased its key interest rate by half a percentage point, something it had committed to weeks before the current crisis emerged.

ECB president Christine Lagarde seems to have convinced markets on the logic of hiking rates to fight inflation while dealing with financial market stability separately. In other words, the two policies are not seen as in conflict at the ECB.

Pressure on the banking sector subsided in Europe after the Swiss National Bank forged a merger between **Credit Suisse (CSGN:SWX)** and **UBS (UBSN:SWX)** although there has been consternation that some bond holders have been wiped out at the expense of shareholders.

The positive market reaction to the ECB's rate increase may be enough to convince the Fed to continue its original course. There is a risk that pausing may cause markets to read something more into the regional US banking turmoil than is warranted.

Looking beyond the near-term, asset manager BlackRock is firmly in the rate hike camp: 'We expect central banks to keep hiking to fight higher inflation – not come to the rescue.

'We believe a further substantial deterioration in the banking situation is unlikely, even if it cannot be ruled out given confidence is fickle and lies at the heart of the issue.

'The banking sector is fundamentally in much better shape than back in the GFC (great financial crisis) and the authorities seem to be taking the necessary action to prevent further marked contagion.'

Asset moves since 3 March

Asset	% change
Bitcoin	38.6
Gold	9.7
Nasdaq	6.2
FTSE 350 banks	−11.6
European banks	−18.3
US two-year yield	−21.2
German two-year yield	−21.6
UK two-year yield	−22.2
US regional banks	−27.5

Table: Shares magazine • Source: Sharepad, Google Finance. Data to 21 March 2023.

WINNERS AMID THE UNCERTAINTY

Bitcoin and gold have benefited from the chaos in the financial sector with the former rising almost 40% to a nine-month high and the latter up by a tenth.

Bitcoin's rise is ironic given the collapse of Silvergate and Signature, two banks which were integral to the cryptocurrency landscape.

Bitcoin has often been touted as a hedge against inflation but the reality over the last 18 months is that it tended to move in lockstep with risky assets.

The drop in interest rates has boosted the value of the Nasdaq 100 index where large cap tech is perceived as relatively safe and supported by strong balance sheets.

The tech sector had suffered the most against the backdrop of rising interest rates which theoretically lowers the value of their longer duration earnings growth.

Also helping sentiment towards the sector has been a shift in focus towards profitability rather than growth in response to overexpansion during lockdowns to meet booming online demand.

Investors have responded positively to job cuts at Facebook owner **Meta Platforms (META:NASDAQ)** and **Amazon (AMZN:NASDAQ)** which announced a further 9,000 layoffs this week on top of the 18,000 jobs cut in January. [MG]

Scottish Mortgage chair to step down after boardroom blow-up

Fiona McBain's exit follows unedifying row over corporate governance and private company expertise

Fiona McBain, chair of popular investment trust **Scottish Mortgage (SMT)**, is stepping down after a boardroom row over corporate governance exploded into the public arena.

In a board update (21 March), Baillie Gifford's flagship fund said senior independent director Justin Dowley will succeed McBain as chair as a result of 'succession planning', though her exit has clearly been hastened by a bust-up between the board and non-executive director Amar Bhide, who has now left the board and is no longer a director.

Bhide told the *Financial Times* (17 March) that Scottish Mortgage asked him to resign at a recent board meeting after he clashed with McBain over the appointment of new board members. Regarding the FTSE 100 fund's unquoted investments, he argued 'they do not have the capabilities and governance clout to be able to monitor the illiquid investments on which there is little audited information in the public sphere'.

The Times reported further comments from Bhide that there has been 'a long series of procedural violations' that were 'brushed aside' at Scottish Mortgage.

Scottish Mortgage's unquoted exposure is an area facing 'understandable scrutiny' according to Numis. As of 28 February 2023, 29.9% of the portfolio was in 52 private investments, up from 19% at September 2021 and 25% at March 2022 and marginally below the 30% limit.

Numis notes this limit is 'based on the percentage at the time of investment, which is crucial to avoid the fund having to be a forced seller of private assets due to movements in the value of public holdings, which could significantly destroy value'.

The broker says this 'does limit the scope for new investment in unquoteds, which could lead the fund to miss out on follow-on opportunities or suffer some dilution if it was unable to back a down-round'.

Given the complexities of investment in private companies, Stifel thinks it would help if Scottish Mortgage appointed a specific manager to deal with that segment of the portfolio.

Scottish Mortgage's shares have fallen by roughly a third over the past year to 664.2p to leave them languishing on a near-20% discount to net asset value (NAV). Sentiment has soured due to the impact of rising interest rates on the 'world's most exceptional growth companies' it favours, such as biotech firm **Moderna (MRNA:NASDAQ)** and Elon Musk-led **Tesla (TSLA:NASDAQ)**.

Scottish Mortgage has an excellent long-run track record. Over the last 10 years the trust has produced NAV and share price total returns of 421% and 362% respectively versus 183% from the FTSE All World Index (total return). However, given this period coincided with near zero interest rates, the question is whether it can sustain its performance in a higher rate environment. [JC]

Scottish Mortgage

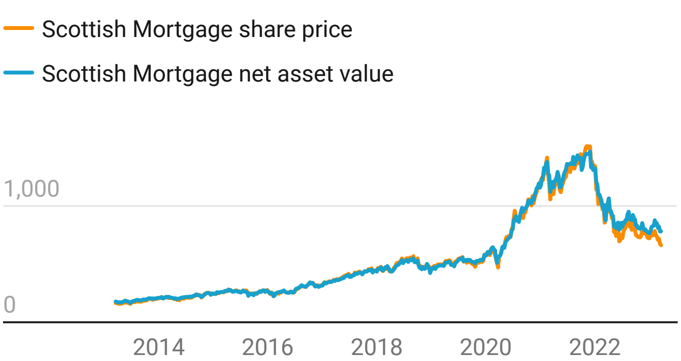


Chart: Shares magazine • Source: Refinitiv

Find out why Volution's shares have fanned higher

Earnings upgrades ensued following the ventilation product maker's excellent first half figures

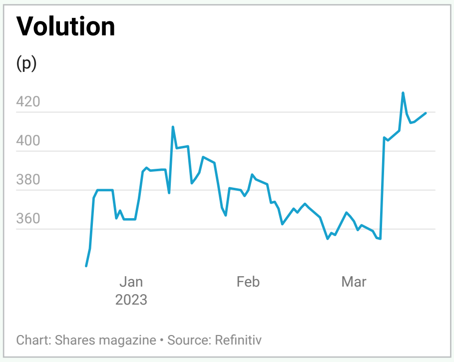


Chart: Shares magazine • Source: Refinitiv

Shares in **Volution (FAN)** have jumped 18%, from 355p to 419p, since the indoor ventilation firm posted strong first results (9 March) and said current trading remains robust.

This builds on the strength the share price has shown since last autumn and has been sustained despite the recent volatility in markets.

Positive trading momentum continued into the half to January 2023, with all three regions - the UK, continental Europe and Australasia - showing growth. Volution highlighted strong UK residential repair, maintenance and improvement (RMI) demand, which is in marked contrast to the rest of the sector.

The designer and manufacturer of energy efficient indoor air quality solutions is bucking a weak construction sector whilst benefiting from environmental and health regulations, driven by the need to decarbonise buildings, drive improvements in air quality and reduce damp and mould in residential homes, which are stoking demand for its products.

Berenberg upgraded its earnings per share estimates for the next three years following the results and believes Volution is 'very well positioned given its sector-leading pricing power, regulatory tailwinds, an increasing focus on indoor air quality, and its strong balance sheet'. [JC]

Currys endures Nordic noir as debt guided to be significantly higher

Electronics retailer to post full-year profit at lower end of expectations

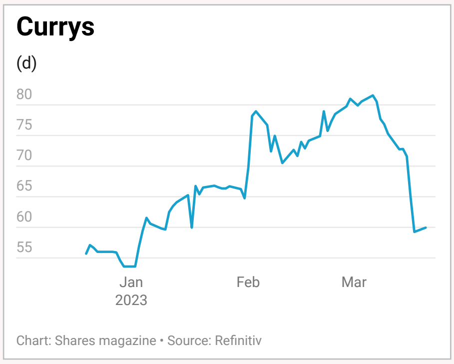


Chart: Shares magazine • Source: Refinitiv

A recent revival in **Currys (CURY)** shares has petered out in spectacular fashion as a previously reliable part of the business has become more and more of a problem.

A tough consumer environment in the Nordics region which had initially been flagged as a short-term issue linked to competitors selling off excess stock at a discount now looks more troubling.

On Currys said that its Nordics business performance 'remains very challenging,' so much so that they have recently appointed a new CEO for the region; Frederik Tonnesen.

Tonnesen's appointment is an attempt by Currys to restore healthy levels of profit and cash generation.

Since the start of the year, the Nordics business has worked hard to reduce marketing spend, remove spend on contractors and there are further cost savings actions planned.

However, this 'Nordic drag' has meant the company forecasting pre-tax profit for the current financial year to 30 April at the lower end of the previously guided range of £100-£124 million with net debt materially higher at up to £150 million compared with a previous steer of less than £100 million. [SG]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

24 March: Ceres Power Holdings
27 March: Life Science REIT, Thungela Resources, Sigmaroc, Dialight, Belvoir, Globaltrans Investment GDR, Tandem
28 March: S&U, Wood Group, Empresaria, EKF Diagnostics Holdings, Flowtech Fluidpower, Animalcare, Team17, Personal Group, Barr (A.G.), Fisher (James) & Sons, VH Global Sustainable Energy Opportunities, Elecosoft, The Mission Group, Synthomer, CPP Group, Good Energy
29 March: Ecora Resources, Big Technologies, Surgical Innovations, Tinybuild, Central Asia Metals, Next, Michelmersh Brick Holdings, Strix, S4 Capital, Inspired
30 March: Aquis Exchange, Chesnara, IGas Energy, BBGI Global Infrastructure, Secure Trust Bank, Artbuthnot Banking, International Public Partnerships, Robinson

HALF-YEAR RESULTS

24 March: Wetherspoon (JD), Smiths Group
27 March: Bellway, Nanoco, Softcat, eEnergy
28 March: Up Global Sourcing

TRADING UPDATES

27 March: Darktrace
29 March: Moonpig, AO World

JD Wetherspoon

Investors will be looking for signs pubs group's sales momentum is poised to pick up in the second half

Pubs group **JD Wetherspoon (JDW)** is scheduled to release first half results to 29 January 2023 on 24 March. The shares have had a strong run since last October gaining around 38% on the back of a general market recovery.

A January trading update said first half like for like sales grew 13% but overall sales remain stubbornly below pre-pandemic levels.

In contrast to positive share price gains full year earnings estimates have been consistently revised down by around 35% over the last five months according to Refinitiv data. Higher costs continue to weigh on the company.

On the brighter side Peel Hunt leisure analyst Douglas Jack notes the company has been putting prices up in recent weeks after a very generous January sale. [MG]

Next

Versatile retailer is winning market share as high street and online pure-play competitors struggle

High street and online apparel seller **Next's (NXT)** results for the year to January 2023 on 29 March will be scrutinised to see if the best-in-class retailer's brick and mortar store trading performance continues to turn around. On 5 January, the retail bellwether raised its full year earnings guidance off the back of better-than-expected Christmas sales, although cost pressures and the squeeze on consumers' disposable incomes from inflation and rising mortgage payments meant Next issued conservative guidance for the year to January 2024. [JC]

Micron Technology

Wells Fargo calls bottom for Micron Technology ahead of second quarter numbers

It's always risky trying to the call the bottom, not that it stops people trying, and Wells Fargo analysts think the worst could be behind **Micron Technology (MU:NASDAQ)**, the memory microchips manufacturer.

Wells Fargo believes that investors are starting to acknowledge that the market is nearing a fundamental bottom, following 'what has been an unprecedented downturn in shipment declines.' But second quarter earnings on 28 March will still be pretty ugly, according to the analysts.

Micron has already sharply cut Q2 2023 revenue, earnings and gross margin guidance with analyst consensus now anticipating $3.75 billion, a loss per share of $0.65 and 9.3%. But, as Wells Fargo points out, Micron anticipates a positive alignment of supply and demand in the second half of 2023, with the focus now shifting to material recovery into 2024. [SF]

Walgreens Boots Alliance

Transformation into a consumer-centric healthcare company continues under CEO Rosalind Brewer

Second quarter results (28 March) from **Walgreens Boots Alliance (WBA:NASDAQ)** will be watched to see if the drugstore behemoth has sustained its solid start to the financial year with consumers facing inflationary pressures. In January, the retail pharmacy behind Walgreens and Boots delivered forecast-beating first quarter results and raised its full year sales outlook, in part helped by robust sales in the run-up to Christmas from Boots. However, the positive news was overshadowed by a lurch into loss after Walgreens Boots Alliance took an opioid litigation charge. [JC]

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

27 March: Jefferies Financial, Opal Fuels, Boston Omaha
28 March: Micron Technology, Walgreens Boots Alliance, McCormick & Company, Evotec, Cal Maine,
29 March: Cintas, Paychex, Buzzi Unicem, Unifirst
30 March: Blackberry, Altus Power, Artemis Gold

EUROPEAN UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

24 March: Secunet
27 March: Aurelius
28 March: Rational AG, Dermapharm
29 March: Poste Italiane, Aroundtown
30 March: Kontron, Adesso, Aumann

Keurig Dr Pepper is a quality staple selling at a discount to its peers

The cash-generative Dr Pepper producer's qualities are so misunderstood

A turbulent year for markets is brewing amid rising geopolitical tensions, stubbornly high inflation and interest rate hikes by central banks which have precipitated a fresh banking crisis.

Given this uncertain backdrop, tilting portfolios towards stocks with defensive characteristics seems an eminently sensible strategy and one overlooked consumer staples name to consider is **Keurig Dr Pepper (KDP:NASDAQ)**.

This North American beverages business is blessed with a diverse brand portfolio and the pricing power to help it offset the impact of cost inflation. The drinks company is serving up resilient earnings growth, whilst returning capital to investors via progressive dividends and buybacks, and a pullback from last summer's $40 per share level offers a compelling entry point.

While drinks goliaths **Coca-Cola (KO:NYSE)** and **PepsiCo (PEP:NASDAQ)** dominate the headlines, lesser-known smaller peer Keurig Dr Pepper offers similar attractions at an attractive discount.

According to Stockopedia, its shares sell for 19.5 times prospective 2023 earnings with a dividend yield of 2.3%, while Coke trades on 23.1 times forward earnings with PepsiCo swapping hands for 24.2 times forecast earnings, premiums which reflect the larger groups' scale and market leadership positions.

Formed through 2018's merger between Keurig Green Mountain Coffee and Dr Pepper Snapple, Keurig Dr Pepper is competing with the big boys with a portfolio diversified across more than 125 owned, licensed and partner brands.

Guided by CEO Robert Gamgort, the $49 billion cap not only distributes coffee brewers and single-serve coffee pods under the Keurig and Green Mountain brands, it also produces the iconic Dr Pepper – the peppery soda established back in 1885 – as well as tipples ranging from Snapple and Canada Dry to Sunkist.

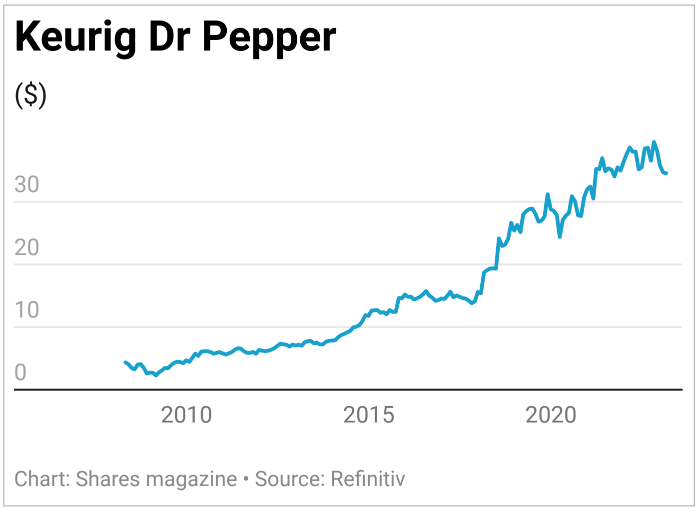
KEURIG DR PEPPER
(SPGP)
Price: $35.07
Market cap: $49 billion

Shares likes the fact Keurig Dr Pepper continues to diversify its portfolio into faster-growing beverage categories. The company recently gained a foothold in the performance energy drinks market through a strategic partnership and investment in Nutrabolt, which included a long-term sales and distribution agreement for C4 Energy drinks.

