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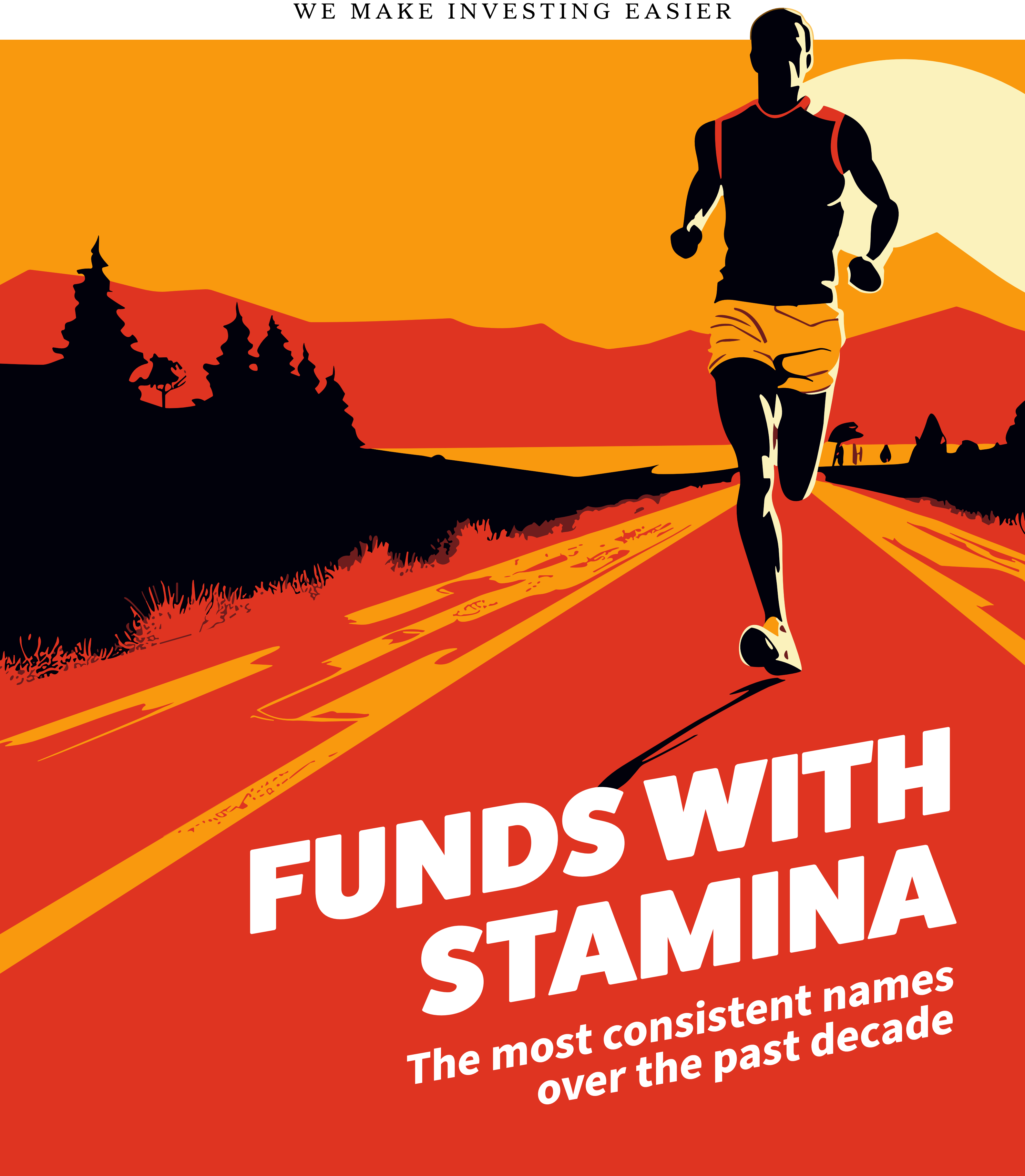

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Which?
Investment Platforms May 2022
Capital at risk.

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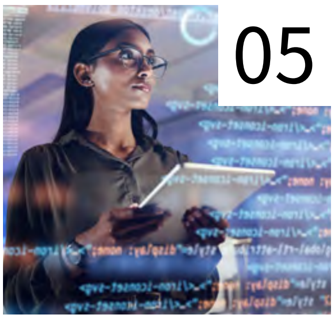
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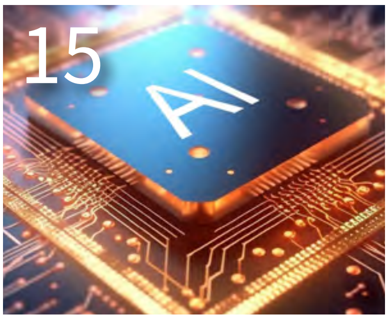
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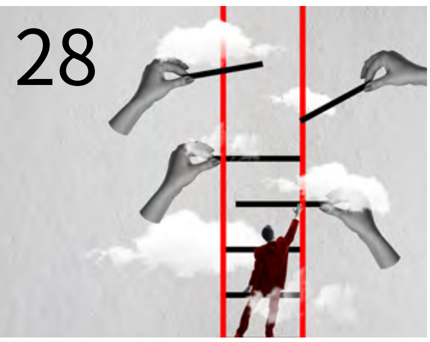
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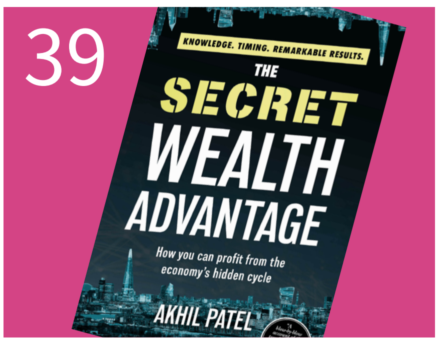
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KNOWLEDGE. TIMING. REMARKABLE RESULTS.
THE SECRET WEALTH ADVANTAGE
How you can profit from the economy's hidden cycle
AKHIL PATEL

Three important things in this week's magazine

Tobacco and vaping stocks are cheap, pay generous dividends but remain out of favour

The industry faces growing regulatory headwinds and many investors no longer want to touch the sector for moral reasons

While the US stock market is considered to be expensive, it is still possible to find good value stocks

We show you ways to get US exposure at a fair price and without excessive exposure to the tech sector

Microchips designer ARM is about to rejoin the stock market, this time floating in the US rather than London

We explain how to buy the shares, what the company might be worth and its growth opportunities

Visit our website for more articles

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

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

Baillie Gifford global growth funds downgraded after poor performance

Nvidia smashes forecasts again to drive its shares to new highs

Why Macy's shares fell 14% despite second quarter earnings beating forecasts

Zoom Communications shares jump after second quarter beat and raised full year guidance

August hasn't been kind to stocks but investors find a silver lining

The prospect of higher US interest rates continues to be front of mind for markets

Investor confidence has been tested this month as global indices have put in their worst performance so far this year, weighed down by the realisation UK, US and European interest rate rises have further to go, despite softening economic data, and by a continued sluggish recovery in China.

As of last Friday's market close (25 August), the FTSE 100 index was down 4.7% on the month and the FTSE 250 index was down 5.3%.

In the US, the S&P 500 index was down 3.4%, the Nasdaq Composite index 4.5% lower and the broad-based Russell 2000 index down 6.7% for the month.

The pain was also felt in Europe, with the Euro Stoxx 50 index down 4%, and in Asia, with Japan's Nikkei 225 losing 4.7% and China's Shanghai Composite index losing 6.9% as its troubled property sector continued to weigh on sentiment. Chinese markets perked up on 29 August after Beijing halved the stamp duty on stock trading but experts suggested this could only have a short-term boost.

There were high hopes the latest results from AI (artificial intelligence) poster child **Nvidia (NVDA:NASDAQ)** would blow estimates away, which they duly did, but after a stellar performance already this year the shares failed to hold their gains and finished the day lower.

Nvidia's earnings beat the Wall Street consensus by nearly 30%, more than the previous quarter when the market suddenly woke up to the company's potential as an AI beneficiary, while sales were over 20% above estimates.

The firm's sales guidance for the current quarter was 27% above market forecasts, yet the shares fizzled, which raises the question of what would have happened if earnings had merely met or, heaven forbid, missed expectations?

There was also a great deal of focus on the central bankers' symposium in Jackson Hole, Wyoming, and on what hints the Federal Reserve Chairman would give regarding the trajectory of US interest rates.

In the event, Jerome Powell didn't beat about the bush, his opening comments being: 'It is the Fed's job to bring inflation down to our 2% goal, and we will do so… Although inflation has come down from its peak, a welcome development, it remains too high… We are prepared to raise rates further, if appropriate, and intend to hold policy at a restrictive level until we are confident inflation is moving sustainably down toward our objective.'

Despite the Fed sticking to its guns, investors reacted positively in the aftermath of the gathering, confident in their belief record low unemployment, strong business investment and resilient consumer spending mean a 'soft landing' for the US economy is still the most likely outcome. [IC]

FTSE 100 and S&P 500 index monthly changes this year

Date	FTSE 100 Change%	S&P 500 Change%
Aug-23	-4.7	-3.4
Jul-23	2.2	3.1
Jun-23	1.2	6.5
May-23	-5.4	0.3
Apr-23	3.1	1.5
Mar-23	-3.1	3.5
Feb-23	1.4	-2.6
Jan-23	4.3	6.2

Data correct as of closing prices 25 August, 2023

Table: Shares Magazine • Source: Google Finance

Discover the reasons behind these three retail share price jitters

Watches of Switzerland, JD Sports and B&M have been volatile in recent sessions

August is a quiet period for UK retail reporting, but the month proved volatile for the share prices of three shopkeepers as investors reacted to the negative read-across from corporate activity and updates from the US retail sector.

Watches of Switzerland's (WOSG) shares plunged 27% to 499p on 25 August, a record one-day move, after Swiss luxury watch-maker Rolex agreed to buy retail partner Bucherer in a surprise move that reshapes the investment landscape for high-end timepieces.

For Watches of Switzerland, the worry is the tie-up will bring Bucherer better access to Rolex watches, while the acquisition paves the way for Rolex to expand its direct-to-consumer sales efforts. Watches of Switzerland said the Bucherer purchase is 'not a strategic move into retail by Rolex' and insisted 'there will be no change in the Rolex processes of product allocation or distribution developments as a consequence of this acquisition'.

Shore Capital says the investment case for Watches of Switzerland has long rested upon the assumption that Rolex would never transition towards a direct-to-consumer model. 'However, the acquisition of Bucherer has shaken the foundations of this belief, raising numerous questions about the future dynamics of the market and Watches of Switzerland's strategic position within it,' it adds.

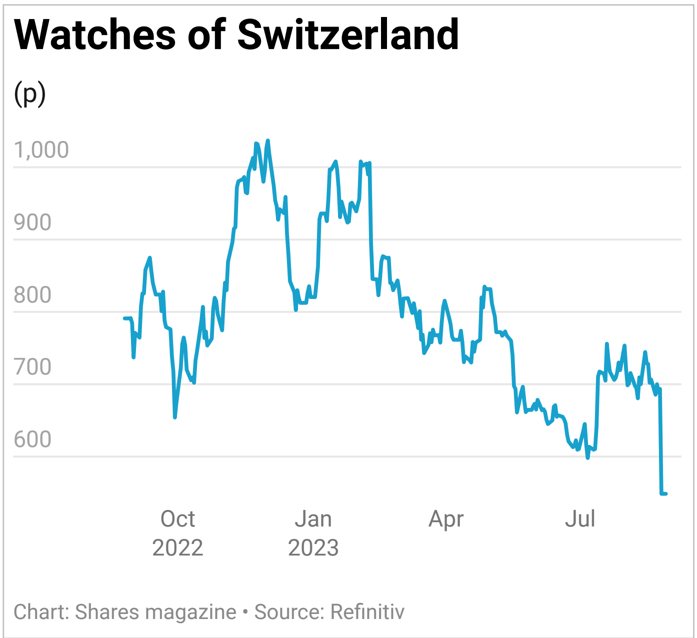


Chart: Shares magazine • Source: Refinitiv

The broker notes Watches of Switzerland's limited geographical overlap with Bucherer and says the deal does not fundamentally alter the need for consolidation in the US and European markets, 'where substantial opportunities remain'.

JD Sports Fashion's (JD.) shares cheapened 6.6% to 142.1p over the past week on a negative read-across after disappointing updates from **Foot Locker (FL:NYSE)** and **Dick's Sporting Goods (DKS:NYSE)** raised fears over the health of the US consumer.

Yet Shore Capital said the read-across from Dick's second quarter update (22 August) was 'unwarranted', since its lower profitability was mainly due to an unexpected higher provision for theft, a growing challenge for retailers in the US, as well as outdoor category markdowns.

Cost-of-living crisis winner **B&M European Value Retail's (BME)** shares are up more than 30% in 2023 to date and have risen on recent hopes the discounter will benefit from the collapse of Wilko, which fell into administration earlier this month, putting the future of its 400 stores in doubt.

B&M was reportedly among the bidders for a significant portion of the Wilko brick and mortar estate. However, the share price has since pulled back after HMV owner Doug Putman and private equity outfit M2 Capital emerged as last-minute bidders for the former high street stalwart. [JC]

Darktrace investment case strengthening, claims analyst

Cybersecurity firm hopes to put a difficult nine months behind it

Analysts have raised **Darktrace (DARK)** profit forecasts ahead of annual results set to be published on 6 September. Having revisited the investment case, Liberum has upgraded 2023 adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) estimates by 14%, and nudged full year 2024 and 2025 adjusted EBITDA higher.

Describing Darktrace as the 'Marmite' of the UK tech sector, Liberum has been impressed with recent trading, believes the cybersecurity group's products have got better over time and sees strong tailwinds for demand from rising cybercrime and new regulation.

The broker estimates that cybersecurity has doubled as a proportion of corporate IT spend over the last three years. 'We have upgraded our adjusted EBITDA estimates by 14%, 5% and 4% for full year 2023, 2024 and 2025 respectively, having previously been 5% ahead of consensus,' it says.

This largely reflects the guidance given in a trading update on 18 July, when Darktrace stated that it expects revenue of $544 million and an EBITDA margin of no less than 22%, compared to previous margin guidance of 19%, in 2023.

In July, Darktrace was given a clean bill of health after accounting firm EY was instructed to run an independent audit of its books. That news, combined with the trading update, propelled Darktrace shares nearly 30% higher across two days of high-volume trading.

Darktrace came under fire at the start of 2023 from New York-based short seller Quintessential Capital Management, an attack that had dragged on the share price for most of this year. That led to the EY report being commissioned.

The EY report flagged several areas where improvement work was needed, but nothing that would impact previous financial statements, nor anything to slow Grant Thornton's audit of the financial year to 30 June 2023.

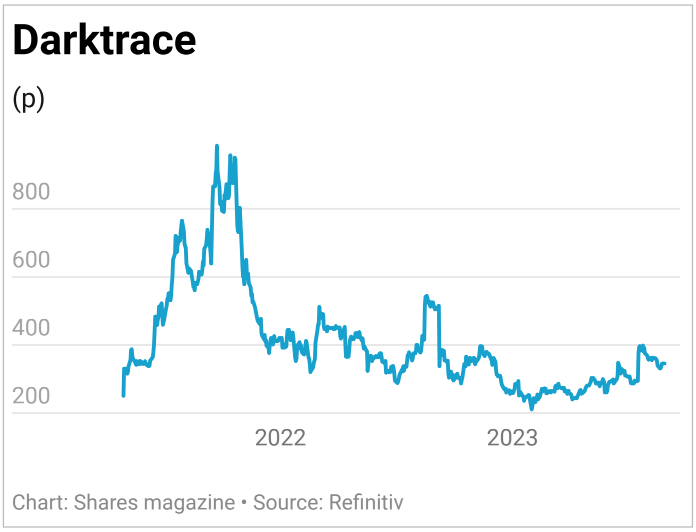


Chart: Shares magazine • Source: Refinitiv

'EY reported several areas where systems, processes or controls could be improved around its channel processes and controls, where it identified a small number of errors and inconsistencies,' said Tom Kennedy, an analyst at Megabuyte.

Kennedy reflected that the report could have wider implications on broader market murmurings that 'something wasn't quite right' at Darktrace. The investigation into the firm's finances 'has essentially proved that the cybersecurity expert doesn't have any skeletons in the closet,' said the analyst, and Liberum now seems to agree.

Liberum's latest calculation suggest nearly 30% upside could be on the cards from Darktrace shares over the next 12 months, from the current 349p to its new target of 440p.

Palo Alto (PANW:NASDAQ), the world's second largest cybersecurity vendor, saw its share price rise 15% on 21 August after reporting fourth quarter results which included a deep dive into its industry, noting that the number of cyber attacks and malicious programs is still on the rise. [SF]

Moderna shares surge on cancer venture and Biden booster plan

Vaccine maker shows it has more strings to its bow than just Covid vaccines

Shares in pharmaceutical and biotechnology company **Moderna (MRNA:NASDAQ)** have had a difficult time since we emerged from the pandemic. However, they've started to move up since mid-August.

The company's success in developing a Covid-19 vaccine using mRNA technology helped propel it to highs of around $450 in 2021 but as demand for these vaccines has eased, the shares dwindled to $96 a few weeks ago.

News the company has signed a deal with China's CARsgen to co-develop a combined cancer vaccine therapy helps lend credence to the idea Moderna's mRNA platform can be used to address all sorts of areas beyond Covid.

It is this potential which has seen Moderna investors like **Scottish Mortgage (SMT)** keep their faith in the business and its long-term prospects. Moderna is already partnered with **Merck (MRK:NYSE)** to work on a bespoke vaccine for patients who have had the skin cancer melanoma surgically removed.

News the Biden administration is planning a programme of booster shots to help counter a new wave of Covid cases, with Moderna developing new vaccines specifically targeting emerging strains, is also providing support to the stock. [TS]

Asset manager Abrdn is having a tough time on the stock market

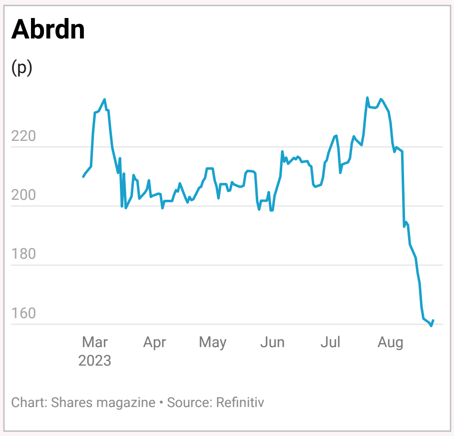
Fund outflows and weak investment returns have sunk the share price

Having only been promoted to the FTSE 100 index last December, fund management firm **Abrdn (ABDN)** is looking to be a leading candidate for demotion from the large-cap benchmark at the next quarterly review. Confirmation of the changes to the index were due as this edition of *Shares* was being finalised.

Since 27 July, the shares have fallen by more than 30% despite the group posting 4% growth in first half revenue and a 10% increase in operating profit as well as doubling its share buyback to £300 million thanks to gains on the sale of its stake in India's HFDC Life.

It seems investors have overlooked the good news in favour of the net outflow figure of £4.4 billion and the 15% drop in operating income in investments due to lower average assets under management.

In a trend which is becoming clear across the fund and wealth management sector, outflows were particularly notable in equities where 'client asset allocation moved to debt products and cash in the rising interest rate environment' according to the firm. [IC]



UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS
September 4: Dechra Pharmaceuticals
September 5: Craneware, Alumasc
September 6: Ashmore, Darktrace, Barratt Developments
September 7: Genus

HALF-YEAR RESULTS
September 4: Belvoir
September 5: Johnson Service, Ecora Resources, Tissue Regenix, Headlam, Gamma Communications, Midwich, Getbusy, Eurocell, The Pebble Group, Luceco
September 6: Apax Global, Oxford Nanopore Technologies, Bakkavor, Nexteq
September 7: Angle, Cairn Homes, Polarean Imaging, Vistry Group, W.A.G Payment Solutions, Inspecs Group, Funding Circle, Direct Line Insurance, MPAC, Hilton Food, Beazley, Energean, Synthomer

TRADING ANNOUNCEMENTS
September 5: Ashtead
September 6: Alpha Financial Markets Consulting
September 7: Currys

Expectations high for construction rental equipment firm Ashtead's next update

As a growth company, the firm cannot afford to disappoint investors

Construction equipment rental specialist **Ashtead (AHT)** has set itself quite a high bar when it comes to its first-quarter earnings report on 5 September.

The firm has beaten revenue forecasts in nine out of the last 10 quarters. Moreover, the comparison with the same quarter last year is a tough one as rental revenue was up 26% to just over $2 billion and adjusted pre-tax profit was up 29% to $555 million versus the previous year.

For the current financial year to April 2024, the firm is targeting group rental revenue growth of 13% to 16% which equates to between $9.8 billion and $10 billion, and free cash flow of around $300 million after capital spending of between $3.9 billion and $4.3 billion.

Chief executive Brendan Horgan said the firm started the new year 'with clear momentum in strong end markets, which are enhanced by the increasing number of mega projects and recent US legislative acts'.

According to the US Census Bureau, construction spending in the first six months of this year grew by 3% to $917 billion, with growth accelerating recently and June posting growth of 3.5%, driven by private sector works including housing. [IC]

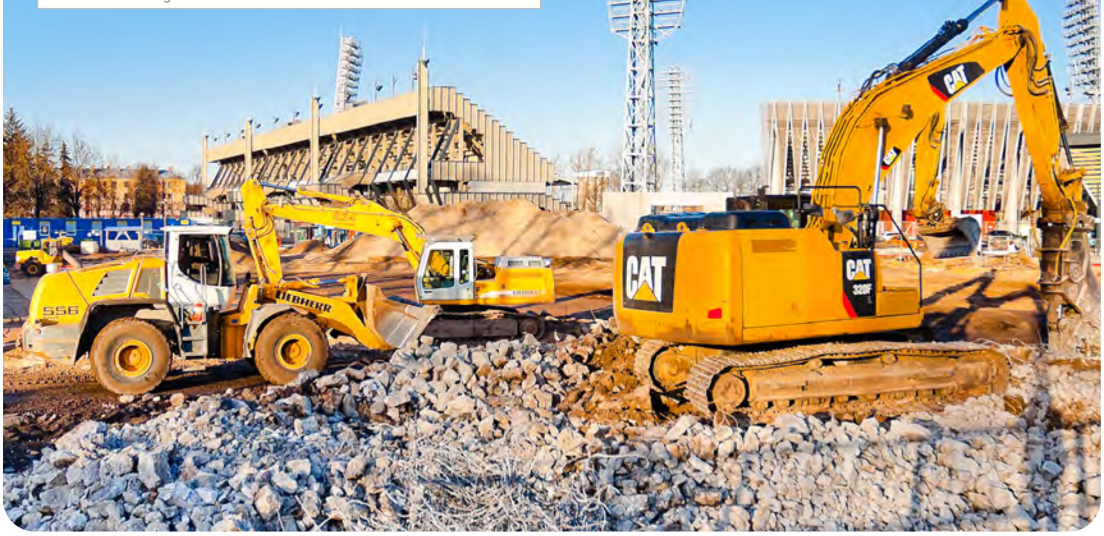
Ashtead

Chart: Shares magazine • Source: Refinitiv

What the market expects of Ashtead

	EPS ($)	Revenue ($bn)
Q1	0.83	$2.08

Table: Shares magazine • Source: Yahoo Finance



Zscaler looks to maintain third quarter momentum with latest earnings

There are strong structural drivers for the company's cloud-based cybersecurity services.