This followed a $50 million investment for a minority stake in American non-alcoholic craft beer market leader Athletic Brewing and the acquisition of non-alcoholic ready-to-drink cocktail brand Atypique.

Keurig Dr Pepper's resilient results for the year to December 2022 (23 February) revealed double-digit sales growth of 11% to the best part of $14.1 billion, comfortably ahead of the company's initial guidance for mid-single-digit growth, underpinned by price increases of 10.6% which demonstrated the strength of the brand portfolio.

The company also guided for constant currency sales growth of 5% for 2023 with adjusted earnings per share growth of between 6% and 7%, estimates we believe could prove conservative. [JC]



Pick up underappreciated growth story Midwich at a great price

The distributor is seizing on a growth opportunity in the audio visual equipment market

MIDWICH
(MIDW:AIM)
Price: 450p
Market cap: £417.7 million

Specialist distributor of AV (audio visual) equipment to the trade market **Midwich (MIDW:AIM)** has established a strong track record of growth since coming to the stock market in 2016.

Although there are added risks to consider when investing in smaller companies, we believe Midwich is a great opportunity to buy above average growth at a below average price.

Sales and adjusted operating profit have grown at a compound annual growth rate (CAGR) of 22% and 19% respectively, outperforming the wider AV market.

The global AV market is worth £219.2 billion and expected to grow at a CAGR of 5.9% a year over the five years to 2027 according to Avixa, the trade association for the professional AV market.

Midwich has historically grown faster than the market and in 2022 delivered 20% organic growth compared with just over 10% for the market.

The company's strategy is to augment organic growth by acquiring two to four companies a year as it builds out new geographies and technologies.

Including acquisitions, revenue grew 41% in 2022 and the company said it has a healthy pipeline of acquisition targets. Post year end the company increased the size of its revolving banking facilities to £175 million from £80 million to support delivery of the pipeline.

Management estimates the company's total addressable market is 15% of the total AV market implying a market share between 3% and 4% and hinting at a significant growth opportunity.

An experienced management team, strong customer relationships and an increasing focus on higher valued-added products are key competitive advantages which should support sustainable growth.

Midwich is a B2B (business to business) specialist working with over 600 vendors including blue chip makers such as Samsung, Sony, Logiteck, and Philips. It supports a comprehensive range of audio visual products including displays, projectors, technical, broadcast, lighting, audio, and unified communications.

It operates as the sole or largest in-country distributor for many of its vendors in their respective product sets. The firm has a diverse base of over 200,000 customers many of which are professional AV integrators and IT resellers such as **Softcat (SCT)** and **Computacenter (CCC)** servicing corporate (30% of sales), education (30% of sales), retail, residential and hospitality sectors.

Most of its products are used by commercial and educational establishments rather than consumers. The company's depth of expertise and close contact with its clients keeps it at the forefront of market and technological developments.

Despite all these attractions the shares trade on just 12 times forecast earnings and offer a solid yield of around 4%. [MG]

Chart: Shares magazine • Source: Refinitiv

Shanta Gold is up 30% in less than three months: time to take profit

Gold producer's production miss for fourth quarter of 2022 shows operational risks remain

Shanta Gold (SHG:AIM) 11.85p

Gain to Date: 31.2%

We made African gold miner **Shanta Gold (SHG:AIM)** one of our key picks for 2023 in the expectation of higher gold prices and with the hope strong operational progress from the company could offer gains over and above those enjoyed by the precious metal.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

Both parts of our investment case have paid off. Gold prices have gone higher, with the latest leg up driven by a crisis in the banking sector. Prices recently moved above the $2,000 per ounce mark for the first time in a year as investors sought out its safe haven credentials.

For its own part Shanta remains on track for first production from its Singida project any day now and has announced positive news on reserves and resources for its Kenyan and Tanzanian assets.

Less positively, production for the fourth quarter fell short of expectations at 65,200 ounces versus the lower end of previous guidance at 68,000 ounces. Power issues and reduced availability of equipment affected the company in the final three months of 2022.

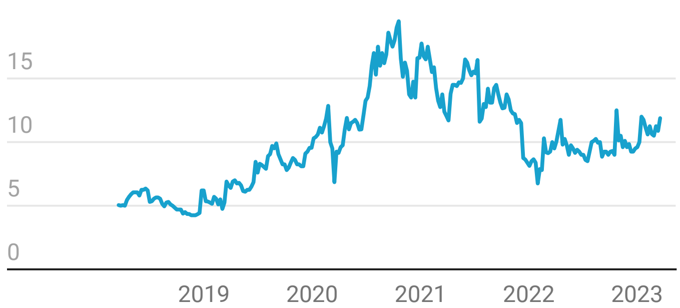


Chart: Shares magazine • Source: Refinitiv

WHAT SHOULD INVESTORS DO NOW?

As the fourth quarter production miss shows, Shanta is still exposed to operational risks. With gold's recent strength helping to lift shares well above our entry point we think it would be worth investors booking profit.

A 30%-plus return in three months is beyond our initial expectations. Therefore, it is time exit in our view. Investors looking to remain exposed to gold could consider switching into **iShares Gold Producers ETF (SPGP)** which we recently added to our regular *Great Ideas* portfolio.

This ETF tracks a diversified basket of larger gold miners meaning the risk of being tripped up by individual company failings is heavily mitigated. [TS]

BlackRock.

THE CHALLENGE OF TURBULENT MARKETS

Good companies can still thrive, even in the toughest economic conditions. This year's ISA season comes amid the most difficult environment for a decade. How do BlackRock fund managers put themselves in the best position to find opportunities?

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.

At the start of 2022, many investors were looking forward to a brighter year ahead after the turbulence of the pandemic. As countries reopened, the world economy appeared to be on a bumpy path to recovery. The invasion of Ukraine by Russian troops fundamentally changed the outlook, ushering in one of the toughest years for financial markets on record.

The Russian invasion brought a spike in energy prices, contributing to mounting inflationary pressures. Prices had already been pushed higher by supply chain disruption during the pandemic. Central banks acted decisively, raising interest rates, and withdrawing quantitative easing measures. In doing so, they reversed a decade-long low interest rate regime. That regime had helped support both bond and equity markets.[1] Its withdrawal saw considerable disruption across financial markets.

It was a perfect storm for investors. Stock markets were volatile and unpredictable, particularly in the previously-strong technology sector,[2] yet bond markets did not provide their usual support. Both areas sold off significantly.

Only a narrow range of companies and sectors have made progress. The energy sector has benefited from strong commodity prices and higher profits. This has also helped commodity-dependent countries, such as Latin America.[3]

There have been some anomalies as well, such as India, which has recovered well from the pandemic and where the stock market has been strong.[4] But for most other areas, it has been a gloomy year.

THE YEAR AHEAD

There are relatively few signs of this improving in the near term. ISA investors may need to accept that environment will remain volatile for some time to come. The Federal Reserve has made it clear that its priority is to tackle inflation, whatever the impact on short-term economic growth.[5] This is echoed by other central banks around the world that recognise the need for price stability.

Nevertheless, financial markets have fallen a long way in 2022 and valuations are lower than where they started in 2022.[6] There are still good companies, with a strong pathway of growth, delivering higher earnings and dividends. At BlackRock, we continue to look for those companies that can deliver value in all economic conditions.

INVESTMENT DISCIPLINE

In this type of febrile market, we believe investors need to fall back on sound investment disciplines. Diversification is particularly important at a time when traditional diversification strategies, notably holding bonds and equities, have not worked as well. This means looking beyond traditional markets such as the UK or US, to those markets that have their own self-sustaining growth stories.

Emerging markets risk: Emerging market investments are usually associated with higher investment risk than developed market investments. Therefore, the value of these investments may be unpredictable and subject to greater variation.

[1] https://www.imf.org/en/Blogs/Articles/2022/01/27/blogs012822-low-real-interest-rates-support-asset-prices-but-risks-are-rising IMF, 27 January 2022.
[2] https://www.bbc.com/news/business-57979268 BBC, 27 July 2022.
[3] https://www.barrons.com/articles/brazil-stock-market-bargains-51650609904 Barrons, 24 April 2022.
[4] https://www.bloomberg.com/news/articles/2022-11-11/records-in-sight-for-indian-stocks-as-they-join-global-rally Bloomberg, 11 November 2022.
[5] https://www.cnbc.com/2022/10/10/feds-evans-says-fighting-inflation-is-the-top-priority-even-if-that-means-job-losses.html CNBC, 10 October 2022.
[6] https://www.macrotrends.net/stocks/charts/MSCI/msci-inc/pe-ratio#:~:text=The%20PE%20ratio%20is%20a,November%2010%2C%202022%20is%2041.83 Macrotrends, 3 January 2022.

Diversification: Diversification and asset allocation may not fully protect you from market risk.

This applies not just to capital growth, but also to income. In the BlackRock investment trusts, we use the full powers of the investment trust structure to explore ideas in overlooked areas. These may not be investable for an open-ended fund due to liquidity constraints, but can be held in an investment trust structure. These may be smaller markets, such as frontiers, or royalty investments or using option-writing to boost dividend income. We may also reserve income in buoyant markets to pay out in tougher times.

It is also a time for strong stock-picking. A difficult economic environment exposes weak companies. Those with high debt could see their repayments rise, while those without pricing power may not be able to put their prices up in the face of higher costs. In contrast, stronger companies can grow even stronger during a downturn, taking market share from struggling rivals. At BlackRock, we draw on our global analyst network to pick up the most compelling ideas.

The investment trust structure can be important in allowing us to take full advantage of those opportunities. In difficult markets, liquidity can be a problem. It can be tough to move in and out of positions. Open ended funds may have this forced upon them, as they may need to buy and sell shares to meet redemptions. In contrast, closed-ended funds have the flexibility to invest as they see fit.

Good risk analysis is also an important discipline in febrile markets. It is important for a fund manager to understand their exposure to different areas: to a rise or fall in interest rates, for example, or a spike in the oil price. This risk discipline is integral to everything we do at BlackRock. We arm our fund managers with all the risk tools they need to understand the decisions they take on investors' behalf, such as the Aladdin platform which provides sophisticated risk analytics.

Risk Warning: While proprietary technology platforms may help manage risk, risk cannot be eliminated.

2023 could be another difficult year, which makes choosing an ISA difficult, but there are opportunities in all market conditions. We aim to put ourselves in the strongest possible position to take advantage of those opportunities.

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

TO INVEST IN THIS TRUST CLICK HERE

RISK WARNINGS

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

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INVESTING IN A WORLD OF HIGHER RATES

Despite recent volatility you shouldn't panic and instead remain patient and diversified say experts

By **Steven Frazer** News Editor

It has been a tricky couple of weeks for investors. The higher or lower speculation over interest rates, particularly in the US, has changed so rapidly it can make you feel like a contestant on Bruce Forsyth's *Play Your Cards Right*.

The collapse of Silicon Valley Bank and New York-based Signature Bank in quick succession, and more recently, a **UBS (UBS:SWX)** rescue for Swiss banking giant **Credit Suisse (CSGN:SWX)**, has left investors' nerves frazzled and sparked worries across global share markets.

Oil prices have slumped, gold is soaring, bond yields have fallen and so have stock markets. The FTSE 100 has lost about 9% since the SVB threat emerged on 8 March, and hundreds of billions of market value has been stripped from global banks.

How investors handle the inherent risks of an iffy economic backcloth and the volatility it will likely bring could make a big difference to portfolio performance over the months and years ahead. If interest rates do stay higher for longer, what should investors do?

As is often the case in uncertainty, dull is usually sensible – don't panic, be patient, stay invested in a diversified asset pool, and steadily and systematically put money to work at what, in due course, could look like attractive market levels.

S&P 500 versus FTSE 100 rebased to 100

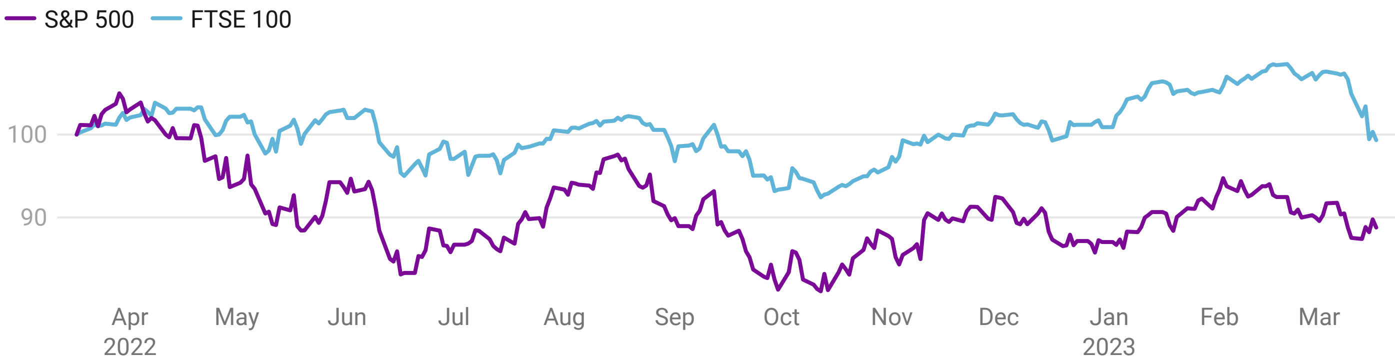
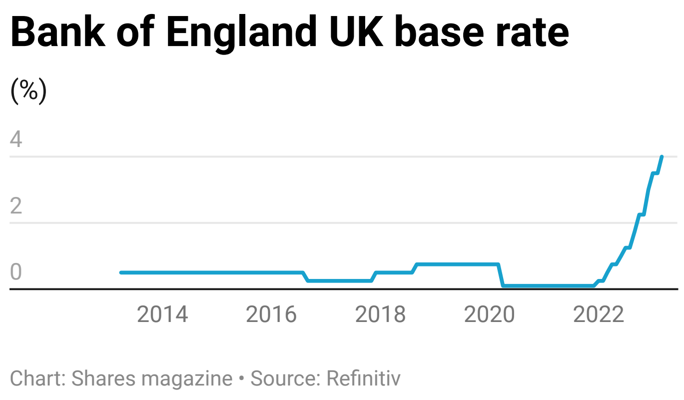


Chart: Shares magazine • Source: Refinitiv



WHY DO HIGH INTEREST RATES MATTER?

Central banks are trying to strike a delicate balance to achieve a 'soft landing' for the economy, or in other words, dampening demand to gradually ease inflation without sending it spiralling into recession. Get it wrong, they crash the economy.

In everyday terms, higher interest rates mean it is more expensive to borrow money, making mortgages, car loan and credit cards more expensive for consumers to service. Businesses also pay more to borrow the money they need to grow their operations, cost of capital. That's why, in response to rising rates, both consumers and businesses tend to rein in their spending, which slows economic growth and eventually lowers the prices of goods and services.

Typically, when the Federal Funds Rate rises, it pushes interest rates for other bonds higher as well. And when interest rates rise, bond prices tend to fall.

The effect isn't the same across the board. A bond's sensitivity to interest rate changes depends on several factors, including its maturity date and coupon (the income from a bond). Bonds with long maturities and low coupons are more sensitive to changes in interest rates.

For investors looking to sell a bond before it reaches maturity, a rise in rates may mean they need to sell at a discount to face value to compete with newer, higher yielding bonds coming to market. However, if you buy and hold individual bonds to maturity, rising interest rates may be less of a concern, as you'll receive your full principal back at maturity, provided the issuer doesn't default.

For investors whose primary objective is income, rising rates mean some fixed-income assets may offer attractive yields. Higher yields also tend to make bonds more attractive relative to riskier assets like stocks.

'I would argue that the interest you're being offered from short-dated bonds is a bit of a gift,' says James Harries, manager of investment trust **Securities Trust of Scotland (STS)**.

The yield on two-year nominal UK gilts is currently around 3.35%, while a two-year US treasury offers 4.1%. Nominal 10-year gilts and treasuries yield 3.4% and 3.5% respectively. This may look attractive to many investors versus higher risk equities right now, especially those in

BOND FUNDS FOR FIXED INCOME EXPOSURE

- **iShares GBP Corporate Bond ETF (SLXX)** has exposure to sterling denominated investment grade corporate bonds, such as **HSBC (HSBA)**, **AT&T (T:NYSE)** and **Verizon Communications (VZ:NYSE)**.

- **Lyxor UK Government Bond 0-5Y ETF (GIL5)** has exposure to short-dated UK government bonds.

- **iShares UK Gilts 0-5 ETF (IGLS)** also runs a portfolio that includes exposure to short-dated UK government bonds.

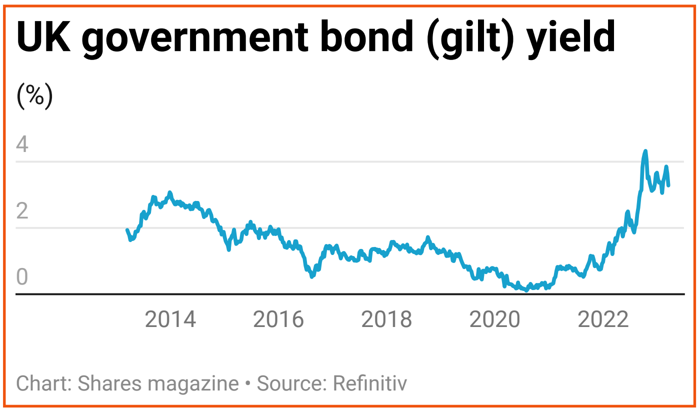
- **Artemis Corporate Bond Fund (BKPWGV3)** has exposure to UK corporate bonds but has a global mandate, including Heathrow Funding, **NatWest (NWG)** and **ING Groep (INGA:AMS)**.

- **Allianz Strategic Bond Fund (BYT2QW8)** can invest across the bond universe and has big exposure to US government bonds, although it includes Canadian, Australian and Korean government bonds too.

retirement already and living off their portfolio income, if they think about duration risk.

'Investors should be using index-linked bonds instead of nominal bonds, at least where you've got longer-dated stuff,' says **Capital Gearing Trust's (CGT)** co-manager, Chris Clothier.

'Outside of war and revolution, the only thing that really threatens an investor in government bonds is inflation, both on the bond and equity sides, as we saw in the 1970s.'



IMPACT ON EQUITIES

Rising rates tend to weigh on stock valuations, as they can drag on corporate profits and growth potential. This effect often plays out in anticipation of Fed action. As investors saw during the first half of 2022, stocks fell from their peaks as the Fed was just beginning its rate hike campaign.

This increase in real yields matters to stock market investors because it is a key input into the valuation models that are used to determine what is a fair value for a share, or indeed the market. It has a particularly negative impact on those shares that are expected to deliver lots of growth over many years because that future growth in earnings is worth less in today's money when it is 'discounted' back using a higher real yield.

DIFFERENT AREAS OF THE MARKET MAY REACT DIFFERENTLY

- **Growth stocks:** When interest rates are trending higher, it can clip the wings of pricey growth stocks, whose valuations are predicated on future returns. When rates go up, it instantly raises the bar on far-out profits needed to justify today's stock prices.

- **Dividend payers:** With bonds now offering investors potentially higher coupon rates and less risk, dividend payers may need to increase their yield to compete. Higher interest rates can also pressure corporate profitability and, therefore, make it harder to maintain and grow dividends, particularly for companies with large debts.

- **Financials:** The financial sector is one area where higher interest rates may serve as a tailwind since lenders can potentially earn more on loans. Historically, banks and financial institutions have outperformed the S&P 500 during periods of rising rates, according to data from Morgan Stanley.

Against a backdrop of persistent inflation, geopolitical turmoil and market volatility, investors may feel like they are navigating unfamiliar waters as the Fed continues to tighten policy. According to Morgan Stanley, this leads to several strategies that may be worth exploring, with the help of a financial adviser, or if you're confident enough in your own investment experience, on your own.

- Strategic bond investment. For many investors, fixed income remains an important part of a well-diversified portfolio. Bond laddering (buying bonds with different maturities) is one way to control the amount of exposure investors have to rising rates, while diversifying bond holdings.

- Actively managed strategy. Benchmark equity indices like the FTSE 100, S&P 500 and MSCI World have become dominated by a handful of mega-cap growth stocks, creating concentration risk for investors whose portfolios are heavily allocated to passive index funds. Actively managed funds are designed to outperform market benchmarks.

WHERE FUND MANAGERS SEE OPPORTUNITIES

'We think there are three things' investors need to consider in an inflationary environment - consumer discretionary spend, the effect of raised interest rates on a business, and the sort of qualities to look for in a business likely to be resilient in an inflationary environment,' says Stephen Yiu, manager of **Blue Whale Growth (BD6PG78)**.

Pressure on consumer discretionary spend is why the fund sold its stake in **Amazon (AMZN)** more than a year ago. Yiu much prefers the like of **Visa (V:NYSE)** and **Mastercard (MC:NYSE)**, which he argues 'should be resilient here as they continue to take their cut regardless of what sort of goods the consumer is buying - necessities, discretionary or otherwise'.

David Cumming, head of UK equities at Newton Investment Management, believes that the UK will outperform global indices this year, certainly against the US, as interest rates are going to peak, while inflation has peaked, in his view.

'I personally think we'll only get another 25-basis point hike in the UK, but Andrew Bailey is not the easiest guy to read. But in the US, it feels more like a war on rates, and we've not seen the US slowdown feed through into earnings yet.'

Some fund managers we spoke to were positive on banks on valuation grounds before the collapse of SVB. While they're even cheaper now, sentiment remains poor towards the sector so only the brave should consider fishing in that industry for opportunities.

Blue Whale manager Yiu likes parts of the financials space, although not banks. Businesses such as **Charles Schwab (SCHW:NYSE)** in the US will benefit from higher rates on cash held on deposit by their customers, are well positioned Yiu believes.

Capital Gearing's Clothier currently likes the energy space, which has seen oil exploration underinvested for years, in his view. 'Like it or not, oil consumption is going to remain at roughly 100 million barrels per day or more until 2030.'

Despite this **Shell (SHEL)** is trading on a forward price to earnings multiple of 6.1, he calculates.

Newton's Cummings also like the oil sector right now, although he is less sure about mining and commodity stocks. Retail he believes has already bounced but sees a potential opportunity in UK housebuilders once the Bank of England signals the end of rate hikes.

Healthcare, consumer staples, and enterprise technology are areas liked by Harries of Securities Trust of Scotland, who believes **Starbucks (SBUX:NASDAQ)** could be interesting. Luxury is also a space he is watching, cautiously. Once purely the preserve of the wealthy, that is no longer the case with millions of us buying upmarket branded clothes, make-up and jewellery, 'which may make them more exposed to the macroeconomic cycle than they once were'.

WHERE INVESTORS ARE LEFT

Optimism about an imminent strong economic recovery and a pivot by the major central banks looks premature. Markets, economies and central banks are still searching for a new balance, a new equilibrium that reflects structural transition, cyclical developments, higher inflation and interest rates, stricter monetary policy and loose fiscal policy.

The path to this new balance, wherever it may be, was always expected to be rough and volatile and not linear. In fact, major central banks are witnessing stubbornly high inflation and still very few signs that recent monetary tightening will destroy demand and hence bring down living costs.

'Every hiking cycle of the last 70 years has ended in recession or financial crisis,' said analysts at Morgan Stanley in a note, and 'after the last week we expect it's not going to be different this time'. A sobering thought.

What can investors do about this? Rebalance here and there. Trying to pull out of the stock market to avoid a 10% or 15% decline is not a realistic proposition for a couple of reasons, according to Fidelity.

First, the cost of moving in and out of the market will eat into the potential benefit of watching the final move lower from the sidelines.

Second, trading a market low requires two decisions, not one - selling and then buying back in. Human nature being what it is, most of us will fluff that second call.

Whatever the near-term outcome, market sentiment is starting to turn to the prospect of lower interest rates after a period of falling inflation. Lower oil and gas prices compared with last year and supply chain adjustments could also turn into tailwinds for growth and company profits moving forward.

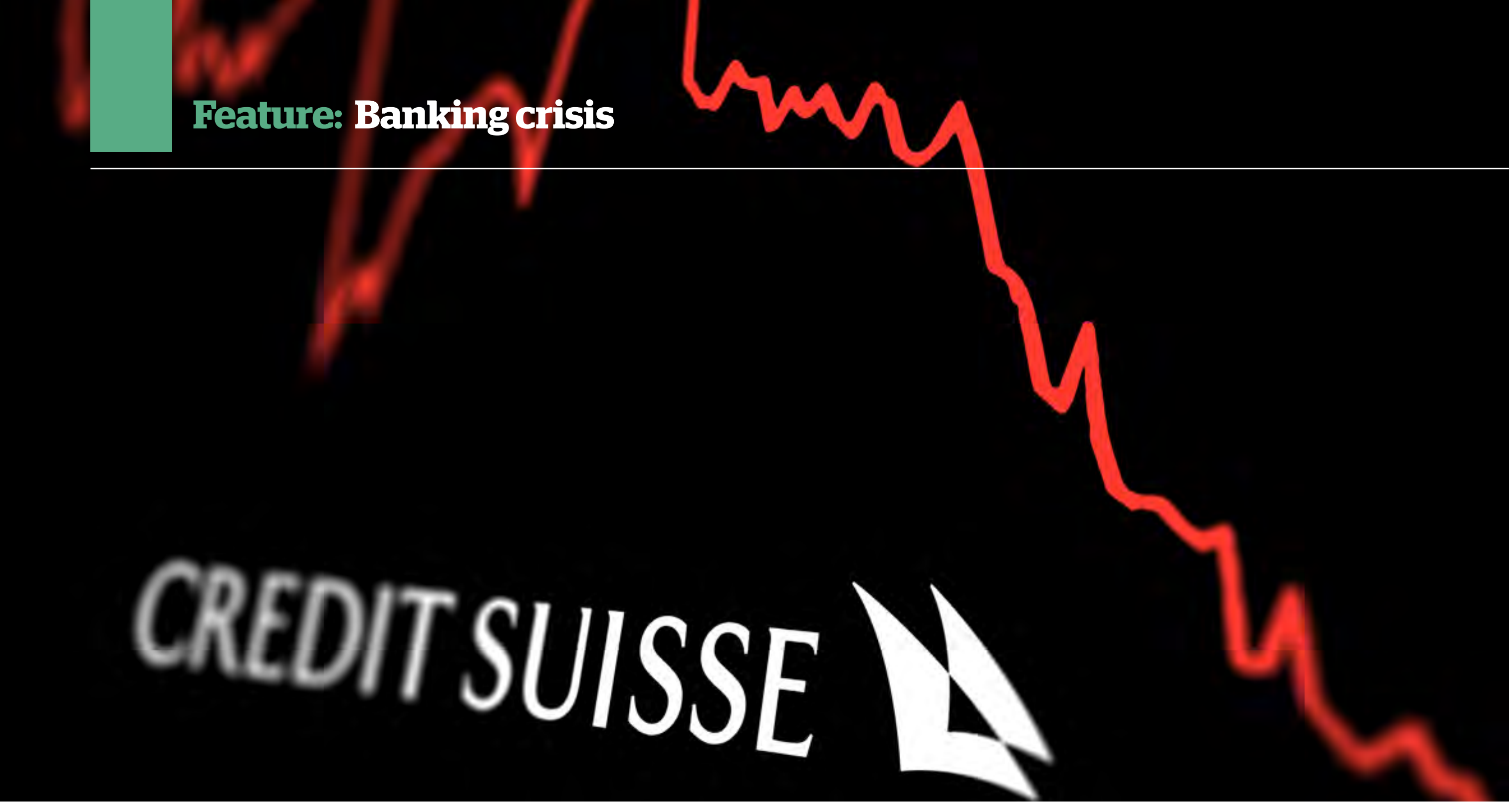
Elsewhere, the evidence mounts that green shoots are taking hold in the world's number-two economy. Business surveys in China (published by the National Bureau of Statistics at the start of March) have shown big jumps in production and new orders since the end of 2022, suggesting companies are gearing up for a sizeable post-Covid bounce.

Diversification can be essential to help smooth the ride for investors in turbulent markets. Consider the benefits of a diversified portfolio that's balanced across sector, region and market capitalisation, most experts say.

> **"Diversification can be essential to help smooth the ride for investors in turbulent markets"**

Capital Gearing's Clothier and his colleagues had previously written-off the 60/40 stock/bond portfolio strategy, but the current market dynamics has changed his mind. 'We think the 60/40 is really relevant, but you want to have the inflation protection on the bond part of the portfolio,' he says.

DISCLAIMER: Author Steven Frazer has a personal investment in Blue Whale Growth.



Why the Credit Suisse bailout has failed to calm investors' nerves

Holders of AT1 bonds sometimes known as 'CoCos' have been effectively wiped out

Another week, another bank failure, or so it seems these days.

News that ailing European lender **Credit Suisse (CSGN:SWX)** had been saved from insolvency over the weekend thanks to a take-over by its larger rival **UBS (UBSN:SWX)** should in theory have eased concerns of 'contagion' across the banking sector.

However, details of the rescue – and in particular the fact the regulator decided to mark the value of some of the bank's debt down to zero – have sparked new fears among bond investors over the value of some financial instruments should other banks get into trouble.

BONDHOLDERS BURNED

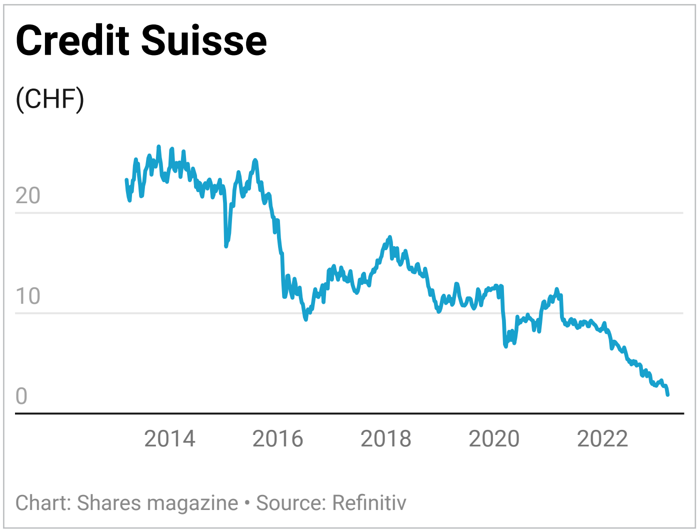
In an unprecedented move, the Swiss banking regulator FINMA allowed shareholders to preserve some of their equity in Credit Suisse – albeit not a great deal – at the expense of holders of the bank's Additional Tier One or AT1 bonds.

AT1s, also known as Contingent Convertibles or CoCos, are bonds issued by banks to boost the level of capital they hold to meet the requirements set by the regulator.

They typically carry a high rate of interest because the coupons are discretionary, so non-payment isn't considered a default, and in the event a bank gets into trouble the bondholders are given shares instead.

'AT1 bonds were introduced in Europe after the global financial crisis to serve as shock absorbers when banks start to fail', explains Charles-Henry Monchau, chief investment officer at Syz Bank.