Cloud security firm **Zscaler (ZS:NASDAQ)** is set to report its fourth quarter and full-year earnings for the period ended 31 July on 5 September. The release comes after a decent run for the share price in recent months.

The San Jose-based cybersecurity business provides tools to protect data centres against hacking attacks. The company sells products which aim to help safely connect the right user to internally and externally managed applications and internet destinations.

At $140, the shares currently trade 775% higher than the $16 price at which it joined the stock market in March 2018.

In common with many cloud-software vendors, Zscaler has found businesses are taking more time to scrutinise deals or subscriptions and this is having a knock-on effect on its earnings. Earlier this year the company announced plans to take costs out of the business through a 3% reduction in its global workforce.

Strong third quarter numbers helped lift sentiment in the interim. Earnings per share came in at $0.48 versus the $0.42 forecast, while revenue was a smidge ahead of the expected $417.4 million at $418.8 million.

These suggested any slowdown in this market is likely to represent a blip rather than anything long term, with clear structural drivers from growing cyber threats in an increasingly digitised world. [TS]

Zscaler

Chart: Shares magazine • Source: Refinitiv

What the market expects of Zscaler

	EPS ($)	Revenue ($bn)
Q4	0.49	0.43
Full year	1.63	1.59

Table: Shares magazine • Source: Yahoo Finance

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

September 1: Hashicorp, Smartsheet
September 5: Zscaler, Caseys, Sigma Lithium Resources
September 6: Guidewire, Korn Ferry, Verint, GameStop
September 7: Toro, Science Applications, John Wiley & Sons, Phreesia, FuelCell Energy

Infrastructure engineer Costain looks far too cheap given its prospects

The firm's large net cash pile makes it an obvious takeover target

Costain	
(COST)	
Price:	54.58p
Market value:	£151 million

It isn't often we come across stocks on a low single-digit PE (price to earnings) multiple with a net cash pile almost equal to their market value but infrastructure and engineering group **Costain (COST)** is one.

Its half-year results were steady rather than spectacular – revenue was flat, operating profit was up 7%, both ahead of forecasts, and basic earnings per share were up 12.8% on an adjusted basis – but its valuation and net cash position made us do a double-take.

The Maidenhead-based firm, which is approaching its 160th birthday, describes itself as providing 'connected, sustainable infrastructure that enables people and the planet to thrive'.

Chart: Shares magazine • Source: Refinitiv

In plain English, the group is involved in the rail, road and transport sectors, the energy and water markets, and the nuclear and defence industries, which has its pros and cons.

On the plus side, projects tend to be big, and in most cases the customer is the government or a utility company so credit risk is minimal, but on the minus side delays with awards or halts to the schedule mean revenue and earnings can be lumpy.

That was evident in the first half, with frequent references to the 'rephasing and rescoping' of various transport works and the timing of customer procurement cycles.

Nor is infrastructure a high-margin business – the first half saw an improvement to 2.3% from 2.1% a year ago, and the firm says it is on track to meet margin targets of 3.5% in the next financial year and 4.5% the year after.

Yet none of this detracts from the fact the firm has excellent visibility of revenue, with a signed-for order book of £2.5 billion and a preferred bidder book of £1.5 billion, and free cash flow is improving to the point where the board is contemplating restarting dividend payments after four years of abstinence.

While the shares climbed 5% to 50p last week on the day of the results, that still leaves them 75% below pre-pandemic levels, and a market value of £151 million is only slightly more than its first-half £132 million net cash position (before £25 million or so of leases).

We suspect at that size the stock is now uninvestable for UK institutions as a £10 million position would make them a major shareholder. As one senior UK investor put it, 'Welcome to the undervalued world of UK small caps.'

Analysts at Liberum have a 'buy' rating and an 80p price target. If we were in private equity, we would be taking a long hard look at Costain, and our guess is 80p per share probably isn't even close to what the business is worth long term. [IC]

Small cap retailer Marks Electrical won't stay under the radar for long

The company offers next day delivery to over 90% of the UK population

Marks Electrical	
(MRK:AIM)	
Price:	98.14p
Market value:	£103 million

We believe **Marks Electrical (MRK:AIM)** has the potential to grow earnings at an attractive rate over the next few years driven by geographical expansion and market share gains.

Although the shares have only been publicly traded since November 2021, the company has been honing its customer proposition for 35 years.

Founded by Mark Smithson in Leicester in 1987 at the tender age of 21 the company sells a huge range of premium branded products, from refrigerators, washers and dryers, dishwashers, audio-visual, small appliances, and add-on services through to sinks and taps.

Since 2018 the company's sales have tripled to a record £98 million while operating profit has increased 12-fold to £5.7 million. Over the last three years its share of the online major domestic appliances market has more than doubled to 4.7% while its share of the online consumer electricals market has increased by a factor of six to 0.6%.

Interestingly, the gains have been made against a shrinking market impacted by the cost-of-living crisis which suggests the company's customer proposition is attractive and resilient.

'This further demonstrates the strength of our business model and the attractiveness and advantage of our market-leading customer offering, as more people continue to discover our brand up and down the country,' said Smithson at the 2023 results.

Brand awareness and customer satisfaction continue an upward trajectory with the former more than doubling from 6% to 15% according to YouGov data and the latter increasing to 4.8 from 4.7 based on Trustpilot scores (which rank from one to five, the higher the better).

The investment case is supported by strong conversion of profit into cash with the business converting 119% of operating profit into cash over the last two years to deliver a free cash flow margin against sales of 7.3%.

'While the company is seeing some gross margin pressure, cost headwinds are easing from the highly inflationary environment over the last two years, which could result in operating leverage if trading strength continues,' says Canaccord Genuity analyst Karl Burns.

Smithson believes the factors underpinning the company's success – a combination of putting the customer first, hard work, getting the price right and honesty – are 'difficult to replicate' and give the business a sustainable competitive advantage.

Marks' sales growth momentum has continued in the first four months of its 2024 financial year to the end of July with sales up 30.7% compared to a year ago.

The UK major domestic appliance market is worth around £4.2 billion in annual sales and consumer electronics is worth around £2.9 billion representing a big opportunity for Marks. [MG]

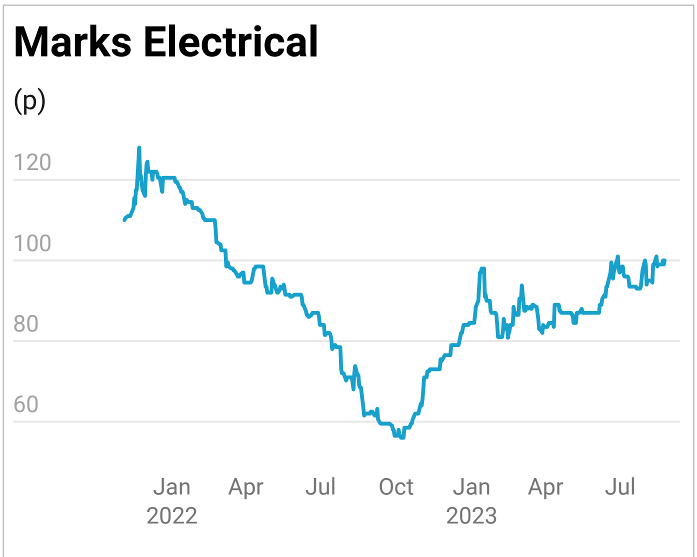


Chart: Shares magazine • Source: Refinitiv

This iShares quality shares tracker is doing exactly the job we hoped

The ETF has delivered a return of more than 6% in six months with a portfolio avoiding market dross

iShares Edge MSCI World Quality Factor ETF
(IWFQ) £42.80

Gain to date: 6.2%

When flagging the **iShares Edge MSCI World Quality Factor ETF (IWFQ)** back in March we were working to a simple hypothesis. Rather than deciding the stocks you want to own as the basis for a diversified investment portfolio, why not decide what you don't want to own and thereby avoid the weakest companies which could help drag down your performance.

This exchange-traded fund seemed a good way of achieving this aim as it applied a series of criteria to separate real quality businesses from the dross.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

Largely it has performed as we'd hoped. The ETF has achieved a gain of more than 6%, more than two-and-half times the 2.3% posted by the MSCI World in sterling terms. Annualise that rough six-month return and you get 12% which, if achieved, would be better than one might expect from equities over the long-term.

While the US market has made progress since we said to buy the iShares ETF it has been uneven and largely centred on stocks like **Nvidia (NVDA:NASDAQ)** with links to the hot AI (artificial intelligence) theme.

Nvidia is one of the top holdings in the 300-strong ETF portfolio along with Danish pharmaceutical firm **Novo Nordisk (NOVO-B:CPH)**. The latter recently achieved a striking breakthrough with its Wegovy weight loss drug – with a key trial suggesting it cuts the risk of heart attack and stroke by 20%.

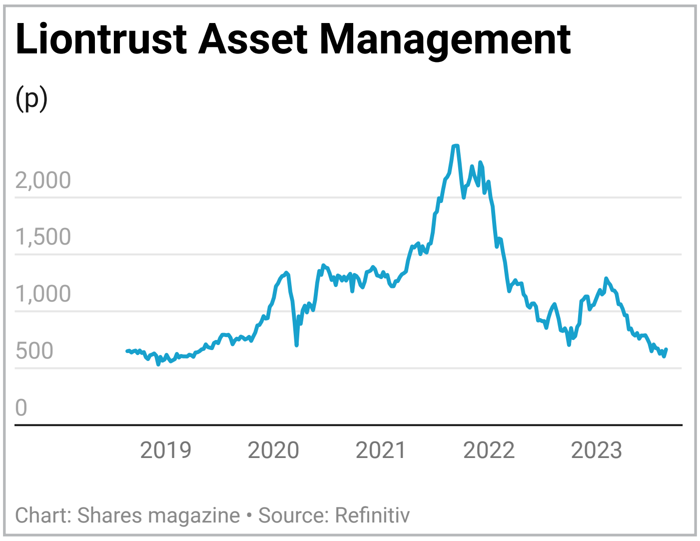
Its US counterpart **Eli Lilly (LLY:NYSE)** has also enjoyed a strong run of late thanks to positive news flow on its own obesity and Alzheimer treatments and is another big holding in the ETF portfolio.

WHAT SHOULD INVESTORS DO NOW?