'They are designed to impose permanent losses on bondholders or be converted into equity if a bank's capital ratios fall below a level, effectively propping up its balance sheet and allowing it to stay in business.'



According to the Swiss bail-in regime, AT1 debt normally ranks above equity in the event of bankruptcy, so the decision to write it down to zero – while it is strictly legal – is 'an arresting development' says Monchau.

The prospectus for Credit Suisse's 9.75% AT1 bonds stated that in the case of a 'contingency event' such as its Core Equity Tier One capital ratio falling below the required threshold, or a 'viability event' such as the bank becoming insolvent or unable to carry on its business, 'the full principal amount of each Note will be written down to zero' and 'the holders will be deemed to have irrevocably waived their rights to repayment of the aggregate principal amount of the Notes'.

HAVEN'T WE BEEN HERE BEFORE?

If all of this sounds familiar, it was fancy financial engineering and an alphabet soup of ABS (asset-backed securities), CDOs (collateralized debt obligations), MBS (mortgage-backed securities) and other novel instruments which brought down the banks, insurers and hedge funds during the great financial crisis.

Ironically, AT1s were part of a 'new regime' called Basel III designed to improve both the quantity and quality of capital held across the European banking system after governments and taxpayers had to bail out a number of lenders.

"This rapid shift in expectations and the sharp swing in short-term interest rates has triggered huge losses for investors"

To meet their minimum or 'core' equity capital, banks in the US were able to tap into the well-established preference-share market to top up their AT1 reserves, while European banks issued bonds instead.

Clearly, neither Credit Suisse, the regulator nor the bondholders ever envisaged a situation where their investment would be written off as, like so many other large lenders, Credit Suisse was considered 'too big to fail'.

With the benefit of hindsight, bondholders are now either trying to sell out of their AT1 bonds – the market is estimated to be worth $275 billion around the globe – or having to mark down their value in their portfolios as prices tumble.

UNINTENDED CONSEQUENECS

One major knock-on effect of the failure of Credit Suisse and the crisis of confidence in US regional lenders after the collapse of Silicon Valley Bank earlier this month has been a sudden about-turn in market expectations for interest rates.

Whereas many observers had expected the US Federal Reserve to increase its benchmark rate by another 0.5% this week, followed by further rises in the summer to head off stubbornly high inflation, most now expect the central bank to move rates up by 0.25% at the most and possibly cut rates later in the year if the economy shows signs of going into recession.

This rapid shift in expectations and the sharp swing in short-term interest rates has triggered huge losses for investors who were betting the Fed would keep ratcheting up rates this year.

According to a recent *Reuters* report, 'trend-following and macro funds, and CTAs (Commodity Trading Advisors), have been badly wrong-footed by the rates reversal, registering up to double-digit losses for the month by early last week'.

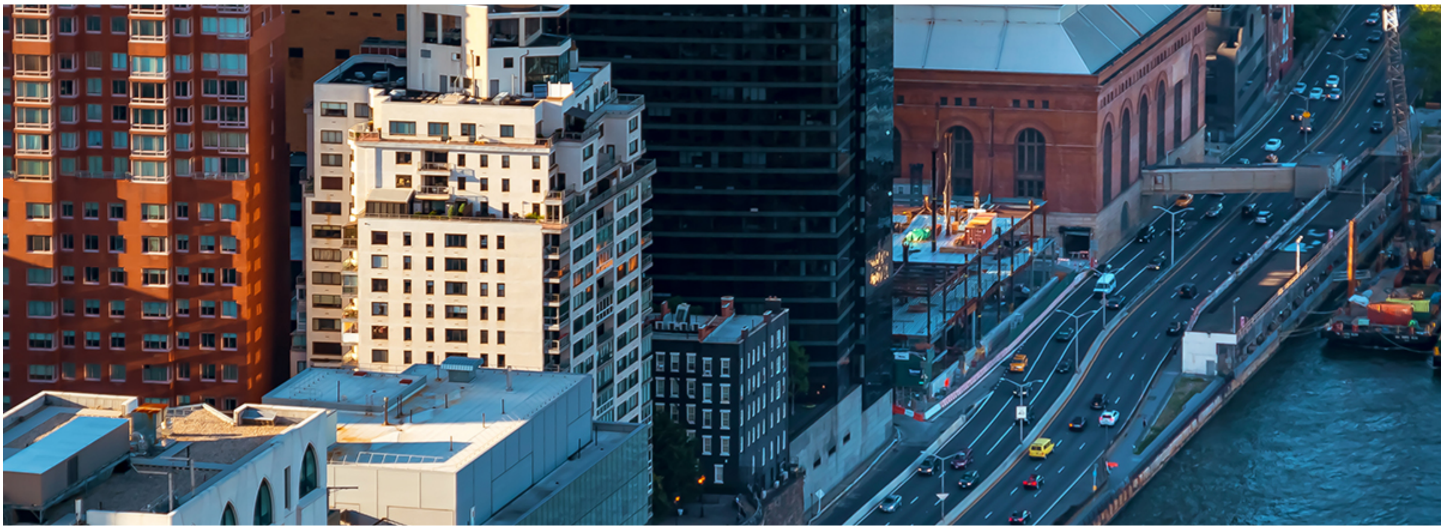
The report adds: 'The damage to investors of all stripes from the recent level of volatility in short-end US interest rates and bond yields cannot be overstated, and those with direct exposure will be hit especially hard.'

It is worth adding that at one stage there were $20 trillion of bonds trading at negative interest rates, which assuming they were held 'to maturity' on the banks' books could mean there are more losses hiding in the system.

By **Ian Conway** Companies Editor

Income in the USA

Fran Radano, Investment Manager, The North American Income Trust plc



- *The US Federal Reserve is likely to keep rates higher for longer, supporting more defensive positioning*
- *Income seekers have a wider range of options this year*
- *It is a better environment for 'value' companies, rather than high growth areas such as technology*

2022 created a new environment for income investors. After a decade where income was scarce, the US Federal Reserve ('Fed') raised interest rates eight times over the year. Financial markets saw a major adjustment. In bond markets, there was a significant rise in yields, in stock markets, high growth areas came under pressure, while 'value' areas thrived.

With 2023 well underway, the process of adjustment is largely complete. Investors continue to speculate about a potential Fed pivot that would see it ease its tightening policy, but it is increasingly clear that the past decade has been an anomaly. Interest rates are likely to remain at more normal levels by historic standards.

We believe financial markets are still too optimistic about the prospect of a pivot from the Federal Reserve in the second half of this year. The central bank will almost certainly keep rates at a higher level. It doesn't want to make another error by cutting too early and keeping inflation around. There are still significant pressures in the labour market and wages are rising. If there is a pivot, it is more likely to be because of significant bad news in the economy so may not be good for markets.

MARKET IMPACT

This leads us to a defensive tilt in **The North American Income Trust** portfolio. Rather than taking sector bets, we are looking for the strongest and more defensive options within each sector. Higher interest rates will push investors to look more closely at valuations. When the cost of capital is negative and companies have unlimited ability to tap capital markets, valuations don't matter as much, but with the Fed Funds rate at 5%, investors care about profitability once again.

We see ongoing support for more 'value' areas of the market – well-priced companies with strong balance sheets and cash flow. Given the strength of some growth areas over the past decade, there is still considerable adjustment to be made in spite of the outperformance of value companies last year. Growth companies still appear highly rated, even where their outlook is uncertain. The market does not appear to be factoring in the impact of a potential recession for many of these companies.

BUOYANT OUTLOOK FOR INCOME

The outlook for income is buoyant. There is certainly greater competition for capital now with higher quality bonds yielding 5-6%. Dividend portfolios tend to yield 3-3.5%. However, income strategies – including ours – strive to combine growth and income. In the Trust, we have limited exposure to 'bond proxy' areas. These are areas such as utilities that pay a reliable dividend year after year, but where that dividend doesn't grow significantly, giving them bond-like characteristics.

In contrast, many of the companies in our portfolio are growing their pay-outs at 5-10%. We have a progressive dividend policy, so aim to outpace inflation. That has been difficult over the past 12 months but should become easier over time.

Our portfolio holds 35-40 companies, allowing us the space to focus on companies' balance sheets, cash generation and conversion. Holding a long tail of companies can dilute the process. It is difficult to have real conviction in 70 or 80 ideas. This focus has helped us deliver real income resilience over time. We only had one dividend cut during the pandemic and it was small. The Trust has reserves of over a year's worth of dividends.

Every year brings a fresh set of risks. Last year, politics became a factor, as markets had to digest the impact of the mid-term elections. This year should bring less political noise, though there may be some volatility surrounding the debt ceiling, where both the Republican and Democrat parties need to sign off on the national debt.

2022 was a year of significant adjustment. While the stock market still has to face down significant challenges, the prospect of a more certain interest rate environment and weaker inflation should be beneficial. In the meantime, it is a better environment for income investors than it has been for many years. Given the outlook for valuation and interest rates, dividends are likely to become a more significant part of investors' total return.

Discover the beneficiaries of China's big reopening in 2023

Shares highlights potential winners as the country rolls back its Covid restrictions

China's rapid retreat from its zero-Covid policy in a bid to boost economic growth is one of the big investment themes of 2023 and is sure to provide a major boon for consumption in the so-called Middle Kingdom. Since November 2022, the government has dramatically reopened the Chinese economy and rolled back pandemic-induced restrictions that had been in place for three years.

While the end of zero-Covid has created challenges for the healthcare system – major cities such as Beijing and Shanghai have seen surging Covid infections – Chinese people are travelling once again and there are signs of recovery in consumer spending as well as in travel and tourism and on leisure activities, while the reopening should also benefit oil exporters as demand for energy increases.

Admittedly, new Chinese guidance for GDP (gross domestic product) growth has checked some of the optimism over any boost from the reopening, with the new growth target announced at the National People's Congress set at just 5% for 2023, at the bottom end of market expectations.

Nevertheless, three years of pent-up demand from 1.4 billion people is being released and the reopening, which is still in its early stages, should act as a positive catalyst for consumer-facing companies generating significant revenues in China.

Indeed, retail sales rebounded in January and February after Beijing abandoned its suffocating zero-Covid policy, reopening borders and ending mandatory quarantine. Growth of 3.5%, released by the National Bureau of Statistics, was much better than the 1.8% retail sales drop witnessed in December, demonstrating that the world's number two economy is picking up.

'REVENGE SPENDING' EXCITES

Rising affluence in China is generating fast growth in premium sectors within food, travel and cosmetics and the country's burgeoning middle class has increasing wealth and an appetite for top tier brands. Therefore, luxury goods purveyors are pinning their hopes on Chinese 'revenge spending' to boost demand, driven by domestic consumption and the fanning out of well-heeled Chinese tourists to cities such as London, New York, Paris and Milan.

Stocks to watch include luxury conglomerate **LVMH (LVMH:BIT)**, the sector goliath behind brands ranging from Dior, Tiffany and Louis Vuitton, as well as Gucci-to-Yves Saint Laurent owner **Kering (KER:EPA)**, Swiss luxury goods group **Compagnie Financière Richemont (CFR: SWX)**, behind the Cartier and Montblanc brands and **Hermes (RMS:EPA)**, the French design house famed for the iconic Birkin handbag.

The reopening is also helpful for **Burberry (BRBY)**, the trench coats-to-cashmere scarves seller which generated almost £1.28 billion of its revenues from the Asia Pacific region in the year ended 2 April 2022. That's comfortably ahead of the £696 million of sales seen in the Americas and

Burberry's revenue by region in 2021/22

Region	Revenue (£m)	Number of stores
Americas	**696**	83
EMEIA	**813**	111
Asia Pacific	**1,276**	224

Table: Shares magazine • Source: Burberry annual report. EMEIA = Europe, Middle East, India, Africa

the £813 million delivered in the Europe, Middle East, India and Africa (EMEIA) region.

And don't forget other beneficiaries such as high-end spirits giants **Diageo (DGE)** and **Pernod Ricard (RI:EPA)** and global cosmetics leaders **L'Oreal (OR:EPA)** and **Estee Lauder (EL:NYSE)**.

As Swetha Ramachandran, investment director, GAM Luxury Equities, argues, the near-term impact of the recovery of the Chinese consumer is underappreciated. 'In 2019, the Chinese consumer drove a third of the (luxury) sector's demand and 90% of its growth,' notes Ramachandran.

'The Chinese traveller has been virtually absent from the world stage for the last three years due to the Covid-19 pandemic. The decreased contribution of the Chinese consumer amounts to approximately €33 billion in absolute terms, thereby creating huge scope for catch up.'

Ramachandran adds: 'This is not a catch up which we think will take a long time. Rather, it is happening already, with queues forming at stores domestically and consumers beginning to spend their substantial accumulated excess savings. This is set to receive a further boost with the eventual resumption of outbound Chinese tourism.'

FUND MANAGERS' FAVOURITES

Zehrid Osmani, manager of **Martin Currie Global Portfolio Trust (MNP)**, points out that China accounts for around 50% of global luxury consumption. Yet despite zero-Covid limiting spending, the sector has remained resilient and top 10 holding **Ferrari (RACE:NYSE)** is 'positioned to benefit from pent-up demand as it reopens'.

Osmani notes Q4 2022 results from the iconic sports car maker 'exceeded expectations, with orders at an all-time high and revenue and EBITDA growth of 12% and 8% respectively. This was the first quarter featuring meaningful contributions from deliveries of the Purosangue SUV and the SP3 Daytona (Icona model). Both models are priced above the group average selling price and therefore accretive to margin.'

He adds: 'This ability to sell at high margins, even by luxury standards, sets Ferrari apart, as it prices its products at a 25% to 75% premium to its nearest competitors. Its focus on ultra-premium limited releases, investment in electric vehicles, and its first SUV in the Purosangue represents encouragement for growth in China, which already accounts for 9% of revenue.'

Also weighing in is Nicholas Price, manager of **Fidelity Japan Trust (FJV)**, who says 'Japanese retailers and consumer product companies that have a high earnings contribution from China stand to benefit' from the reopening and 'an accompanying recovery in consumption'.

Price sees 'significant growth potential' for a range of portfolio holdings 'that can capitalise on their competitive strengths and product appeal. **Fast Retailing (9983:TYO)** and **Ryohin Keikaku (7453:TYO)**, operators of the UNIQLO and MUJI brands respectively, and sportswear company **Descente (8114:TYO)** are key examples,' he enthuses.

In the manufacturing sector, he sees economic recovery in China and an 'attendant pickup in capacity utilisation' as positive for companies such as **Harmonic Drive Systems (6324:TYO)** and **MISUMI Group (9962:TYO)**. Finally, Price flags the prospect of 'a recovery in inbound demand with the eventual return of Chinese tourists to Japan, which would benefit urban retailers and various hospitality industries.'

Fidelity colleague Marcel Stotzel, manager of the **Fidelity European Trust (FEV)** and the **Fidelity**

Ferrari shipments by region in FY 2022

Region	%	Shipments growth (%)
Americas	**26%**	21.8
EMEA	**45%**	8.5
Mainland China, Hong Kong & Taiwan	**12%**	72.6
Rest of APAC	**17%**	17.1

Table: Shares magazine • Source: Ferrari 2022 results presentation. EMEIA = Europe, Middle East, India, Africa. APAC = Asia Pacific

European Fund (BFRT350), estimates that as China reopens there will be 'roughly 150 million outbound Chinese consumers returning, with many planning to visit Europe. Holdings in our portfolio that could benefit are luxury conglomerate LVMH, and **Amadeus (AMS:BME)**, a Spanish business that provides technology solutions for the travel industry'.

Stotzel says Amadeus 'uses its web across the travel industry to aggregate data and ensure things operate smoothly. The data analytics used to optimise the procedure of booking a flight, travelling to the airport, flying and staying in a hotel is very powerful. The company suffered through Covid, but it left the two biggest competitors in weaker positions and Amadeus is gaining material market share'.

OPPORTUNITIES IN SNEAKERS & CAPPUCCINOS

Also geared into the China reopening story are two of corporate America's best-known brands, **Nike (NKE:NYSE)**, the world's largest sportswear company, and Seattle-based coffee roaster and retailer **Starbucks (SBUX:NASDAQ)**.

China is Nike's third biggest market by sales, where the sneakers-to-soccer balls behemoth does face competition in China from homegrown competitors including **Anta (2020:HKG)** and **Li Ning (2331:HKG)**, the latter founded by the eponymous former Olympic gymnast Li Ning.

But neither brand has the international cache of Nike, which offers investors a great way to play trends towards health and fitness, the casualisation of fashion and the growth in athleisure.

Based on Stockopedia data, Nike is expensive, shares swapping hands for 37.1 times forecast

2023 earnings falling to 29.3 times on 2024's estimates, but we believe Nike merits this premium as it will remain the world's preferred sportswear brand for years to come given its strong brand, scale and digital savvy.

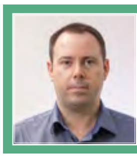
Second quarter (20 December) sales and earnings smashed analysts' estimates as sales in largest market North America surged 30% higher, offsetting weakness in China, where quarterly sales dropped by 3% year-on-year. Nike was set to post third quarter results as *Shares* went to press on 21 March.

Behind the US, China is the second biggest market for coffeehouse colossus Starbucks, whose sales and earnings in the first quarter ended 1 January 23 fell short of analysts' estimates as Covid-related disruption in China impacted international sales.

While Starbucks generated impressive same-store sales growth in the US, its biggest market, comparable sales slumped 29% in China, the Flat White-to-Peppermint Mocha seller's second biggest market, where it has over 6,000 stores and counting.

Starbucks' shares aren't cheap, trading on 29.2 times forecast 2023 earnings according to Stockopedia, but that rating drops to 24.3 times estimated 2024 earnings and there is scope for positive earnings surprises as the progressive dividend payer laps easy China comparatives.

Starbucks' founder and interim CEO Howard Schultz handed over the reins to well-regarded former **Reckitt Benckiser (RKT)** boss Laxman Narasimhan in March.



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

ADVERTISING PROMOTION

Fidelity European Trust PLC

Chosen by AJ Bell for its Select List

Fidelity European Trust PLC aims to be the cornerstone long-term investment of choice for those seeking European exposure across market cycles.

Aiming to capture the diversity of Europe across a range of countries and sectors, this Trust looks beyond the noise of market sentiment and concentrates on the real-life progress of European businesses. It researches and selects stocks with the potential to grow their dividends consistently, irrespective of the economic environment.

Holding a steady course throughout market cycles

It is an uncertain time for the world and particularly for Europe. It is however vitally important for investors not to be blown off course. Good companies are still good companies and finding them remains the 'secret sauce' of any effective investment strategy.

We will remain focused on the companies in which we have invested and, in particular, on their ability to continue to grow their dividends. As always, we will ask ourselves if that rate of dividend growth is already discounted in the share price.

We continue to seek new opportunities to add to the portfolio at the right price and remain confident in those names we currently hold. This approach has historically served the portfolio well - including through the recent volatility of the last few months - and we see no reason to change course.

To find out more visit www.fidelity.co.uk/europe

Performance over five years

	Feb 2018 - Feb 2019	Feb 2019 - Feb 2020	Feb 2020 - Feb 2021	Feb 2021 - Feb 2022	Feb 2022 - Feb 2023
Net Asset Value	2.4%	10.8%	11.3%	15.7%	14.4%
Share Price	2.8%	11.6%	13.9%	15.9%	14.6%
FTSE World Europe ex-UK Total Return Index	−3.3%	6.5%	14.4%	8.9%	10.0%

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 World Europe ex-UK Total Return Index is a comparative index of the investment trust.

Important information

The value of investments and the income from them can go down as well as up, so you may get back less than you invest. Investors should note that the views expressed may no longer be current and may have already been acted upon. Changes in currency exchange rates may affect the value of an investment in overseas markets. This trust can use financial derivative instruments for investment purposes, which may expose them to a higher degree of risk and can cause investments to experience larger than average price fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. 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.

The latest annual reports, key information documents (KID) and factsheets can be obtained from our website at www.fidelity.co.uk/its or by calling 0800 41 41 10. The full prospectus may also be obtained from Fidelity. The Alternative Investment Fund Manager (AIFM) of Fidelity Investment Trusts is FIL Investment Services (UK) Limited. Issued by Financial Administration Services Limited, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. UKM0223/381031/SSO/0523

What an escalating AI-powered search war might mean for media stocks

As Alphabet and Microsoft battle it out, new research highlights the longer-term impacts

First there was ChatGPT – the disruptive AI chatbot made by OpenAI (Chat Generative Pre-Trained Transformer) and now there are searches powered by AI (artificial intelligence) which could bring a revolution in digital advertising as well as spell the end of bog-standard online enquiries.

REINVENTING SEARCH

In early February 2023, **Microsoft (MSFT:NASDAQ)** and OpenAI introduced AI-powered Bing and Microsoft Edge, aiming to 'reinvent search' and take the market share from Google-owner **Alphabet (GOOG:NASDAQ)**.

By answering complex queries on the fly and acting as a user's 'co-pilot' for the web, AI has the potential to increase user time spent on the search engine home page and reduce click-through rates (CTRs) to websites, ultimately leading to lower traffic, creating a headwind for advertising and affiliate revenue models, according to recent research by Berenberg. Affiliate marketing is a process where publishers earn a commission by promoting a product or service made by another retailer or advertiser using an affiliate link.

In summary as giant tech companies like Microsoft, Google, **Meta Platforms (META:NASDAQ)**, **Amazon (AMZN:NASDAQ)** and **Apple (AAPL:NASDAQ)** develop AI-powered search this will having a knock-on effect not only for the consumer, but media publishers. Even if, for now, the full effects are still uncertain and some way off.

MEDIA BROWSER WAR

Microsoft seems to be winning the early skirmishes against Alphabet in AI-linked search. At the launch event for Google's ChatGPT competitor Bard on 8 February more than $100 billion was wiped off Alphabet's market value after it flagged incorrect information about the James Webb Space Telescope.

In contrast, on 16 March, Microsoft launched its AI office co-pilot for Microsoft 365, which includes Word, Excel, PowerPoint, Teams, and Outlook.

AI will offer a draft in these applications 'speeding up content creation and freeing up workers' time,' the tech giant said. Microsoft shares reacted positively to the news on that day rising 4% to $276.20.

In terms of names exposed to AI search – Microsoft, Alphabet, Amazon (which has already incorporated several AI-powered features into its Amazon Web Services business) or Apple. The consumer electronics giant has bought many private AI companies over the past three years, these investments could augment several of their products and services, such as Siri, facial recognition, and possibly augmented/virtual reality, says Morningstar strategist Abhinav Davuluri.

In terms of the businesses which are likely to be impacted by the development of AI-driven online searches, LADbible owner **LBG Media (LBG:AIM)** and financial services comparison

Google is highly dominant in the search space - global search market share Feb 2023

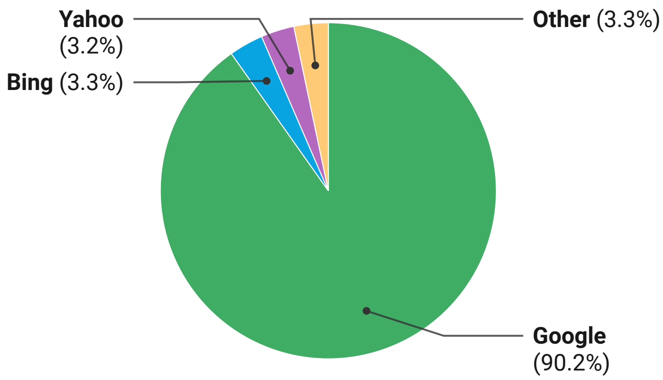


Chart: Shares magazine • Source: Berenberg, Jumpshot

website **Moneysupermarket (MONY)** are relatively insulated from negative impacts according to Berenberg. The investment bank notes LBG Media 'will escape the headwinds of AI-powered search due to its focus on social and video'.

LBG has in total 168 million followers across all its brands' websites and social media channels. In 2018, LBG entered into an agreement in 2018 to share revenue from in-video advertising within Facebook.

In Berenberg's view, online marketing specialist **CentralNic (CNIC:AIM)** is 'not only protected from the core risks posed by Search 2.0' but 'may even benefit from the disruption to other digital advertising models'.

For publisher **Future (FUTR)**, the acceleration of AI-powered search could be significant. Future generates 63% of its online traffic from organic search and 35% of group sales stem from B2C (business to consumer) advertising and affiliate revenue.

REDUCING EDITORIAL COSTS

One potential use for AI for publishers will be to reduce editorial costs and make their business models more cost efficient.

The use of AI to write editorial content is probably more relevant for generalist publishers that focus on 'soft news' summaries (for example, traffic, weather, gossip, etc) and the creation of personalised content for audiences (for example quizzes, personalised stories), rather than hard-news journalism or specialist publishers whose entire value proposition is to be an authoritative voice on a subject or vertical.

Berenberg says: 'We do believe there is scope for AI to help with the cost, time-to-market, and optimisation of ad creative development.'

BuzzFeed said it would rely on ChatGPT to enhance its quizzes and personalise some content for its audiences.

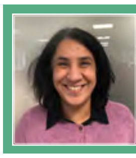
London-listed regional publisher **Reach (RCH)** with brands such as the *Daily Express*, *Daily Mirror*, and *Liverpool Echo*, is also exploring how AI can support its editorial teams.

In an interview with the *Financial Times*, Reach CEO Jim Mullen said that the company had 'tasked a working group, across our tech and editorial teams, to explore the potential and limitations of machine-learning such as ChatGPT,' adding 'we can see potential to use it in the future to support our journalists for more routine stories like local traffic and weather or to find creative uses for it, outside of our traditional content areas'.

IRONING OUT THE FLAWS

There may be drawbacks to using AI-powered search for the consumer in terms of accuracy. For now AI-powered search can throw up random results and AI-writing might be awkward, stilted and not make sense. This may be because AI-powered search is in its initial stages.

Morningstar senior equity analyst Dan Romanoff says that while products like Bard AI and ChatGPT are a more advanced version of AI than the public is used to, it's not too different from the basic forms of AI consumers have been able to interact with over the past decade, such as Siri or Alexa, or even just basic search engines.



By **Sabuhi Gard** Investment Writer

THIS IS AN ADVERTORIAL

RIGHTS AND ISSUES: COMBINING STRONG HERITAGE WITH NEW RESOURCES

Rights and Issues Investment Trust plc was launched in 1962 but has now appointed Jupiter as investment manager. Dan Nickols and Matt Cable, managers since October 2022, answer questions about their strategy.

Dan Nickols

Matt Cable

Since being appointed investment adviser to Rights and Issues, have you changed the way it is managed?

Our predecessor, Simon Knott, had a very successful 39-year tenure. We plan to retain the core principles that have made Rights and Issues so successful over the last four decades. Our approach is to retain the best of the heritage of the Trust, and combine it with the benefits of a large, well-resourced investment team.

Jupiter's UK small and mid-cap equities team has nine investment professionals as well as a dedicated Environmental, Social & Governance (ESG) Investment Director. We believe we are one of the largest and best-resourced small cap teams in the UK market. In a part of the market that is often under-researched by both buy- and sell-side analysts, this is a key differentiator.

It means a step-change in the resource available to Rights and Issues. Jupiter offers a market-leading investment platform, with dedicated teams of dealers, risk experts, data scientists and all the infrastructure you would expert of a leading asset management company. As well as the Trust's own board, this means Rights and Issues will also benefit from the oversight structures Jupiter has in place for all its investment products.

We are combining that with the Trust's strong heritage. We think this has the potential to offer long-term investors something different and compelling.

You say the best of the heritage will be retained - can you give an example?

A concentrated and high-conviction approach has been a hallmark of Rights and Issues over the years, and we plan to continue in that tradition. We expect the portfolio to remain concentrated, in the region of 20 to 30 stocks.

The closed-ended structure of an investment trust brings the advantage of not having, as in an open-ended fund, daily flows of investor money. This means the Trust can cope with greater volatility and lower liquidity in the shares it holds. It allows us to bring greater focus to bear. We can concentrate on a smaller number of our highest conviction ideas.

We will continue to invest in good companies that we can hold for the long term, aiming to generate value for shareholders over time – we will not be looking for short-term trading opportunities.

The Trust will not use leverage (such as for example borrowing money, or using derivatives) and will aim to provide a steady and, hopefully, growing dividend stream. While we are external managers, the Trust retains its independent board to provide strong oversight. Simon Knott sits on the board and will no doubt keep a very close eye on our stewardship of his legacy.

OK, so what are you planning to change?

Over time, we are planning to change the balance of the portfolio. When we took over as managers in October 2022, the top 10 holdings accounted for about 84% of its assets. As of the end of January 2023, that was down to around 71%, and we expect it to come down somewhat further.

At the other end of the portfolio, we are keen to make sure that all positions are of a size that can be meaningful to performance. We believe very strongly in responsible ownership, so are likely to spend as much time engaging with a company that is a tiny holding as with a large one. With a tiny holding, any improvement we help to bring about through engagement does not contribute much to overall Trust performance – simply because that holding is only a small portion of the portfolio. We have therefore reduced the number of holdings worth less than 1% of the portfolio from nine to four and expect to make further progress.

Apart from the overall shape of the portfolio, what other changes can we expect?

We are in the process of focusing our holdings on the part of the market where we believe we have an edge – the small and mid-cap companies we research as a team. For this reason, we have begun the process of reducing holdings in stocks that are too large in market cap terms for this kind of mandate.

JUPITER
ASSET MANAGEMENT

At the smaller end, we are unlikely to hold very small companies in the long term. The reason for this is that it is difficult in practice to hold them in sufficient size to make the positions meaningful to overall Trust performance. Again, we have started to make some progress in this respect and now have only two holdings with a market cap below £50m, down from four when we took over management.

The final aspect of the portfolio we are developing is its balance in terms of sector and style exposures. The Trust has traditionally been run with a distinct skew towards certain sectors – for example industrial and engineering business. We plan to broaden its exposure by adding investments in sectors which have tended to be under-represented, such as financial services. As well as helping to diversify the portfolio, this is could help ensure that our shareholders benefit from the sector-specific expertise we have in the team, by capturing the best ideas we have in each area.

Finally, do you have any message for current shareholders?

We are honoured to be appointed to what in our view is one of the most successful and venerable Investment Trusts in the UK small cap sector.

We plan to retain the core principles that have made Rights and Issues so successful over the last four decades under Simon Knott. We are taking a very considered approach to evolving the portfolio, and indeed we expect to retain a significant number of the holdings we inherited in October.

We are excited to be taking on the Trust at this time. On a medium-term view it does appear that the risk of a deep or prolonged recession has reduced somewhat. Progress on a long-term trade deal for Northern Ireland, and a generally more pragmatic approach from the UK government, suggests that we may see a period of relative calm which should allow UK equities to close up some of their valuation discount to global peers.

[1] The growth theme means investment in companies that have relatively faster-growing revenues. The value theme means investment in companies that have relatively cheaper share prices in relation to their earnings or balance sheets.

The principal risks are as follows:

Market risk – the portfolio will be invested predominantly in listed equities and therefore will be exposed to a range of market risks including economic conditions, market disruptions, accuracy of company information, global health crises, competition and volatility

Idiosyncratic risk – the portfolio will be concentrated and therefore will be exposed to the idiosyncratic risks of each underlying investment

The portfolio will be exposed to liquidity risk given the focus on smaller companies.

The portfolio will be exposed to interest rate risk both as a consequence of any financial leverage within the underlying investments and as a consequence of the impact of interest rates on the market valuation of companies.

Currency exposure – The portfolio may invest in companies whose revenues, profits and / or balance sheets may have exposure to foreign currencies.

New issues – The AIFM on behalf of the Company may invest in new issues which can pose additional risks related to transient illiquidity, lack of trading history and concentration of ownership.