The ETF remains an excellent option for investors. The ongoing charge of 0.3%, while more expensive than the vanilla ETFs which track the mainstream indices, compares favourably with actively managed funds. This is a great investment to make in an ISA or SIPP via monthly contributions. [TS]

Can this former FTSE 350 superstar stock regain its mojo?

Failure to buy GAM could be a good thing for Liontrust, but might it now be a takeover target?



Running the data on the best performing FTSE 350 stocks in the 10 years to September 2021, **Liontrust Asset Management (LIO)** sits in second place with a 3,180% return. It becomes the sixth worst performing stock when you delve into the index's performance for the past two years.

Are we at another turning point for the stock? On 24 August, Liontrust shot to the top of the FTSE 350 risers table with a 13% gain after its takeover offer for Swiss asset manager GAM flopped. The deal looked doomed from the start, with analysts questioning its merits and saying Liontrust did not have a good history with acquisitions.

The market had certainly given the bid the thumbs-down. Liontrust's shares had fallen hard since talks first emerged about the company's interest in GAM. That the shares have subsequently started to rise again is the market feeling relieved. Not buying GAM could be a lucky escape.

Numis analyst David McCann said Liontrust's acquisitions of Majedie and Architas resulted in a loss of shareholder value, saying it paid too much for the former and did not generate the expected performance and asset gains for the latter. He also thought the GAM acquisition would be value destructive.

Liontrust used to be rated as one of the UK's best asset managers. All four funds under Liontrust's 'Economic Advantage' process rank top quartile for performance since launch or being appointed as manager, according to the company's latest annual report. A further eight funds in its stable are also top quartile whereas only two of its funds are bottom quartile since launch date or fund manager appointment.

It deserves credit for going from small boutique status to becoming an asset manager capable of taking on the big players with confidence. Understandably, investors are now asking if Liontrust has lost its way.

Eight out of 10 products under its 'Sustainable Future Funds' process are ranked bottom quartile for performance over the year to 31 March 2023, according to the annual report. Growth stocks which populate these funds went out of favour at the start of 2022 thanks to higher interest rates negatively impacting valuations.

The failed GAM bid could be costly on multiple levels. First, Liontrust faces up to £11 million of legal and corporate finance costs linked to the deal. Second, it needs to recover an £18 million loan from GAM, a business in a fragile state. Third, Liontrust's senior management have lost credibility given the 73% share price decline in two years.

There are very bright people working for Liontrust and I am sure there are rival asset managers who would love to poach whole teams from the business. That is an underappreciated risk to the share price.

To win back the market's favour, Liontrust needs its funds to be at the top of the pack in performance terms so it can start to attract more customer inflows. Attempting another acquisition to drive growth would be a mistake in the near term.

Trading on 7.2 times forecast earnings for the year to March 2024 and just 3.4 times enterprise value to earnings before interest, tax, depreciation and amortisation, Liontrust could easily switch from being predator to prey.

Everything you need to know about ARM's IPO and how to buy the shares

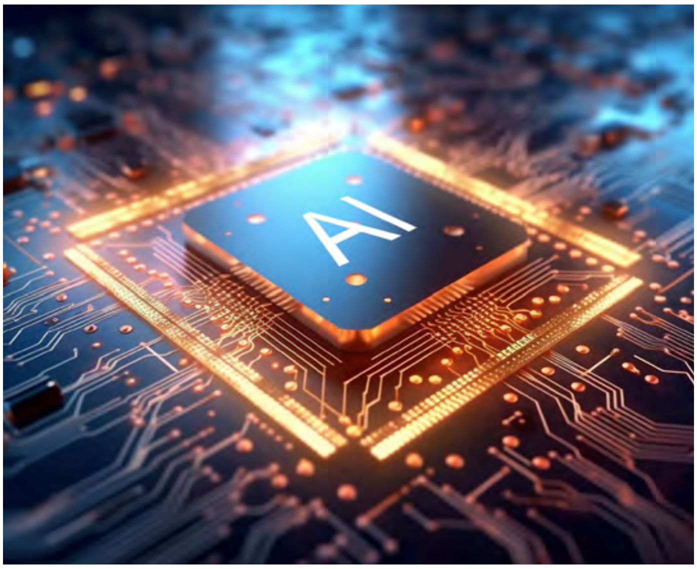
When and where it will float, likely valuation and how UK investors can get involved

Giant UK microchips designer **ARM** has filed its highly anticipated Wall Street IPO (initial public offering) prospectus, firing the gun on a long mooted and highly anticipated return to equity markets for the Cambridge-based company that has been owned by Japan's **Softbank (9984:TYO)** since 2016.

Once described as 'the jewel in the crown of British technology', when ARM was last listed (in London) it built a massive and loyal fanbase among investors thanks to years of above-average returns.

As *Shares* wrote at the time of the company's $32 billion takeover by Softbank in 2016, 'investors who put money into this fantastic British technology success story at any time during its 26-year run on the UK stock market have made money, potentially lots of it'.

For example, £1,000 invested a year before the bid went through would have been worth £1,820, based on the £17.00 per share take-out price. The same sum put in three years before would have grown into a £1,905 nest egg, while investors that took *Shares'* hint on the stock back in August 2011 at 490p would have seen their £1,000 turn into a £3,468 lump sum by the time of the takeover.



And even that pales by comparison to the 14-fold-plus returns over 10 years up until the takeover, which would have turned your £1,000 into a staggering £15,179 cash pile, clearly illustrating the enormous value creation potential of some technology investments if you're willing to play the long game.

ARM made investors a fortune when it was last listed on the stock market

How a £1,000 investment turned into something much bigger

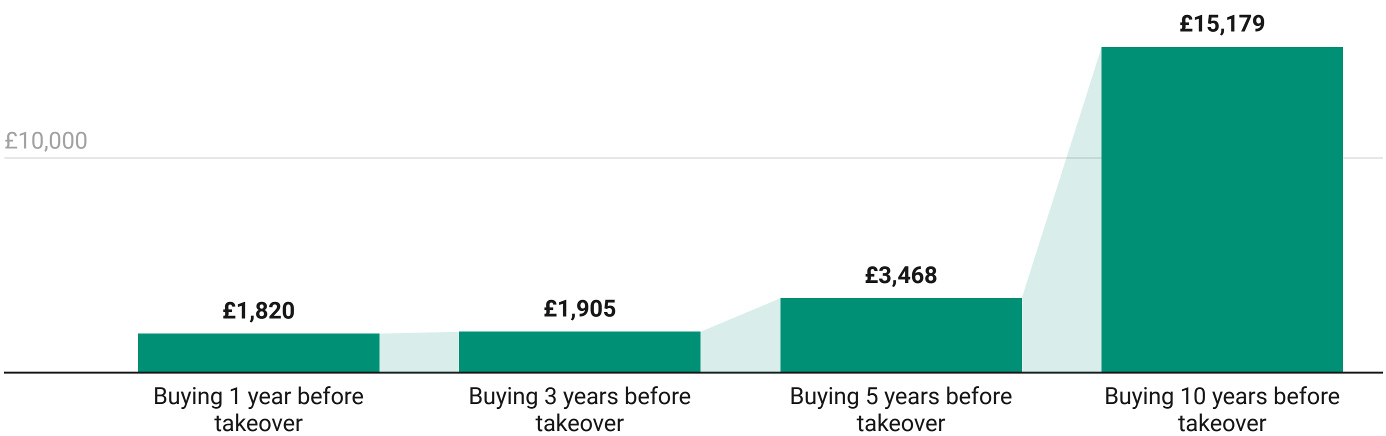
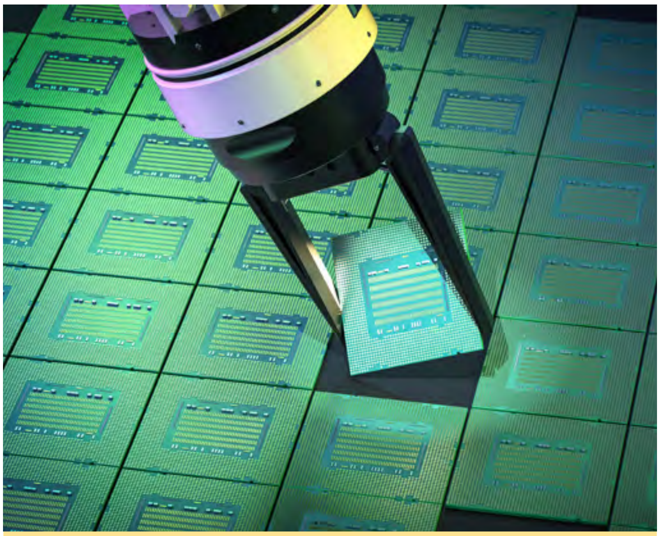


Chart: Shares magazine • Source: Shares, based on £17 per share 2016 takeover



ARM by numbers

Founded: 1990
Headquarters: Cambridge, UK
Number of employees: 6,000 approx.
Revenue March 2023 financial year: $2.68 billion
Stock market: Nasdaq
Potential valuation: $60 billion to $70 billion
Source: Reuters, Shares

WHEN & WHERE WILL ARM LIST ITS SHARES THIS TIME?

The IPO will likely happen sometime in September although the exact date will depend on market conditions and how much time the company needs to complete its investor roadshow, where it sells its investment story to potential backers.

Despite an intense lobbying campaign by the UK Government, Softbank snubbed the London Stock Exchange in favour of Wall Street's Nasdaq, where the Japanese firm clearly believes it will attract a higher valuation.

This was a slap in the face for the London market's ambitions to attract more high quality, high growth technology listings, but it is hard to argue with Softbank's logic. US tech valuations are among the highest in the world and the country has a vast investor base of tech specialists that the UK simply cannot match.

Nasdaq is also home to the largest tech firms in the world – **Apple (AAPL:NASDAQ)**, **Alphabet (GOOG:NASDAQ)**, **Microsoft (MSFT:NASDAQ)**, and chips star **Nvidia (NVDA:NASDAQ)** are all listed on Nasdaq, so ARM will be in great company.

WHAT DOES ARM DO?

ARM does not make microchips but instead designs the architecture on which chipmakers create their semiconductor designs. Building a new house might be a decent analogy. While fabless (meaning they don't directly manufacture) chip designers like Nvidia, for example, might decide where to put interior partition walls, doors and furniture, ARM designs where load-baring walls, windows, plumbing and gas/electricity supply go, so to speak.

The chip manufacturers – **TSMC (2330:TPE)**, **Samsung (005930:KRX)**, **Intel (INTC:NASDAQ)** – provide the bricklayers, carpenters, plumbers, etc to build the property.

ARM operates a licence and royalties model. It sells the right to use its chip designs to customers for a fixed term, then takes a small cut of every chip produced by the customer using that design.

HOW MUCH WILL ARM BE WORTH?

It's too early to say and estimating pre-flotation valuations for any company ahead of an IPO is always tricky, but ARM is a unique business which should see the shares attract a rarity premium, especially given the frenzy for AI technology stocks this year, an area where ARM sees plenty of opportunity.

Bloomberg has previously reported that Softbank is aiming for a valuation in the $60 billion and $70 billion ballpark, which would imply a rough price to sales multiple between 22 and 26-times.

SoftBank recently bought the 24.99% stake in ARM that it didn't own outright from its own Vision Fund, and this reportedly implied a valuation of more than $64 billion for the whole business. This would tally with the *Bloomberg* reports yet as an inter-Softbank deal, it's difficult to say how good a marker that transaction will be.