Corporate management and financial reporting risk – The AIFM relies on financial information made available by the companies in which it invests. This information may not be independently verified by the AIFM. Corporate mismanagement, fraud and accounting irregularities relating to the underlying investments may result in material losses.

DISCLAIMER

Important Information

Market and exchange rate movements can cause the value of an investment to fall as well as rise, and you may get back less than originally invested.

We recommend you discuss any investment decisions with a financial adviser, particularly if you are unsure whether an investment is suitable. Jupiter is unable to provide investment advice.

Investment trust companies are traded on the London stock exchange, therefore the ability to buy or sell shares will be dependent on their market price, which may be at a premium or discount to their net asset value. Before making an investment decision, please read the PRIIPS Key Information Document which is available from Jupiter on request and at **www.jupiteram.com**.

Past performance is no guide to the future.

Company examples are for illustrative purposes only and are not a recommendation to buy or sell.

The Company currently conducts its affairs so that its shares can be recommended by Financial Advisers to ordinary retail investors in accordance with the Financial Conduct Authority's (FCA) rules in relation to non-mainstream pooled investment products and intends to continue to do so for the foreseeable future.

The Company's shares are excluded from the FCA's restrictions which apply to non-mainstream pooled investment products because they are shares in an investment trust.

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Why a company's longevity is important to some of the best fund managers

Businesses often stand the test of time for a good reason

Given some of the most successful fund managers go to the trouble of calculating the average age of companies in their portfolios it is fair to conclude it is an important characteristic of how they invest.

In this article we look at why longevity in companies matters and identify some of the oldest firms across the UK, Europe, and US. Later in the article we look at some of the oldest investment companies in the UK.

Terry Smith's **Fundsmith (B4MR8G8)** fact sheet shows the average founding date of companies across its 27 holdings is 1922, or 101 years.

Nick Train, founder of **Finsbury Growth and Income Trust (FGT)** calculates the average age of companies in its portfolio is 115 years.

FGT's largest holding **RELX (REL)** is the result of a merger between Reed International and Dutch firm Elsevier which dates to 1880 while the third largest holding is **London Stock Exchange Group (LSEG)** which was founded in 1801.

Fund manager Christian Diebitsch, founder of Heptagon Capital also has a penchant for companies which have been around for a long time.

One of the key criteria Diebitsch looks for in these businesses is 'their end-markets' need to continuously grow by value and by volume. 'That way they are unlikely to become mature or turn into cyclical businesses' the fund manager told *Shares*.

The average age of the companies across the **Heptagon European Focus Equity Fund (BTP3468)** is 90 years and the oldest is luxury brand **Hermes International (RMS:EPA)**.

Other holdings which Diebitsch has held 'pretty much forever' include medical technology company **Coloplast (COLO-B:CPH)** beauty products giant **L'Oreal (OR:EPA)** and Swiss premium chocolate maker **Lindt & Sprüngli (LISN:SWX)**.

Some of the UK's oldest companies

	Founded	Age (yrs)
Barclays	1690	333
GSK	1715	308
Natwest Group	1717	306
Lloyds Bank	1765	258
Intercontinental Hotels	1777	246
Reckitt Benckiser	1819	204
Pearson	1844	179
Prudential	1848	175
BHP Group	1851	172
Smith & Nephew	1856	167

Table: Shares magazine • Source: Stockanalysis.com, Google

One trait which connects these fund managers is their preference for predictable and durable earnings.

The thinking is that if a company can survive events such as world wars and pandemics, the chances are good it can continue to prosper not matter what the future holds.

Because these fund managers envisage sticking around as shareholders for decades to squeeze as much benefit as possible from compounding earnings, durability and predictability are essential attributes of the investment case.

There is a phenomenon pertaining to longevity which supports the case for investing in companies which have stood the test of time. The Lindy Effect

Some of the oldest European companies

	Founded	Age (yrs)
Hermes	1837	186
Siemens	1847	176
Carlsberg	1847	176
EssilorLuxottica	1849	174
Banco Santander	1857	166
Heineken	1864	159
Nestle	1866	157
Elsevier (Relx)	1880	143
Allianz	1890	133
Philips	1891	132

Table: Shares magazine • Source: Stockanalysis.com, Google

Some of the oldest companies in the US

	Founded	Age (yrs)
Bank of New York Mellon	1784	239
State Street Corp	1792	231
JPMorgan Chase (Chase)	1799	224
Colgate-Palmolive	1806	217
John Wiley & Sons	1807	216
Philip Morris Int'l	1847	176
Pfizer	1849	174
Procter & Gamble	1837	186
John Deere	1837	186
Smith & Wesson	1852	171

Table: Shares magazine • Source: Stockanalysis.com, Google

is the idea that the older something is the more likely it will stick around in the future.

In his book *Antifragile*, investor and writer Nicholas Taleb described the Lindy Effect in the following way: 'The robustness of an item is proportional to its life.'

NO CYCLICAL EXPOSURE PLEASE

A preference for dependability means avoiding speculative and cyclical businesses which may have their 'day in the sunshine' during economic expansions but eventually falter in some way.

Research by Hendrik Bessembinder evaluated lifetime returns for every US stock from 1926 to 2015. One of its surprising findings is the average life of a company which turns out to be a meagre seven years.

The standout finding from the research is that the top 1,000 performing stocks (around 4% of the total) accounted for all the wealth created, estimated to be $32 trillion. The other 96% only matched the return from one-month Treasury bills (a short-term US Government debt obligation).

The startling conclusion makes it clear that outstanding companies are relatively rare. Searching for them among those which have already demonstrated a pedigree and staying power seems like a winning investment approach.

An investment case is usually multifaceted, and longevity and durability are only part of the wider story.

There are no guarantees that older businesses will not run into trouble and the banks which feature in the tables are a good reminder of this.

Healthcare and personal goods companies are well represented which suggest they continue to be reliable and dependable. Likewise, some luxury goods and alcoholic beverages firms clearly demonstrate staying power.

Publishing is an old business and the appearance of **Pearson (PSON)** and **John Wiley & Sons (WLY:NYSE)** suggests they can be decent businesses despite the challenges from a structural shift online.

Pearson was a holding in Finsbury Income and Growth trust for 18 years until it was sold in the spring of 2022.

THE OLDEST INVESTMENT TRUSTS

Interestingly the oldest investment trusts have been around longer than some of the UK's oldest surviving companies. While their original purposes have since morphed into other more relevant investment areas, their long tenures suggest they have a key role to play for investors.

A handful including **Bankers (BNKR)** and **City of London Investment Trust (CTY)** have increased their dividends every year for the last 50 years.

Investment trusts are closed ended companies which means the capital they have is permanent, provided they maintain the support of shareholders and the board of directors.

The shares trade on the stock market just like other companies and their value can differ from underlying net asset value, creating premiums or discounts.

The oldest trust is **F&C Investment Trust (FCIT)** which dates to 1868, the same year as the discovery of helium.

It originally focused investing in foreign and colonial government bonds but is now a diversified investor in global stock markets.

The **Dunedin Growth Income (DIG)** trust was Scotland's first investment trust and the brainchild

The oldest UK investment trusts

	Founded	Age (yrs)
F&C Investment Trust	1868	155
Dunedin Income Growth	1873	150
Scottish American	1874	149
Bankers	1888	135
City of London	1888	135
Alliance	1888	135
JP Morgan American	1882	141
Mercantile	1885	138
Scottish Mortgage	1909	114
Witan	1909	114

Table: Shares magazine • Source: Stockanalysis.com, Google

of Robert Fleming. It was launched in 1873 to finance the building of the railway network and originally named The Scottish American Investment Trust.

In the same year he founded Flemings, one of London's most famous merchant banks. Today it is part of JP Morgan Asset Management.

Alliance Trust (ATST) was launched in 1888 and originally founded as a mortgage bank lending to pioneer farmers in the northwest of the US.

The founders of Baillie Gifford launched **Scottish Mortgage (SMT)** trust in 1909 to offer mortgages to Malaysian rubber plantation owners eager to satisfy demand coming from **Ford Motor (F:NYSE)** company which was rolling out its Model T car.

By **Martin Gamble** Education Editor

What should your investment portfolio look like in your 70s?

You should be weighed towards safer income and capital protection rather than growth

This article follows on directly from [last week's look] at investing in your 60s by moving forward a decade to identify the factors affecting investors in their 70s.

By this age most investors will be retired or are very close to giving up on full-time work. The article assumes an investor has entered drawdown rather than purchasing an annuity which converts a fixed lump sum into a monthly income for life. Although beyond the scope of the article it is important to consider the most tax efficient way to take retirement income including taking advantage of the 25% tax free lump withdrawal.

At 70 years of age, with good luck and judgement, and no income withdrawn, a typical share-only investment pot would have just about doubled from a decade earlier assuming long-term annual total equity returns of around 7% a year.

As discussed in the previous article the average life expectancy for women is 87 years while for men it is 84 years which means there is still plenty of investment runway ahead, assuming good health.

But while it made sense to keep a good proportion invested in stocks and shares at 60 years of age, beyond 70 it becomes more important to strike a conservative balance between safer fixed income investments, cash and shares.

The main reason is related to the uncertainty and volatility of stock markets which can move down unexpectedly and temporarily reduce the value of your pot at the most inconvenient times.

This puts a premium on constructing a portfolio which balances the need to generate income, offers an element of capital protection whilst also not ignoring the need for some capital appreciation.

MEDICAL COSTS CAN BE EXPENSIVE

Age-related illnesses become more likely with the passage of time and can strike unexpectedly. Keeping a progressively higher cash balance as you move through your 70s is a prudent step towards meeting increased medical expenses and dialling down your risk exposure.

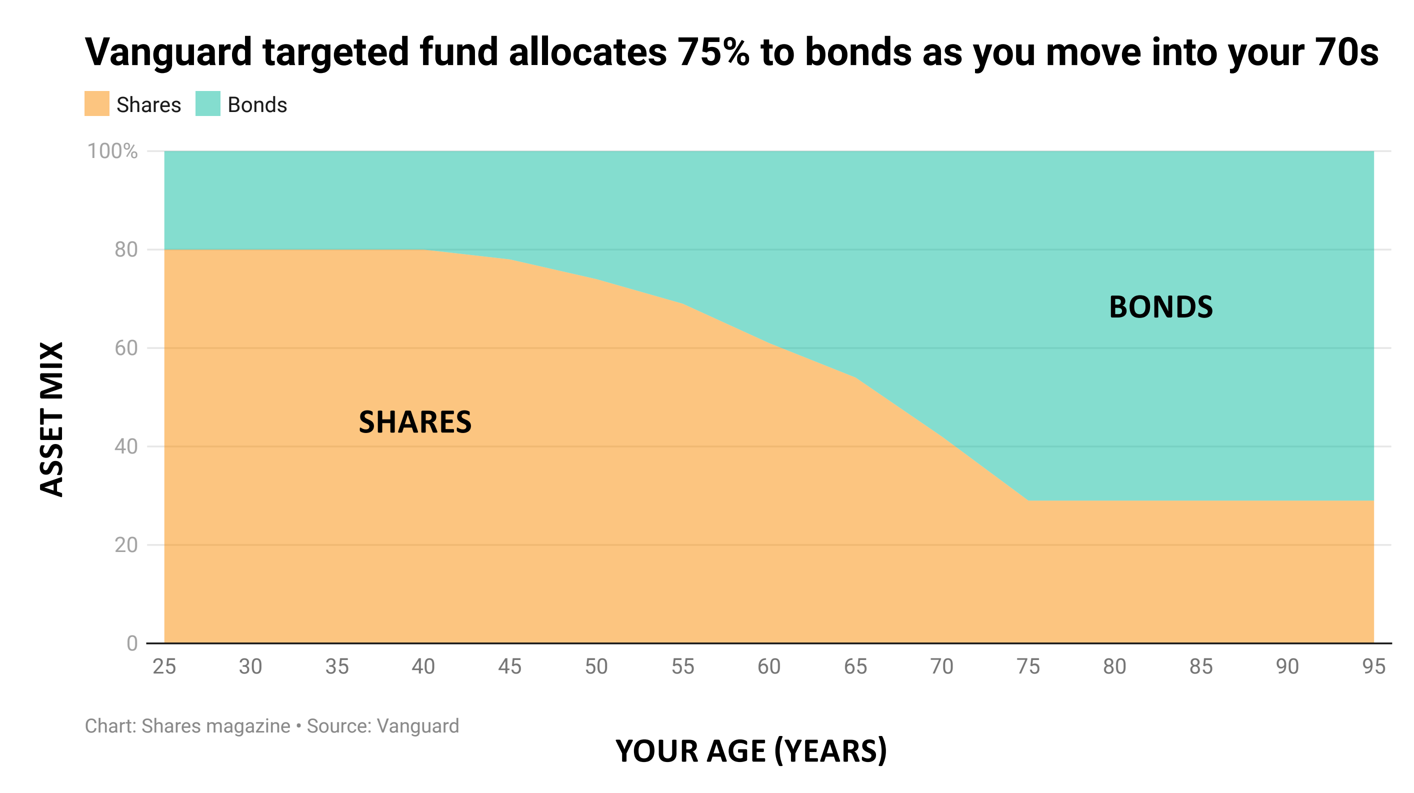
It is worth pointing out that care home costs can be expensive depending on the facilities and location. From October 2023 the government will introduce a new £86,000 cap on the amount anyone in England will need to spend on personal care over a lifetime. The point at which people become eligible to receive support will increase from £23,250 to £100,000.

People with less than £100,000 of assets will never contribute more than 20% of these assets per year. People with assets below £20,000 will no longer contribute from assets but only what they can afford from income.

ARE BONDS RISKY?

Although targeted funds are popular in the US for providing age-based retirement plans they have a mixed reputation.

They aim to allocate a bigger proportion to bonds as investors age to reduce risk. The Vanguard product allocates 75% to bonds from the age of 70 as the chart demonstrates.



Fixed income investing requires specialist knowledge and given bonds will typically comprise the bulk of a portfolio from the age of 70, it makes sense for most investors to access these markets through active and passively managed funds.

This can be done via dedicated bond funds investing in different parts of the fixed income markets or selecting specialist managers which are discussed later.

It is worth highlighting that bond markets had a horrible time over the last year caused by aggressive interest rate increases from central banks. Bond prices move in the opposite direction to yields.

This means bonds did not provide their customary protection against falling stock markets in 2022 with global bonds losing 14% of their value.

However, with 10-year UK government bonds yielding 3.4% and investment grade corporate bonds over 5% the landscape has changed dramatically over the last 12 months.

Bonds provide a decent income for the first time in decades and with the interest rate hiking cycle now likely in its late stages bonds have a good chance of re-establishing their traditional protection in falling stock markets.

Despite inflation appearing stickier than economists originally thought there are signs it is falling steadily. The OBR (Office for Budget Responsibility) said in last week's spring budget it expected inflation to fall to 2.9% by the end of the year and 0.1% by 2025. Falling inflation and interest rates should provide a positive tailwind for bonds.

BOND RISK LADDER

There is a risk spectrum to consider in bonds with government bonds being the least risky and high yield bonds the riskiest. Government bonds are also called gilts in the UK.

To compensate for higher risk, high yield bonds offer a spread over government bonds which is currently around 5%.

In the government bond markets longer dated issues are riskier than shorter dated ones. This means longer dated bond prices are more sensitive (both up and down) to a move in interest rates.

UK short dated two-year bonds yield 3.3% in line with 10-year bonds. Higher yields and income can be achieved by looking outside the UK to emerging markets, but they are riskier and exposed to currency effects which can wipe out the extra yield.

For investors looking to add bond exposure a good starting point is to consider the broad-based

Lxyor FTSE Actuaries UK Gilts ETF (GILS) which invests across the entire UK Gilts market. It has an ongoing charge of 0.05% a year.

Alternatively, for access to the shorter end of the UK market consider the **Lxyor FTSE Actuaries UK Gilts 0-5-year ETF (GIL5)** which has the same ongoing charge.

MOVING UP THE RISK LADDER

The investment grade corporate bond market offers a return over and above government bonds of around 1.5%.

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

The **iShares GBP Corporate Bond ETF (SLXX)** has a trailing yield of 2.74% and an ongoing charge of 0.2% a year.

An actively managed bond fund to consider which has the flexibility to invest across all types of bonds and is currently defensively positioned is the **Allianz Strategic Bond Fund (BYT2QW8)**.

MULTI-ASSET AND LIFESTYLE FUNDS

If the prospect of deciding an appropriate asset allocation is too intimidating, there are readymade asset allocation options available via 'one-stop-shop multi-asset funds and Lifestyle funds.

One Lifestyle fund to consider is the **Vanguard LifeStrategy 20% Equity Fund (B462029)** which invests 20% in shares and 80% in fixed income.

The £1.6 billion fund has a trailing yield of 1.5% and an ongoing charge of 0.22% a year. Just over a third of the fund is invested in UK and European assets, around a half in the US and the rest in Greater Asia.

For those looking for greater proportion in shares the **40-60 version (B41F6L43)** could be considered.

In the multi-asset space, there are funds available which limit their equity exposure to a maximum of 20%.

One of the best performers in this category is the **Fidelity Multi Asset Open Defensive Acc in GBP (BC7GXK5)**. The fund targets an annual total return after ongoing fees of 4% a year over a typical market cycle of five to seven years.

It has an ongoing charge of 1.01%, a trailing yield of 2.1% and has delivered a gain in net asset value of 10.87% over the last three years.

Currently the portfolio has a low 0.6% exposure to equities and its three largest positions make up close to half of the assets. The fund holds its bond exposure through two funds and some direct exposure to US treasuries.

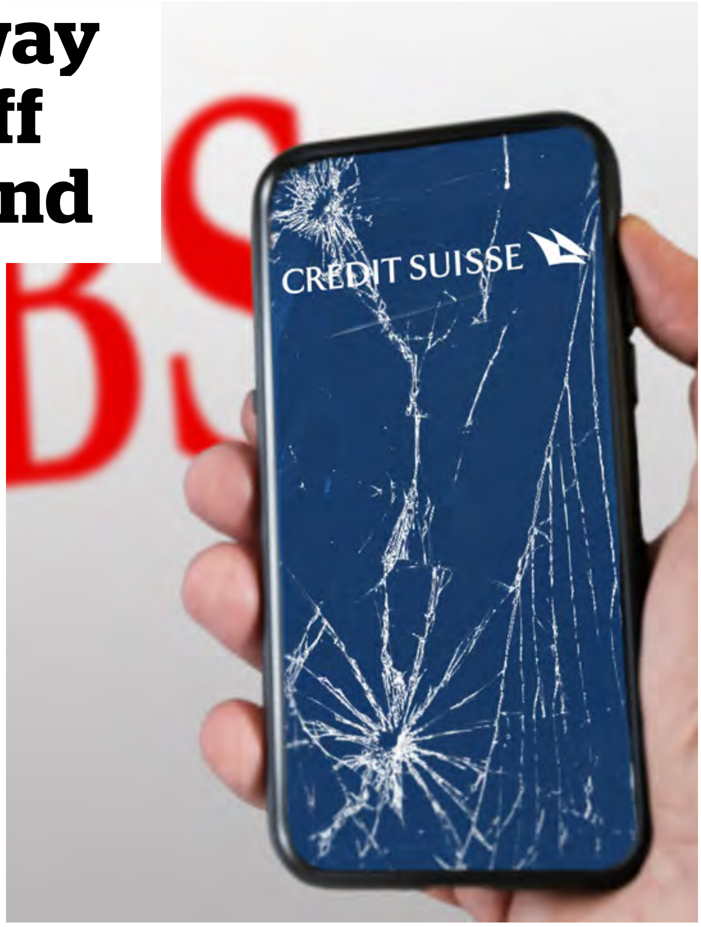
The largest position (34%) is a holding in the **Fidelity Global Aggregate Bond GBP Acc Fund (BC7GXK5)**. A further 11% of assets are in short term US treasury bonds and 10% of assets are invested in the **Jupiter Strategic Bond Acc Fund (B4T6SD5)**.

While this article has focused on the fixed income component of a portfolio, remember the portion in stock and shares could also be tilted towards dividend-payers to complement income while providing some capital growth.

By **Martin Gamble** Education Editor

Editor's View: Tom Sieber

Learning the hard way only to invest in stuff you really understand



Even the professionals sometimes lose sight of the fine details

The events of the past week have underlined the importance of only investing in things you really understand.

We look more deeply at the fallout from the **Credit Suisse (CSGN:SWX)** rescue job in a separate feature but a key reason it has not fully ended the concern over the banking system is the way holders of AT1 bonds or 'CoCos' have been wiped out.

If they'd read the small print on these instruments, they might have been aware of the risks but it seems many failed to do so. A colleague chatted to the manager of a bond fund not too long ago who happily talked about investing in these vehicles but then seemed unable to explain how they worked.

As an individual you could almost take some comfort from the fact even professionals can make these mistakes, yet it is somewhat worrying on a wider level. The great financial crisis arose in large part because institutions had invested in instruments where the risks were not fully understood.

As markets become more unforgiving it's going to be even more important to do your homework properly. The stress created by a rapid and aggressive increase in interest rates is starting to break things and you don't want to be stuck holding something which is vulnerable.

So often assets like AT1 bonds only come to the market's attention at times of market stress. Just look at how LDIs (liability-driven investments) were put under the spotlight off the back of the mini-Budget in September 2022 and few people knew what they were.

What does all this mean for the way you should manage your portfolio? Newcomers to the world of investing should consider testing the waters by allocating their cash to firms whose products they recognise, understand and can easily research.

Don't be afraid to admit that you feel out of your depth with certain parts of the investment world. There is nothing clever about leaping in with both feet only to face big losses.

This does not mean investments in more complex areas such as technology or natural resources are entirely off limits, particularly if you have relevant knowledge or experience, but they should be approached with more care and it is worth swotting up on key industry jargon before getting involved. Often it makes more sense to invest through a fund where you can spread your risks.

When entrusting your money to a fund manager, longevity is a key consideration. If the person at the helm has experienced a few market or economic cycles there is less risk of them getting caught up in putting cash into something without substance which is flavour of the month.

At the end of the day, it is no good pleading ignorance if you are caught out by investing in an area you didn't understand. Just ask holders of Credit Suisse AT1 bonds.

Finding Compelling Opportunities in Japan

AJOT
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.

Discover AJOT at www.ajot.co.uk

*Source CLSA and AVI, as at 31 December 2022.
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

Will Jeremy Hunt's childcare plan really make a difference for parents?

Who is eligible for the free hours and when the changes are being brought in

Jeremy Hunt unveiled a new plan to help parents with childcare costs at the Budget, but lots will be disappointed to miss out as the full scheme won't be in place until late 2025.

The chancellor said that parents will be able to access 30 hours of free childcare a week, per child, from the time their child is nine months old. Currently parents of three and four year olds get 30 hours free but those with younger children get nothing.

WHEN IS THE SCHEME COMING IN?

The Government is rolling out the scheme gradually, to ensure that the nurseries aren't inundated with requests for spaces and that there isn't too much demand and not enough supply. It means that from April next year parents of two-year-olds will be able to claim 15 free hours a week. From September next year those with children nine-months-old to two-years-old will get their 15 free hours and then from September 2025 everyone with a child nine months and older will get the full 30 free hours (until they reach school age).

WHO IS ELIGIBLE

There are some caveats as to who can claim the money. Both parents have to be working (or on sick leave or maternity/paternity leave) and they must work a minimum of 16 hours a week earning at least the minimum wage. This equates to earnings £1,976 across three months if you're aged 23 and over.

You also can't have an 'adjusted net income' of £100,000 or more. This generally is your income from salary, investments and dividends minus any pension contributions. This limit is per parent, not for a couple. So, a family with two parents each earning £99,000 would be eligible but a family with one working parent earning £101,000 wouldn't be eligible.

SO ARE THE CHANGES POSITIVE?

There is a lot of debate on this at the moment. Parents of toddlers now are frustrated that the system isn't coming in sooner, meaning many will miss out. It will actually be most beneficial for children who haven't even been conceived yet.

There is also some concern about how nurseries will deal with the changes. Currently the Government pays nurseries far less than the going rate for the 'free' childcare hours. It means nurseries have to charge parents a hodge-podge of different fees to top-up the Government money and ensure they can cover their costs and make a profit. The Government has pledged to increase the hourly rate it pays nurseries – but hasn't been explicit about how much per hour it will be paying.

The worry is that if the Government doesn't pay a sufficient hourly rate either nurseries won't be able to continue operating or parents will be charged top-up fees – effectively making the scheme far less effective.

The other worry is whether there are actually the spaces to meet the expected higher demand. This is why the Government is staggering the introduction of the scheme, to ensure the nursery sector can build up the supply to meet the demand. However, a recent study by charity Coram Childcare and Family found that only half of

local authorities said there was enough childcare provision to meet demand in their area.

DID THE CHANCELLOR ANNOUNCE ANYTHING ELSE ON CHILDCARE?

Hunt also said that nurseries can change the ratio of staff to children for two-year-olds, moving it from one carer for every four children to one to five. There is no obligation for nurseries to adopt this, but it's intended to free up more staff and mean that nurseries can take on more children (presumably to cope with the increased demand now more parents are entitled to free hours).

He also made two key changes to how people on Universal Credit can reclaim their childcare costs. For anyone increasing their work hours or taking on work for the first time, the Government will now pay the additional childcare costs upfront (currently the claimant has to pay for them and reclaim the money).

His next move was to increase the cap on the amount the Government will pay towards childcare costs. Currently the help parents can claim is capped at £646 a month per child and hasn't increased in almost two decades despite childcare costs soaring. It will now rise to £951 for one child and £1,630 for two children.

By **Laura Suter**
AJ Bell Head of Personal Finance

GLOBAL X ETFs RESEARCH

Robotic Adoption Gains Momentum

Authored by:
Global X Research Team

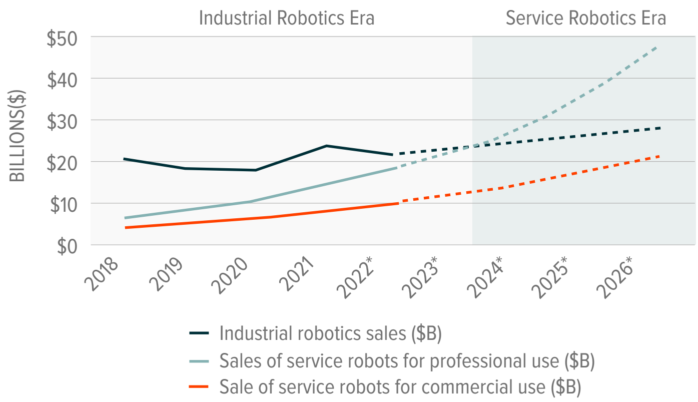
The growing use of robotics and artificial intelligence (AI) can be attributed to several factors, including technological advancements, falling costs, and demographic changes. This shift toward a more autonomous world is being felt across myriad industries and in our day-to-day lives. It's also a trend that is likely to accelerate.

From the COVID-19 pandemic and climate change to geopolitical tensions, exogeneous risks have forced companies to rethink their supply chains and labour pools. Against this backdrop, robotic solutions are increasingly attractive, especially when combined with lower implementation costs. The integration of more powerful AI programs makes the appeal even greater. With automation reducing onshore manufacturing and logistics costs, robotics could be a key beneficiary in the post-COVID world.

Potential use cases for these technologies explode outside of traditional industrial/manufacturing applications and range from assisting in surgical procedures to providing banking services without human interaction and more. In fact, sales of professional service robots, such as those used for delivery or health care applications, appear set to overtake industrial robot sales in 2023.[1] Numerous tailwinds are likely to drive adoption of these revolutionary technologies.

SALES OF GLOBAL INDUSTRIAL AND SERVICES ROBOTICS MARKET ($B)

Source: Guerry, Müeller, Kraus, & Bieller, 2021.

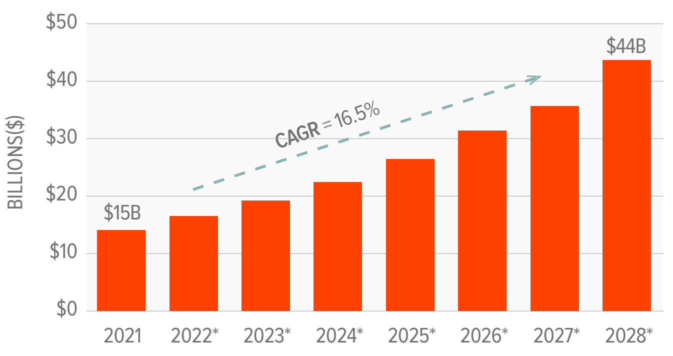


FALLING PRICES

The cost of robotics solutions has been decreasing in recent years, a trend that is expected to continue, thereby aiding adoption. For example, we estimate that the cost of industrial robots has decreased over 30% during the last two decades.[2] The relative cost of robotics and AI solutions has likely fallen even further. As labour costs climb due to staff shortages and inflationary pressures (according to the UK's Office for National Statistics, nominal unit labour costs in Q4 2021 were up nearly 10% versus 2019[3]), the cost of these twin innovations is coming down, fast.[4] That said, the purchase and installation of this technology typically still requires large capital outlays. Consequently, demand for a less burdensome way to gain exposure to robotics is rising, especially for small- and medium-sized enterprises, where short-term cost efficiency is often essential. Companies can now use robotics-as-a-service (RaaS) subscriptions to scale robotics into their manufacturing processes. They can lease units to reduce upfront costs and lower entry barriers to technological acquisition. The total addressable market for RaaS is expected to grow nearly threefold by 2028, as barriers to technology acquisition decline.[5]

GLOBAL ROBOT AS A SERVICE (RAAS) MARKET ($)

Source: Global X analysis of data derived from: Facts & Factors, 2022; Indeed, n.d.; U.S. Bureau of Labor Statistics, n.d.; Yates, 2021.



DEMOGRAPHICS

Through 2100, the birth rate per capita is expected to decline 38%, while the elderly population grows 218%.[6,7] Such a scenario would likely result in labour shortages, increased health care demand, and lifestyle changes. Robotics and automation have been viewed as a way to move forward when dealing with labour shortages. Not relegated to the manufacturing and construction industries, other labour-intensive sectors like elder care and assisted living could also embrace robotic solutions to help with daily operations, monitor health conditions, perform surgical procedures, and provide physical therapy.

TRANSPORTATION

One could argue that autonomous vehicles (AVs) are at the nexus of robotics and AI, and this technology continues to make strides, pointing to a potential future with driver-free ride hailing and robo-taxi services. Automakers are expected to invest nearly $50 billion in autonomous vehicle development through 2025.[8] Market share could increase rapidly, and AVs are forecast to reach 37% of new passenger car sales by 2035, potentially creating up to $400 billion in revenue.[9]

CONCLUSION: LONG RUNWAY FOR POTENTIAL GROWTH

The fields of robotics and AI have been advancing rapidly in recent years, with numerous applications in various industries, including health care, manufacturing, and transportation. We are confident that the demand for robotics and automation will remain strong, driven by disrupted supply chains, aging populations, decreasing costs, rising rates of adoption, and technological advancement. The global robotics technology market size was valued at $89.27 billion in 2022 and is projected to reach $225.6 billion by 2030.[10] Robotics and AI are still in the early stages of adoption, and growth is poised to accelerate. In fact, the market for AI-integrated robots is expected to increase at a compound annual growth rate of nearly 40% through 2026.[11] Overall, the future of robotics and AI looks promising, and we expect to see more applications and integrations of these technologies in a variety of fields in the years to come, likely resulting in some exciting investment opportunities.

RELATED ETF

BOTZ: The Global X Robotics & Artificial Intelligence UCITS ETF (BOTZ LN) seeks to invest in companies that potentially stand to benefit from increased adoption and utilisation of robotics and artificial intelligence (AI), including those involved with industrial robotics and automation, non-industrial robots, and autonomous vehicles.