WHAT ARE THE BIG OPPORTUNITIES FOR ARM?

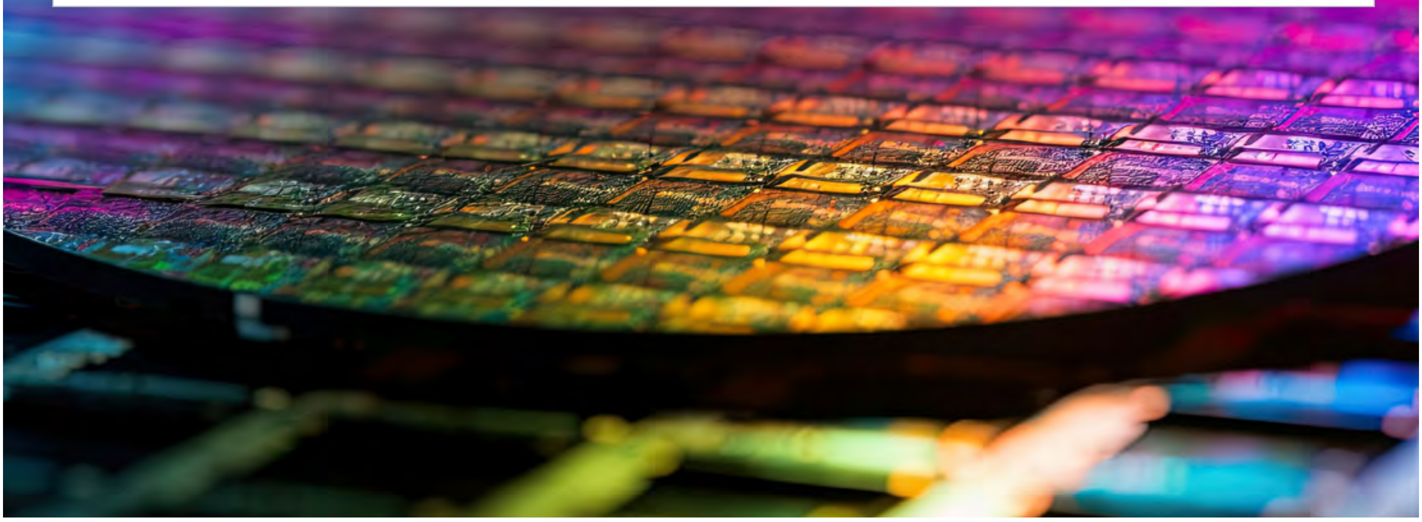
ARM has become world leader in the design of low power chips, perfect for mobile devices that rely on battery power. It has virtually cornered the global mobile devices market but there's plenty more growth from new vertical markets. It has been deepening its technological edge in both automotive and super-connectivity Internet-of-Things for years, while data centres represent another opportunity.

The company also sees a significant role for itself

Valuations of ARM's peer group

	Price to sales ratio	Price to earnings ratio
Nvidia	21.3	48.3
Advanced Micro Devices	6.6	30.3
Qualcomm	3.4	12.8
Synopsys	10.3	35.4
Cadence Design Systems	14.5	42.4

Table: Shares magazine • Source: Koyfin, next 12 months



in the AI space and has been increasingly touting itself as an AI company. In May, ARM unveiled two new chipsets targeted at machine learning applications. One, a new CPU (central processing unit) called Cortex-4, is a chipset that delivers faster machine learning performance and consumes 40% less power than its predecessor, according to ARM.

The other, a GPU (graphics processing unit) called G720, offers better performance and uses up 22% less memory bandwidth than its predecessor, ARM claims.

WHAT ARE THE RISKS WITH INVESTING IN ARM?

Scattered throughout the hundreds of pages of ARM's IPO prospectus are details of the company's labyrinthine relationship with China, its second-largest market. Sales in China contributed 24.5% of its $2.68 billion revenue in fiscal 2023, and nearly all of that comes from ARM China, an independent entity that has the exclusive rights to distribute Arm's technology in the country.

A group of Chinese investors and a private equity firm control a majority stake in ARM China (51%), with ARM a minority shareholder (4.8%). Tensions between Washington and Beijing mean sanctions are an obvious risk, while ARM China has been dogged by lawsuits in the past and has a history of overdue payments to ARM, so these are things to be aware of.

There are also questions about ARM's opportunity in emerging tech like AI and machine learning. The vast data calculations require enormous processing power and this will mostly happen in data centres that are plunged directly into the mains, not an area where ARM has dominance. Lowering data centre energy needs seems to be where ARM's immediate opportunity lies, but there can be no guarantee of success.

The global semiconductors industry is typically cyclical, so bouts of chip de-stocking tend to slow royalty income and put pressure on earnings. This is nothing new, ARM has been dealing with these challenges for years so investors should have reasonable confidence it will continue to manage these threats in the future, and keeping a strong pipeline of licence wins show help to offset this.

WHO IS LIKELY TO BACK THE IPO?

ARM has engaged in discussions with some of its major customers about supporting the IPO, and we would expect a good handful to participate as strategic investors. ARM will also join the Nasdaq Composite, so tracker funds and ETFs will buy stakes in ARM, although probably after the flotation.

ARM may also join the Nasdaq 100 index, based on even the lowest valuations estimates. Based on current data, about 10 of the index's constituents would be smaller than ARM.

We would also expect many technology and growth company funds to back the IPO, perhaps **Scottish Mortgage (SMT)**, the **Polar Capital Global Technology Fund (B42W4J8)** or even **Fundsmith Equity (B41YBW7)**, given the company's earnings and cash flow quality in the past. Only time will tell.

HOW CAN INVESTORS IN THE UK BUY ARM SHARES?

As is typically the case with IPOs in the US, there is no retail investor offer so ordinary investors will have to bide their time until after the listing has happened. But buying on the open stock market should be easy across most investment platforms.

The shares may not initially be available on some platforms, often there is a delay of several days before ordinary investors can trade new IPOs. But this could work to your advantage since we have seen many new IPOs soar in the first few days post-float, only to drift back to lower levels thereafter as initial excitement dissipates.

Shares will keep a close eye on ARM and will aim to provide a more thorough analysis of the investment case when more data is available.

DISCLAIMER: The author of this article owns shares in Scottish Mortgage and Fundsmith Equity.

By **Steven Frazer** News Editor

FUNDS WITH STAMINA

The most consistent names over the past decade

It has not been an easy decade to be a fund manager. Brexit, a global pandemic, the largest war in Europe for a generation and an inflation crisis have punctuated a 10-year period which has seen significant market volatility. However, steering investors' money through difficult waters is how a good fund manager earns their corn.

Using FE Analytics' platform, *Shares* has crunched the numbers to identify funds with stamina.

At first, we set a goal of identifying funds and investment trusts which have delivered a minimum total return of 6% every year for each of the last 10 years. However, it is unrealistic to expect a fund or investment trust to do well every single year as stock markets move up and down. Even the best-run investment products go through bad patches.

That's clear from looking at the performance data. The best we could find was one trust which had reached our returns threshold in eight of the 10 years and nine funds, from an admittedly larger universe, which had done so in nine out of the 10 years. There are 17 funds which have achieved this feat in eight out of 10 years and six trusts which have achieved returns of at least 6% in seven out of the 10 years.

In this article we reveal the names in question, ranking them by their 10-year annualised total return. We examine any patterns or trends which are thrown up and profile some of the investment vehicles. We also consider what the data reveals about the challenges of achieving positive returns during the last decade.

THE CREAM OF THE CROP

Let's start with the funds which had delivered at least 6% total return in nine out of the past 10 years. Not all of these funds are actively managed and this list effectively tells us as much about the strong performance of the US market over the period as anything else, with nearly every fund

Funds which have achieved at least a 6% total return in nine out of the past 10 years

Fund	10-year annualised total return	Which year (to August) did they fail to hit the mark?
Natixis Loomis Sayles US Equity Leaders	17.1%	2021-2022
Fidelity Index US	14.1%	2022-2023
CT American	13.9%	2022-2023
L&G US Index Trust	13.8%	2022-2023
Premier Miton US Opportunities	13.5%	2022-2023
Vanguard US Equity Index	13.5%	2022-2023
Janus Henderson Institutional North American Index Opportunities	13.3%	2022-2023
Marlborough US Multi-Cap Income	12.5%	2022-2023
L&G Global Health & Pharmaceutical Index Trust	11.3%	2022-2023

Table: Shares magazine • Source: FE Analytics. Data to 22 August 2023

having a North American focus.

This makes the achievement of those few actively managed funds which have been able to keep pace with runaway US stocks impressive. A tracker fund – **L&G Global Health & Pharmaceutical Index Trust (B0CNH38)** – is also a notable outlier. Its strong showing reflects both the consistency of this sector and its importance during the pandemic period.

Natixis Loomis Sayles US Equity Leaders (B8Y83Y0) is worth highlighting because it has cleared the 6% hurdle in every 12-month period bar one (between August 2021 and August 2022) and has the highest 10-year annualised return. The fund places a big emphasis on investing in businesses as partners rather than simply trading stocks.

It employs a seven-step research framework to identify those few high-quality businesses with sustainable competitive advantages to deliver profitable growth and which trade at a discount to intrinsic value. The fund's holdings include **Visa (V:NYSE)** and **Boeing (BA:NYSE)** alongside several big technology firms. The ongoing charge is 0.6%.

All our other 'nine out of 10-year performers' failed to hit the mark in the most recent 12-month period to August 2023.

Interestingly, while the headline US indices have performed reasonably well over the last year, a lot of that has been linked to a handful of stocks, notably **Nvidia (NVDA:NASDAQ)**, which has been helped by the hype around artificial intelligence and which is among Natixis Loomis Sayles US Equity Leaders' top holdings.

Many stocks have struggled this year as inflation has continued to run hot and as central banks have responded with a rapid increase in interest rates. This is rarely a recipe for strong returns from equities.

COVID MADE A BIG DENT IN PERFORMANCE

If we also lose the year which encompassed the global sell-off linked to the Covid pandemic we come up with a broader list of names. Several have an income focus and while there are more US-focused funds on the list there are also names with a global remit.

This could be significant if we look at the potential for future returns. As investment disclaimers are keen to remind us, past performance is no guarantee of future performance and stretched US valuations could make global diversification important.

For an ongoing charge of 0.9% **Morgan Stanley Global Brands (3248249)** provides exposure to the some of the world's leading household names. Strong brands matter for the most part because they give owners pricing power, which is the ability to increase the prices for goods and services without unduly impacting demand. The fund holds 34 names in total, including **Microsoft**

Examples of funds which have achieved at least a 6% total return in eight out of the past 10 years

Fund	10-year annualised total return	Which years (to August) did they fail to hit the mark?
HSBC American Index	14.1%	2019-2020, 2022-2023
CT North American Equity	13.5%	2019-2020, 2022-2023
St James's Place North American	12.8%	2019-2020, 2022-2023
Scottish Widows American Growth	12.6%	2019-2020, 2022-2023
M&G North American Dividend	12.5%	2019-2020, 2022-2023
Morgan Stanley Global Brands	11.9%	2019-2020, 2022-2023
BNY Mellon Global Income	10.3%	2019-2020, 2022-2023
JOHCM Global Opportunities	9.9%	2019-2020, 2022-2023
Sarasin Global Higher Dividend	8.7%	2019-2020, 2022-2023

Table: Shares magazine • Source: FE Analytics. Data to 22 August 2023

(MSFT:NASDAQ) and the company behind Durex, Detoll and Nurofen, **Reckitt (RB.)**.