Capital at risk. The value of an investment in ETFs may go down as well as up. Prospectuses and Key Investor Information Documents (KIIDs) for this ETF is available in English at https://globalxetfs.eu/funds/botz.

INTERESTED IN LEARNING MORE? EXPLORE OUR INSIGHTS AND SUBSCRIBE TO FUTURE UPDATES.

[1] Guerry, M., Müeller, C., Kraus, W. & Bieller, S. (2021, October 28). World robotics 2021 [PowerPoint slides]. International Federation of Robotics.

[2] Global X analysis of data derived from: Jurkat, A., Klump, R., Schneider, F. (2021, September 20). Tracking the rise of robots: A survey of the IFR database and its applications. Munich Personal RePEc Archive.

[3] UK Office of National Statistics. (2022, May 13). Labour Costs and Labour Income, UK: 2022.

[4] Forbes. (2022, Sep 17). Economist's View of Artificial Intelligence: Beyond Cheaper Prediction Power.

[5] Facts & Factors. (2022, March 14). At 16.5% CAGR, global robot as a service (RaaS) market size & share worth USD 44 billion by 2028 | service robotics industry trends & forecast report by facts & factors. Globe News Wire.

[6] United Nations, World Bank, Standard Projections of Fertility, Accessed December 2022.

[7] United Nations, World Bank, Standard Projections of Population, Accessed December 2022.

[8] McKinsey. (2023, January 6). Autonomous driving's future: Convenient and connected.

[9] Ibid.

[10] Precedence Research (2022, October). Robotics Technology Market.

[11] Markets and Markets (2023, January 19). Artificial Intelligence Robots Market.

Russ Mould: Insightful commentary on market issues

How three years of sound and fury on the markets signified nothing

Amid a banking crisis, assets which have soared since 2020 have come firmly back down to earth

The collapse of Silicon Valley Bank and the latest round of strife to engulf **Credit Suisse (CSGN:SWX)**, forced into a union with **UBS (UBS:SWX)**, are once more putting the spotlight on monetary policy and begging the question of whether central banks may already be running it too tightly, as they hike interest rates and seek to shrink their balance sheets through quantitative tightening or QT for short.

The two banks' weak risk controls are the biggest problem by far, as both institutions have been poorly run, but this column is inclined to suggest that another reason for their woes is not the sharp interest rate increases pushed through by central banks in the past year, but the lengthy period of ZIRP (zero-interest rate policy) and QE (quantitative easing) which preceded it.

A period of central bank manipulation to keep the cost of money artificially low – albeit you can argue for good reason in an era of the great financial crisis, the European debt crisis and Covid-19 – encouraged risk taking on an epic scale. As interest rates and bond yields rise, we are now discovering what may be the genuine cost of money, with the result that capital is again as risk appetite wanes and capital is treated with greater respect.

BACK TO THE FUTURE

Just look at the share price chart for Silicon Valley Bank. In the technology, media and telecoms bubble of 1998 to 2000 it soared from $15 to $65 but then collapsed and gave all of that back between 2000 and 2002 as the bubble burst. It then took the stock eleven years to get back to $65, only for it to then go wild amid of rush of technology floats and fresh deposits from newly minted (multi)millionaire entrepreneurs and soar to a peak of $753 in November 2021.

The 2020-21 boom in SVB shares way outstripped the 1998-2000 TMT bubble

Source: Refinitiv data

The 1998-2000 bubble paled into insignificance compared to the that of 2020-21 but the vibrant party has now given way to a hangover. SVB had crashed to $106 before the suspension of its stock.

But it is not just Silicon Valley Bank that shows this boom-and-bust pattern. Just look at the price charts of the rash of new listings that came to market (as benchmarked by a pair of US-listed exchange-traded funds, or ETFs); Special Purpose Acquisition Companies, set up to go for other, unspecified firms (where one specially-created ETF has already ceased to trade); and meme stocks, like **GameStop (GME:NYSE)** and **AMC Entertainment (AMC:NYSE)**.

Hot initial public offerings have turned cold

Source: Refinitiv data

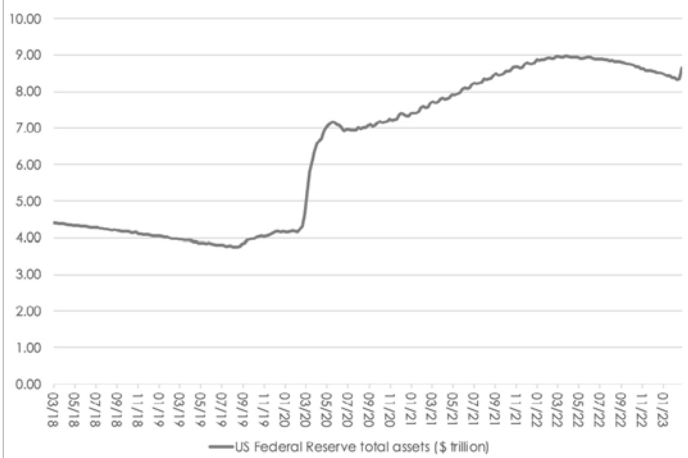
Meme stocks cannot seem to break a price trend of lower highs and lower lows

Source: Refinitiv data

Special Purpose Acquisition Vehicle Companies (SPACs) have lost their way

Source: Refinitiv data

The Federal Reserve's balance sheet is expanding again



Source: Refinitiv data

It is almost as if the last three years never happened. Prices that went up like a rocket have come down like the stick, back to where they were, if not lower. The tide of cheap liquidity that carried these assets higher has started to go out and, as Warren Buffett noted: 'Only when the tide goes out do you discover who has been swimming naked.'

NO EASY EXIT FROM ZERO RATES

These asset price drops, last autumn's gilt market chaos and now banking shivers show it may not be easy for the central banks to extricate themselves from ZIRP and QE without something breaking somewhere. The US Federal Reserve's balance sheet is starting to expand again, although this is because of banks tapping it for liquidity rather than a return to QE.

Markets have been baying for a pause in interest rates and then a pivot to rate cuts, but in the hope of a cooling in inflation and a gentle economic slowdown, not in response to fresh financial market chaos. They may have to be careful what they wish for. A return to rate cuts, or even QE, at a time when inflation is still above target, might not be the positive sign that markets are seeking, if the reason for the policy pivot is either a faltering economy, a blockage in the financial systems' plumbing, or both.

PIP | PANTHEON INTERNATIONAL PLC

THIS IS AN ADVERTISING PROMOTION

PIP: Exceptional companies, excellent long-term outperformance

Helen Steers, Pantheon Investment Partner and lead manager of Pantheon International Plc, discusses the recent interim results of one of the longest established private equity investment companies.

Pantheon International Plc ("PIP") is a FTSE 250 private equity investment company managed by Pantheon, a leading global private markets investor, and overseen by an independent Board of Directors. PIP provides investors with exposure to high growth, exciting private companies, many of which are in niche sectors, managed by some of the best private equity managers in the world.

Continued long-term outperformance

Helen Steers, Partner at Pantheon and manager of PIP

As demonstrated by its recent interim results, PIP's long-term track record of outperformance through multiple economic cycles continues to be strong. Despite the current macroeconomic environment, PIP grew the value of its net assets ("NAV") by 4.0% over the six months to 30 November 2022. While past performance is not indicative of future results, since inception PIP's NAV has grown by an average of 12.3% per year, outperforming its public market benchmarks. This performance is stated net of all fees.

PIP continued to make new commitments over the period, with 21 new investments during the six months to 30 November 2022 totalling £303.2m. Furthermore, PIP has committed £121.1m following the period end to three investments, one of which was a £93.5m ($112.5m) commitment to the **Pantheon Secondary Opportunity Fund II (PSOF II)**, which is focused on manager-led secondaries. This forms part of PIP's strategy to capitalise on attractive opportunities in this fast-growing segment of the secondaries market.

In the current macroeconomic environment, there has been a slowdown in the distributions received by PIP but nevertheless the portfolio still generated a net cash inflow of £34m during the period. With net available cash of £52m, as at the end of November 2022, combined with access to a fully undrawn £500m loan facility, PIP has a strong balance sheet that enables the company to meet its existing investment commitments while continuing to invest in exciting private companies.

View PIP's Interim Report [here]

The number of direct company holdings in the portfolio has continued to increase and now stands at over 50% for the first time. The enhanced portfolio concentration provides shareholders with greater exposure to individual companies, which have the potential to deliver a boost to performance while, importantly, the benefits of diversification are not lost as PIP continues to invest in a well-balanced portfolio of private equity funds and direct investments in companies.

Investing in growing companies in resilient sectors

Pantheon has positioned PIP's portfolio to be resilient

	1yr	3yrs	5yrs	10yrs	Since inception
NAV per share	11.5%	18.8%	15.9%	14.4%	12.3%
Ordinary share price	-15.5%	5.2%	7.7%	12.1%	10.9%
FTSE All-Share, Total Return	6.5%	3.9%	4.2%	6.8%	7.5%
MSCI World, Total Return (Sterling)	-0.5%	11.1%	10.7%	13.4%	8.4%

Source: PIP November 2022 Newsletter. As at 30 November 2022. Inception date is September 1987. Past performance is not indicative of future results. Future performance is not guaranteed and a loss of principal may occur.

in times of economic stress. The portfolio has been actively managed to build exposure to high growth and defensive sectors such as Information Technology (IT) and Healthcare, which together now account for over 50% of the portfolio. The growth in these sectors is driven by long-term trends such as automation and digitalisation, ageing demographics and energy efficiency, that are less dependent on the macroeconomic environment.

The IT companies in PIP's portfolio are focused on mission-critical, enterprise software businesses. They are high quality, cash generative companies with strong recurring revenues. For example, during the half year, PIP invested in The Access Group, a leading provider of fully integrated mission-critical business management software solutions, headquartered in the UK. This company has delivered uninterrupted profitable growth over the past 15 years, and has doubled in size since 2020. This additional investment will enable The Access Group to continue its growth strategy and enhance its products and solutions.

In the Healthcare sector, PIP invested in ShiftKey during the period. This company operates a platform that connects available nurses with healthcare facilities across the United States by enabling nurses to share their credentials and then apply to work daily shifts that match their requirements. The platform has benefitted from the fundamental supply/demand imbalance caused by an ageing population and a severe, ongoing nursing shortage. ShiftKey is focused on post-acute care but there are growth opportunities in other healthcare end markets such as pharmacy and dentistry.

We also continue to invest PIP's capital in a responsible manner. As a firm, Pantheon believes that a clear focus on ESG leads to strong value creation across our investment portfolio, which benefits all stakeholders. ESG has been incorporated into our pre- and post-investment process for many years and we continue to enhance our approach. The appointment of Eimear Palmer as Partner and Global Head of ESG will strengthen Pantheon's ESG capabilities and support the continued evolution of its policies, practices and strategies while the launch of a new ESG due diligence scorecard, incorporating climate risk, reputational risk, diversity, equity and inclusion ('DEI') and biodiversity adds further depth to the ESG due diligence and monitoring that we undertake.

Download PIP's latest newsletter

Outlook

While we are in no doubt that the current economic environment brings challenges for private equity investors and that future performance is not guaranteed, our 40 years of investment experience has shown that this asset class typically comes to the fore in difficult times. PIP has a long-term track record of outperforming the public market benchmarks throughout multiple economic cycles and while private equity has outperformed public markets over the past ten years, data from Capital IQ suggests that private equity outperformance tends to be even greater during periods of lower public market returns. This is a testament to the active ownership that our private equity managers employ, and we expect this approach to become more important than ever through 2023 and beyond.

Our decades of investment experience and expertise present us with a strong platform which will enable us to take advantage of opportunities in the market on behalf of PIP. Furthermore, PIP's balance sheet is robust and the companies in the portfolio continue to perform well, delivering revenue and earnings growth in excess of the MSCI World index. Investors must carefully assess what is suitable for them and their investment objectives and tolerance for, and attitude to, risk, but these factors give us confidence that PIP is well placed to continue to provide attractive returns to shareholders over the long term.

What exactly do the big Budget changes mean for pension investments?

The scrapping of the lifetime allowance could be reversed by a future government

I appreciate it is early days but can you explain the key pensions measures from the Budget and how they will affect people? And what happens if Labour comes in and reverses it all?
Stephen

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

Jeremy Hunt's first Budget as chancellor delivered a series of big changes for pensions taxation which will boost retirement savings allowances for millions of people.

The headline measure was around the lifetime allowance, which currently controls the total value of pension benefits someone can build up without being subject to a tax charge over their lifetime. As things stand today, if you breach the lifetime allowance, which currently stands at £1,073,100, you will pay a lifetime allowance charge on the excess. This charge will be 25% if the excess is taken as income and 55% if taken as a lump sum.

LIFETIME ALLOWANCE WIPED OUT

However, from 6 April 2023, the lifetime allowance charge will be reduced to 0%, with the government eventually intending to scrap the lifetime allowance altogether. This will dramatically simplify pensions saving decisions for those close to or over the lifetime allowance and, crucially, remove the disincentive to take investment risk for anyone worried about being hit with a lifetime allowance charge as a result. As part of the changes, the maximum tax-free lump sum someone can take will be held at £268,275 – a quarter of the current £1,073,100 lifetime allowance.

One key thing to note: if by crystallising your pension (or part of your pension) you will have used up all your lifetime allowance, it makes sense to hold off doing so until 6 April if you can. If you crystallise your pension – such as by taking your tax-free cash or entering drawdown – before 6 April, your fund will be tested against the lifetime allowance and you could still be hit with a tax charge as a result.

If you have one of the forms of lifetime allowance 'protection' introduced since 2006, these will be honoured under the new reforms. This means if, for example, you have a tax-free cash entitlement higher than £268,275, you will be able to keep it. What's more, you will be able to top-up contributions from 6 April 2023 without losing any protected tax-free cash entitlement you have.

ANNUAL PENSION LIMITS LIFTED

As well as setting out his intention to scrap the lifetime allowance, the chancellor also announced significant boosts to pensions annual allowances. These govern how much can be paid into a pension each tax year before an annual allowance charge is levied.

The main annual allowance, which covers personal contributions, employer contributions and tax relief, will rise from £40,000 to £60,000 from 6 April this year. In addition, the minimum level of the tapered annual allowance, which affects very high earners, will increase from £4,000 to £10,000.

At the same time, the money purchase annual allowance, which is triggered when you flexibly access taxable income from your retirement pot, will rise from £4,000 to £10,000.

If you breach any of these annual allowances, a tax charge will be applied to the excess designed to remove the upfront tax relief your contribution received.

WHAT IF THE PLANS ARE REVERSED

Lots of people are already worrying about whether Labour could reverse this decision if they win the next general election. Some might even be thinking about taking decisions with their pension to mitigate against this risk.

Second-guessing what a politician may or may not do if they win power is a fool's game and certainly isn't something you want to be hanging your financial future on. There is also a risk that in trying to dodge something which is entirely uncertain, you end up making a poor financial decision. We have no idea what a Labour reversal of this policy would look like or if they would follow through with it, so rather than being distracted by politics, deal with the tax rules as you find them and stay focused on your long-term retirement strategy.

We are still waiting for all the rules around these changes to be finalised, so expect more updates in due course. In the meantime, if you have any questions about this or anything else, send them to the usual email address.

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.

WHO WE ARE

EDITOR:
Daniel Coatsworth
@Dan_Coatsworth

DEPUTY EDITOR:
Tom Sieber
@SharesMagTom

NEWS EDITOR:
Steven Frazer
@SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR:
James Crux
@SharesMagJames

EDUCATION EDITOR:
Martin Gamble
@Chilligg

COMPANIES EDITOR:
Ian Conway
@SharesMagIan

INVESTMENT WRITER:
Sabuhi Gard
@sabuhi_gard

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

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

Shares magazine is published weekly every Thursday (50 times per year) by AJ Bell Media Limited, 49 Southwark Bridge Road, London, SE1 9HH. Company Registration No: 3733852.

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