Steered by Ben Leyland and Robert Lancastle, **JOHCM Global Opportunities Fund (BJ5JMC0)** is a high conviction portfolio of 39 holdings with no constraints in terms of following a particular benchmark.

The managers look to find undervalued quality companies based on the hypothesis that the market underestimates the value created by well-managed firms operating in growth areas which are reinvesting sensibly in their business. They operate a 'sell-to-zero' policy meaning that rather than trimming holdings when they identify a material downside risk, they sell out entirely.

Top holdings include outsourced supply chain and warehousing outfit **GXO Logistics (GXO:NYSE)** and dental supplies specialist **Henry Schein (HSIC:NASDAQ)**. Its ongoing charge is 0.99%.

WHAT ABOUT INVESTMENT TRUSTS?

Losing the last 12 months and the 12-month period impacted by the pandemic reveals one investment

Trusts which have achieved at least a 6% total return in eight out of the past 10 years

Fund	10-year annualised total return	Which years (to August) did they fail to hit the mark?
3i Infrastructure	12.0%	2019-2020, 2022-2023

Table: Shares magazine • Source: FE Analytics. Data to 22 August 2023

Trusts which have achieved at least a 6% total return in seven out of the past 10 years

Fund	10-year annualised total return	Which years (to August) did they fail to hit the mark?
Allianz Technology Trust	20.1%	2019-2020, 2021-2022, 2022-2023
Polar Capital Technology	19.0%	2019-2020, 2021-2022, 2022-2023
Mid Wynd International	12.0%	2019-2020, 2021-2022, 2022-2023
Pantheon International	9.8%	2019-2020, 2021-2022, 2022-2023
Finsbury Growth & Income	8.4%	2019-2020, 2021-2022, 2022-2023
The Bankers Investment Trust	8.2%	2019-2020, 2021-2022, 2022-2023

Table: Shares magazine • Source: FE Analytics. Data to 22 August 2023

trust which has achieved 6% or more in total returns in eight out of last 10 years. Namely **3i Infrastructure (3IN)**.

The trust comes from the same stable as private equity firm **3i Group (III)**, a core shareholder and one of the best performers on the FTSE 100 over the past decade. 3i Infrastructure holds assets which fit into one of five 'megatrend' categories including the energy transition, digitalisation, globalisation, demographic change and renewing social infrastructure.

Rising interest rates have led to higher discount rates on long duration assets like infrastructure. Two key elements make up the discount rate – the risk-free rate which is typically taken as the yield on government bonds and the risk premium which reflects the risk associated with investing your money. The risk-free rate has moved materially higher over the past 18 months or so. 3i Infrastructure is trading at a 12.7% discount to net asset value and has an ongoing charge of 1.59%.

Using the less onerous measure of seven out of 10 years at a total return of at least 6% we arrive at a slightly longer list of names. The success of the technology sector is reflected in the presence of **Allianz Technology Trust (ATT)** and **Polar Capital Technology (PCT)** on our list – both of which have achieved exceptional 10-year annualised returns.

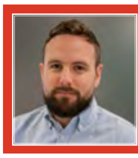
Coming in behind them is **Mid Wynd International (MWY)**. The trust has been managed for the past decade by Simon Edelsten at Artemis and looks for growth from long-term trends. It has a focus on quality stocks and a self-described disciplined approach which is intended to make it more resilient at times of crisis.

Along with the usual smattering of leading US technology names it also holds luxury goods giant **LVMH (MC:EPA)** and US healthcare and insurance firm **UnitedHealth (UNH:NYSE)**. Its ongoing charge is a competitive 0.61%.

It is important to note that asset manager Lazard is taking over management of Mid Wynd, expected to happen during the fourth quarter of 2023. Lazard will take a quality growth approach.

Elsewhere, private equity trust **Pantheon International's (PIN)** performance is impressive, particularly in the context of the patchier returns served up by the private equity peer group.

Investec analysts Alan Brierley and Ben Newell see Pantheon as a 'core holding for investors looking for a high quality, actively managed and globally diversified exposure to private equity' and the trust recently announced a £200 million share buyback as it looks to close a near-40% discount to net asset value. It has an ongoing charge of 1.25%.



By **Tom Sieber** Deputy Editor

How the tobacco sector presents investors with a moral dilemma

The shares are typically cheap and pay decent dividends but their products are a health risk

Investing in tobacco stocks can be an ethical minefield for investors due to the ongoing health risks associated with smoking and vaping. In the UK, 76,000 people a year die from smoking according to the NHS, and 480,000 people in the US according to the Centers for Disease Control and Prevention.

Russ Mould, investment director at AJ Bell, says: 'A lot of investors have turned their back on the sector due to ESG (environmental, social and governance) concerns, which explains why shares in stocks like British American Tobacco are relatively cheap and offer high dividend yields. They are deeply unloved.

'While these businesses remain highly cash-generative, they are having to find new ways to attract investors and win over sceptics.'

In this article we discuss how **British American Tobacco (BATS)**, **Imperial Brands (IMB)** and **Philip Morris International (PM:NYSE)** have fared with the shift to next generation products such as vaping and are going further to make themselves fit for the future, such as buying into health products like asthma inhalers.

REINVENTING THE SECTOR

Philip Gorham, a director of equity research at Morningstar, is optimistic about the changing face of the tobacco sector. He says: 'The advent of e-cigarettes has created the most significant change in the tobacco industry since the 1960s.

'Early forms of e-cigarettes have existed for a generation, but with the consumer arguably less brand-loyal and more aware of health issues than ever before, the industry is undergoing a shift to next-generation products.

'It seems likely that cigarettes will remain the driving force of the industry profit pool for the next decade, but Big Tobacco manufacturers are

How does the total return of tobacco stocks compare to the market?

Company	10-year total return
Altria	178%
Philip Morris	115%
Imperial Brands	62%
British American Tobacco	33%
Index	**10-year total return**
S&P 500	274%
FTSE 100	65%

Table: Shares magazine • Source: FE Analytics. All returns in pounds sterling. Data to 24 August 2023 nevertheless placing their bets on new categories most likely to win share of smokers.'

British American Tobacco is among the companies to have branched out from traditional cigarettes. The Dunhill, Kent, Lucky Strike and Rothmans brands owner has invested heavily in developing non-combustible products including vapes and nicotine pouches.

The company has lofty ambitions to achieve 50 million consumers of non-combustible products by 2030 and to accelerate the growth of its new category revenues at a faster rate than total revenue, reaching £5 billion in 2025.

'British American Tobacco's next generation product revenue was £2.9 billion in 2022; divisional revenue has grown at a 33% compound annualised rate since 2018,' says Gorham.

'However, the company will soon face greater competition in the US from **Altria's (MO:NYSE)** acquisition of Njoy, the partnership between Altria and **Japan Tobacco (2914:TYO)** in heated tobacco, and the potential re-entry of IQOS, a line of heated tobacco and electronic cigarette products manufactured by Philip Morris.

'We also expect adoption of heated tobacco to slow globally in the absence of transformational innovation.'

British American Tobacco has invested heavily in products such as nicotine pouches

The move towards next generation products for tobacco companies has been a double-edged sword as although it has grabbed the attention of investors who would not normally invest in tobacco stocks, it has sparked the rise in the use of vaping among adults and children aged between 11 and 17 in the UK.

RISE OF VAPING

According to charity ASH (Action on Smoking and Health), since 2021 the proportion of children currently vaping has been greater than those smoking. This year, the figure stands at 7.6% vaping compared to 3.6% smoking. That is an alarming statistic.

What are next generation products?

Product	What is it?
Vapes	Vapes are electronic devices that let you inhale nicotine in a vapour instead of smoke. This is done by heating a solution (e-liquid) that typically contains propylene glycol, vegetable glycerine, flavourings and nicotine.
Heated tobacco	This is heat processed tobacco leaf, allowing users to inhale nicotine into their lungs
Electronic cigarettes	E-cigarettes are sometimes referred to as vape pens or electronic nicotine delivery systems. Some e-cigarettes look like regular cigarettes, cigars or pipes. E-cigarettes do not contain tobacco.
Oral nicotine pouches and lozenges	This white pouch or lozenge is small and 'bite-sized' and contains nicotine and other ingredients such as spearmint.

Table: Shares magazine • Source: University of Nebraska, CDC, NHS

Top 10 tobacco companies worldwide by market cap

Company	$ billion	Country
Philip Morris International	$150.9	US
Altria	$79.7	US
British American Tobacco	$78.3	UK
ITC	$58.1	India
Japan Tobacco	$42.2	Japan
Imperial Brands	$21.3	UK
KT&G	$8.9	South Korea
PT Hanjaya Mandala Sampoerna	$8.7	Indonesia
PT Gudang Garam	$3.3	Indonesia
Vector	$1.9	US

Table: Shares magazine • Source: Global Data, Shares magazine

ASH also says that in March/April 2023 the proportion of children experimenting with vaping had grown 50% year-on-year, from one in 13 to one in nine.

British American's foray into next generation products and its promise to build 'A Better Tomorrow' has not stopped its share price falling 24% year-to-date (as of 21 August).

New proposed laws to reduce the visibility of vape products in the UK and a ban on non-therapeutic and single use vapes in Australia might have played a role in knocking British American Tobacco's share price this year as sentiment towards the sector weakens.

While selling vapes to under-eighteens is illegal in the UK, advertisements for the products often feature on social media apps used by children. The UK government is looking into banning fruit-flavoured vapes to deter young people from taking up the habit.

WHY INVEST IN THE SECTOR?

Given the multitude of concerns around addiction and health issues, one might ask why anyone invests in the sector. The answer lies in the dividends as you can find some of the highest yields on the market among tobacco stocks.

British American Tobacco has a 9.6% prospective yield versus 8.6% from Imperial Brands. Both are much better rates than you can get with cash in the bank, even after the rise in interest rates over the past 18 months or so.

However, high yields are less attractive if the value of the shares is falling. Imperial Brands' shares are down 16% year-to-date, meaning that an investor who bought at the start of 2023 would be sitting on a loss despite the generous dividends.

Anyone considering putting money into tobacco stocks, or if they already own them, needs to take a view whether the sector is facing a short-term blip or that it could soon return to the prosperous times of 2000 to 2016, during which shares in Imperial Brands increased more than 14-fold in value.

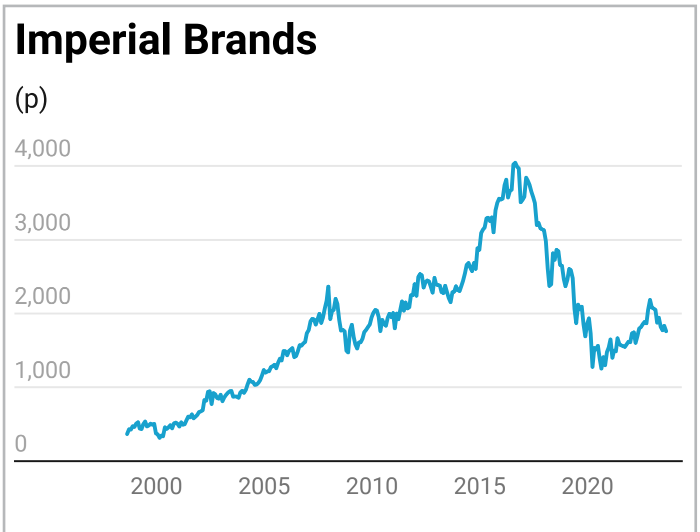


Chart: Shares magazine • Source: Refinitiv

Imperial Brands' shares enjoyed a good run between 2000 and the end of 2007, the latter period coinciding with the smoking ban in UK pubs, restaurants, nightclubs and most workplaces.

The stock was subsequently caught up in the global market sell-off linked to the credit crunch. It then rebounded and rose higher up to 2016, helped by investors being excited about the earnings prospects from next generation products.

The shares then fell back as it was clear that next generation product sales growth expectations were too high, and then investors started paying more attention to ESG matters, and certain people no longer wanted to invest in the tobacco sector.

The stock rebounded after the Covid-related global market sell-off in 2020 and kept rising until late 2022, helped by investors warming to value stocks including tobacco makers.

This year has been a harder slog for the sector which we can attribute to two factors. First, investors have warmed to growth stocks again and value shares are less appealing when we see this market rotation. Second, concerns about children vaping have been all over the news, which creates a headwind for companies involved in the manufacture of these products.

Imperial has an array of brands which includes JPS, Davidoff and Gauloises, and the company still has pricing power, despite regulators' restrictions on packaging and advertising, says Danni Hewson, AJ Bell's head of financial analysis.

In 2021, Imperial Brands' CEO Stefan Bomhard launched a five-year plan after profit warnings, managerial upheaval and a dividend cut. For the full year to September 2023, analysts are forecasting 7% growth in revenue to £9.46 billion and 3.9% growth in pre-tax profit to £3.51 billion.

US-LISTED TOBACCO COMPANIES

Philip Morris is taking a 'metaphorical leaf' from the other British American Tobacco and Imperial Brands by committing itself to replace cigarettes with less harmful alternatives as soon as possible.

The world's largest tobacco company – with 23% global market share – surprised investors in 2021 by buying UK inhaler firm Vectura for £1 billion.

This was effectively an attempt by the US tobacco company to pivot into the healthcare space. Vectura makes medicines and devices to treat respiratory illnesses like asthma. At the time of this acquisition, Philip Morris said that since 2008, it had invested more than $8 billion in developing smoke-free products.

The US tobacco company aims to generate over half of its revenue from non-combustibles by 2025.

Analysts at Morningstar have given the stock a fair value estimate of $103 per share, which implies a forward 2023 multiple of 17 times earnings per share, around 12 times enterprise value to earnings before interest, taxation, depreciation and amortisation, a free cash flow yield of 6%, and a dividend yield of 5%. The shares currently

trade at $94.

'Our valuation is at the high end of both the historical trading range of the tobacco industry and our valuation of the tobacco group because we think PMI's leadership position in heated tobacco means it could grow not only faster than its tobacco group peers, but also faster than most multinational consumer staples manufacturers over the next three to five years,' add the Morningstar analysts.

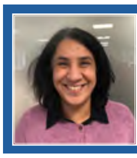
CAN I INVEST IN THE SECTOR VIA FUNDS?

While there is not a tobacco-specific tracker fund, several actively managed funds invest in tobacco stocks as part of a diversified portfolio.

For example, **Trojan Global Income (BD82KP3)** has British American Tobacco as its top holding, representing 5.2% of the portfolio at the time of writing. A further 4.5% of its assets are held in Philip Morris shares.

Man GLG Income (B0117D3) has 4.3% of its portfolio in Imperial Brands, sitting alongside investments in the banking, oil and pharmaceutical sectors, among others.

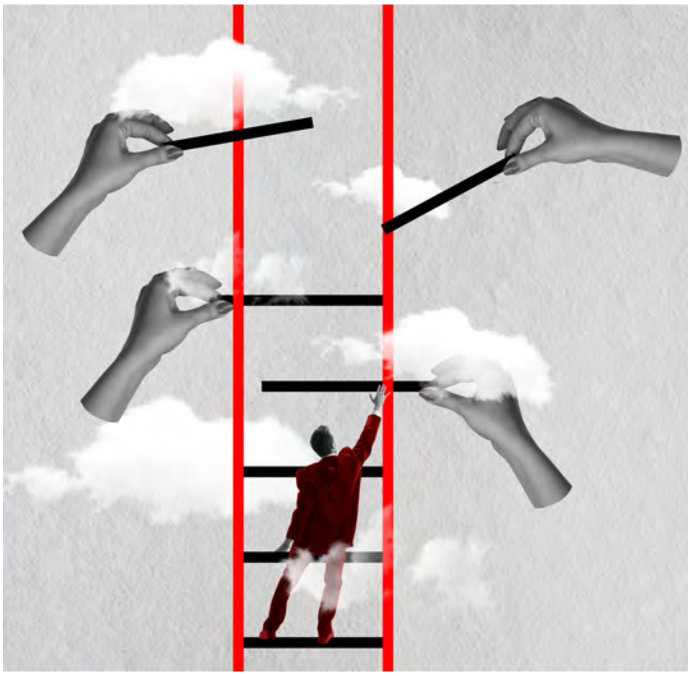
DISCLAIMER: AJ Bell is the publisher of Shares magazine. The author of this article (Sabuhi Gard) and the editor (Daniel Coatsworth) own shares in AJ Bell.



By **Sabuhi Gard** Investment Writer

Find out about the rapidly growing actively-managed ETF market

Traditionally used to track indices, these instruments are branching out with professionally selected portfolios



Traditionally, exchange-traded funds have been seen as wholly passive products, set up to give investors cheap, accessible and transparent access to the world's biggest markets.

Over time this market has developed to include products tracking niches, sectors and themes and the latest leg in their development is the actively managed ETF – which does not just follow an index but instead has a professional at the helm constructing a tailor-made portfolio.

In this article we will examine what an active ETF is, the pros and cons of this type of product, look at some examples and explore how this space might develop over time.

WHAT IS AN ACTIVELY-MANAGED ETF?

'An active ETF resembles a traditional actively managed mutual fund, but the ETF product trades on an exchange with the benefits of the ETF structure,' says Jason Xavier, head of EMEA ETF Capital Markets at Franklin Templeton.

'Active management doesn't have the constraints of tracking an index, which means an active manager can choose which stocks or bonds to buy, when to buy, when to buy them and at what size/price.

'In an effort to outperform its portfolio index, fund managers can actively respond to market events and adjust allocations amid changing market environments. In some instances, they even have some leeway to invest outside the confines of their benchmark index.'

There has been nothing necessarily stopping providers from offering active ETFs since the inception of these products more than two decades ago but one big obstacle was removed in the US with a regulatory change in 2019.

Fund managers often like to closely guard a full list of their holdings for fear a rival or individual investor might simply piggy-back on their success by copying their approach. In other words, they do not want to give away the secret ingredients behind their success.

This is at odds with ETFs' mandated transparency, where they must disclose all their holdings on daily basis. In 2019 the US flexed the rules to allow semi-transparency, with the underlying holdings obscured by proxy holdings, for example.

There is currently no such flexibility in Europe and before 2022, investors were not able to trade actively managed ETFs at all in Japan, until the Tokyo Stock Exchange announced that it would allow active ETFs with daily transparency to become listed in the second half of 2023.

A RAPIDLY GROWING MARKET

Mainly, though not exclusively, in the US the active ETF market has been growing rapidly and while they remain just 5.3% of total assets invested in global ETFs, they saw inflows of $60 billion in the first half of 2023.

Edward Malcolm, UK head of ETF distribution for JPMorgan Asset Management, says: 'The UK and Europe actively managed ETFs market is very

Examples of London-listed actively-managed ETFs

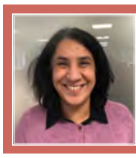
ETF	Fund size	Ongoing charge	One-year performance
Invesco Quantitative Strategies ESG Global Equity Multi-Factor UCITS ETF Acc	£73m	0.30%	12.0%
Fidelity Sustainable Research Enhanced Europe Equity UCITS ETF Acc	£144m	0.30%	10.2%
Fidelity Sustainable Research Enhanced US Equity UCITS ETF Acc	£446m	0.30%	7.5%
Fidelity Sustainable Research Enhanced Global Equity UCITS ETF Acc	£33m	0.35%	7.3%
HSBC Multi-Factor Worldwide Equity UCITS ETF USD	£927m	0.25%	5.6%
JPMorganEUR Ultra-Short Income UCITS ETF - EUR (Acc)	£917m	0.08%	4.8%
Frankin Euro Short Maturity UCITS ETF DIS	£393m	0.05%	4.4%
Lyxor Smart Overnight Return UCITS ETF C-GBP	£430m	0.07%	3.6%
Ossiam ESG Low Carbon Shiller Barclays CAPE US Sector UCITS ETF	£639m	0.75%	2.3%
JPMorgan EUR Corporate Bond 1-5 yr Research Enhanced Index (ESG) UCITS ETF	£60m	0.04%	1.2%
PIMCO Sterling Short Maturity UCITS ETF Dist	£164m	0.35%	−0.7%
Ossiam ESG Low Carbon Equity Factors UCITS ETF 1A (USD)	£118m	0.45%	−2.1%
Franklin Euro Green Bond UCITS ETF	£224m	0.18%	−5.1%
Franklin USD Investment Grade Corporate Bond UCITS ETF	£7m	0.35%	−6.3%

Table: Shares magazine • Source: JustETF (as of 3 August 2023) much a growing sector. We [JPMorgan] now have 18 actively managed ETFs in the UK and Europe, compared to the US where there are 27 and currently have global assets under management of £130 billion.’

A key attraction of ETFs, beyond the transparency and liquidity provided by their market listing, is their cost. The typical active equity fund costs around 0.7 percentage points more per year than an ETF. However, simple ETF trackers obviously don’t have the extra costs which come with paying a team of professionals to manage a portfolio.

As JPMorgan’s Malcom says: ‘ETFs offer investors flexibility with trading, transparency and lower costs.’

It is relatively early days for actively managed ETFs on the UK market and therefore difficult to judge their performance, for this area to really take off it may require the sort of regulatory changes seen across the Atlantic.



By **Sabuhi Gard** Investment Writer

SNAPSHOT OF AN ACTIVE ETF

Callum Abbot is one four portfolio managers of the **JPMorgan UK Equity Core UCITS ETF (JUKC)** – an actively managed ETF launched on 14 June 2022 with an ongoing charge of 0.25%.

It has produced an annualised return of 6.85% since launch compared to a 6.96% annualised return of its benchmark the FTSE All-Share Index.

Abbot rebalances the portfolio monthly using a ‘core investment process’ and the named fund managers have a team-based approach.

The top 10 holdings reflect the benchmark index, with some of the largest holdings in **AstraZeneca (AZN)**, energy giant **Shell (SHELL)**, **HSBC (HSBC)** and **Unilever (ULVR)**.

According to its factsheet a typical investor for this JPMorgan ETF is one who ‘wants to take broad market exposure to the UK stock market, who seek to benefit from potential excess returns after fees with similar risks to investing in securities representing the benchmark.’

Think there's no value to be found in the US? Think again

There are several funds which look to identify less expensive stocks from across the Atlantic

It is the biggest, most liquid stock market in the world, offers huge diversification, access to top innovation, and all under the watchful eye of strict governance rules to protect investors.

That there should be a place in every UK investor's portfolio for US equities is to bang a well-worn drum and such is the market cap might of the US's largest companies, even world index ETFs will provide significant US exposure.

WHY YOU NEED US EXPOSURE

There are several reasons to consider having specific exposure to US stocks right now. First, no market benefits more from AI (artificial intelligence) than the US – it has got the planet's biggest tech industry and is the centre of AI innovation. Labour markets have been tight across the world and AI can significantly boost productivity and lower costs. In simple terms, it can really rev up the profitability of US companies.

Analysts at Goldman Sachs estimate that AI could jack up US productivity by 1.5% annually, translating into an extra 1.1% in economic growth every year for a decade.

With the risk of a global growth slowdown, it makes sense to load up on companies with more defensive and structural growth drivers. Compared to its peers, the US stock market has less exposure to recession-vulnerable industrials and basic material firms, and a heavy exposure to technology companies, whose revenues and profits often hold up better in tough times.

Low-cost exchange-traded funds are an obvious way to do it. There are any number of ETFs that will track the US stock market in general terms, or the major indices – the S&P 500, Dow Jones Industrial Average, Nasdaq Composite, Nasdaq 100, and even the Russell 2000, the main smaller cap index stateside.

Vanguard FTSE North America ETF (VNRG) is one of the cheapest routes into the US equity market, tracking an all-encompassing collection of 640-odd US and Canadian stocks with an ongoing charge of 0.1%.

Index tracking ETFs are great for low-cost exposure to mainstream stocks, like **Apple (AAPL:NASDAQ)**, **Coca-Cola (KO:NYSE)** or **Tesla (TSLA:NASDAQ)**, but what if you want to avoid some of the higher rated, higher risks stock and add US value to your portfolio?

HOW INVESTORS CAN TAP VALUE IN AMERICA

Most investors will not associate the US markets with value. The 12-month forward price to earnings multiple for the S&P 500, for example, currently stands at 20.3. Yes, it has been higher in the past – it was more than 23 a year ago – but this is hardly value territory.

PE and yield multiples for US markets

	Forward price to earnings ratio	Dividend yield
Dow Jones	19	2.1%
Russell 2000	30	1.7%
S&P 500	20	1.6%
Nasdaq 100	30	0.9%

Table: Shares magazine • Source: Birinyi Associates, Dow Jones Market Data

Yet value investors have both ETF and actively managed options available to them, although you might have to do some digging to see if they are appropriate for you.

For example, the **M&G North American Value Fund (B61S424)** aims to deliver capital and income performance, net of 0.97% ongoing charges, which beat the total returns of the S&P 500 over any five-year period.

The strategy is to invest in 'undervalued' stocks, what the manager calls 'cheap and out-of-favour companies', whose share price does not accurately reflect the valuation of the business. Given that the S&P 500 is dominated by large cap technology and growth stocks, beating the S&P 500 sounds like a tall order for a traditional value portfolio.

Peeking inside the M&G fund's top 10 holdings and investors might conclude that this is anything but a traditional value portfolio. Google and Facebook parents **Alphabet (GOOG:NASDAQ)** and **Meta Platforms (META:NASDAQ)** are its two largest holdings, worth a combined 8.2% of assets.

Having a pair of stocks trading on forward price to earnings (PE) multiples of 21.3 and 18.9 respectively (according to Stockopedia data) might surprise for a fund with the word 'value' in its name.

Readers must consider that it is the manager's opinion that both stocks are undervalued despite elevated PEs. Other metrics may be relevant and it is their job to make calls on investors behalf.

It is also true that the top 10 holdings include the likes of **Johnson & Johnson (JNJ:NYSE)** – whose PE is below 15 – while banks and big oil are present, but so too is **Oracle (ORCL:NYSE)**, on a PE of 20.5. The fund's average PE is 13.9.

The portfolio top 10 of the **MFS Meridian US Value Fund (B08N668)** looks more suited to a traditional value ethos, featuring **JPMorgan Chase (JPM:NYSE)** (PE 9.7) as its largest holding. You can't get much more value orientated than a big bank, while insurance – **Aon (AON:NYSE)**, healthcare – **Cigna (CI:NYSE)** and Johnson & Johnson again, big oil – **ConocoPhillips (COP:NYSE)** and defence group **Northrop Grumman (NOP:NYSE)** are also in the top 10.

Yet MFS Meridian US Value Fund's average PE is 16.2, according to Morningstar data. This illustrates that investors need to look under the bonnet of a fund before committing to make sure of what you are backing.

LOW-COST ETF VALUE OPTION

A cheaper value alterative to consider is the **iShares Edge MSCI USA Value Factor ETF (IUVF)**. The iShares fund is designed to mirror the performance of the MSCI USA Enhanced Value index, which is composed of US large and mid-cap companies with favourable value characteristics, based on the price to book value, price to forward earnings, and enterprise value to cash flow from operations. The ETF has a 0.2% ongoing charge.

There are approximately 150 holdings in the index, which as of 22 August 2023, had an average price to forward earnings ratio of 10.9 and price to book ratio of 1.5, according to Morningstar.

From a sector perspective technology has the

largest weighting at 29.5%, followed by healthcare (14.1%), financials (10.9%) and consumer discretionary (10.6%).

TUNING OUT OF TECH

What if you want exposure to the world's largest economy but without highly valued tech companies? The **Premier Miton US Opportunities (B8278F5)** is one option. This fund aims to grow capital growth over the longer-term (at least five years) but largely eschewing the tech sphere. Less than 15% of assets are in the TMT (technology, media, telecommunications) space and many of the top 10 names would be unfamiliar to most readers (see table).

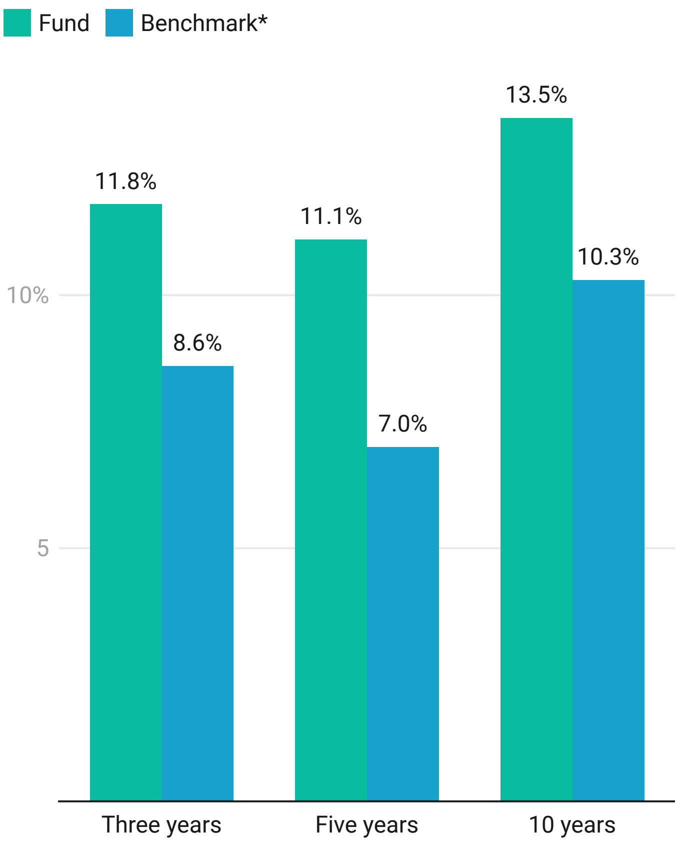
Premier Miton US Opportunities Top 10

Watsco	3.8%
Graphic Packaging	3.5%
WESCO International	3.1%
Beacon Roofing Supply	3.1%
SiteOne Landscape Supply	3.0%
PulteGroup	3.0%
Waste Connections	2.9%
Arthur J Gallagher	2.9%
Vulcan Materials	2.8%
Marriott International	2.7%

Table: Shares magazine • Source: Premier Miton

But despite this lack of tech, the strategy seems to have worked well, providing consistent above-benchmark returns over three, five and 10-year periods.

Premier Miton US Opportunities annualised performance



*US Flex-Cap Equity

Chart: Shares magazine • Source: Morningstar

By **Steven Frazer** News Editor

Big domestic consumption is driving growth in India

China is hoping to enjoy the same benefits in time

A big transition in the development of emerging markets tends to be an increase in the contribution of domestic consumption to economic growth.

Historically, emerging markets have tended to be much more reliant on exports to the West to grow their economies.

Making the transition to greater domestic-led economic activity has been a key part of China's economic strategy in recent years and a similar trend is already in motion with one of the best performing markets in the developing world – namely India.

The MSCI India index has delivered an annualised return over 10 years of 13%, compared with just 7% for the broader MSCI Emerging Markets benchmark.

A young, rapidly growing and increasingly affluent population has driven consumer spending higher in India; up 6.5% in 2022 and 17.6% in 2021, down 5.2% in 2020 thanks to the pandemic, but up 7.8% in 2019 according to World Bank data.

In the International Monetary Fund's July 2023 update to its World Economic Outlook, it raised its Indian growth forecast. The IMF observed: 'Growth in India is projected at 6.1% in 2023, a 0.2 percentage point upward revision compared with the April projection, reflecting momentum from stronger-than-expected growth in the fourth quarter of 2022 as a result of stronger domestic investment.'

The recovery in the buying power of the India consumer following the pandemic can also be seen by comparing the make-up of the MSCI India index from September 2021 with today. The consumer discretionary sector has a significantly increased weighting.

This outlook is part of a series being sponsored by Templeton Emerging Markets Investment Trust. For more information on the trust, visit **www.temit.co.uk**

MSCI India - sector breakdown - September 2021

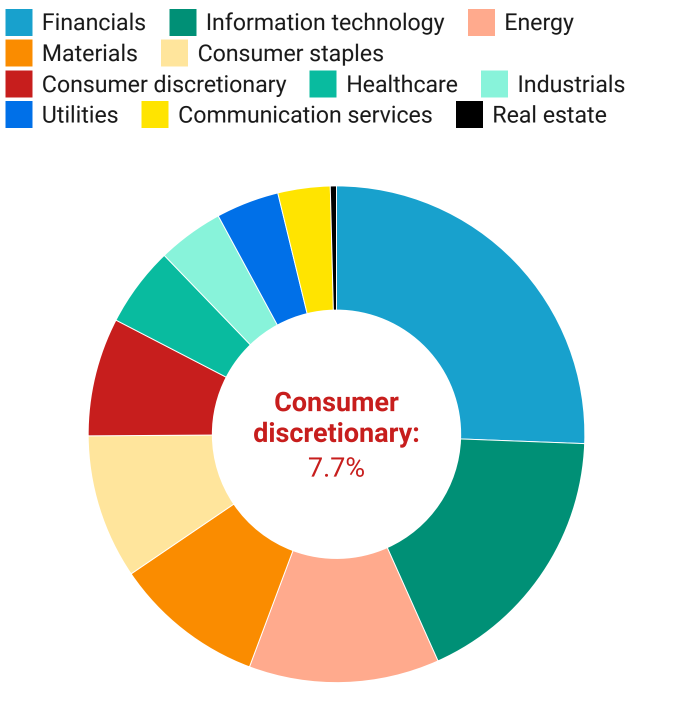


Chart: Shares magazine • Source: MSCI, 30 September 2021

MSCI India - sector breakdown - July 2023

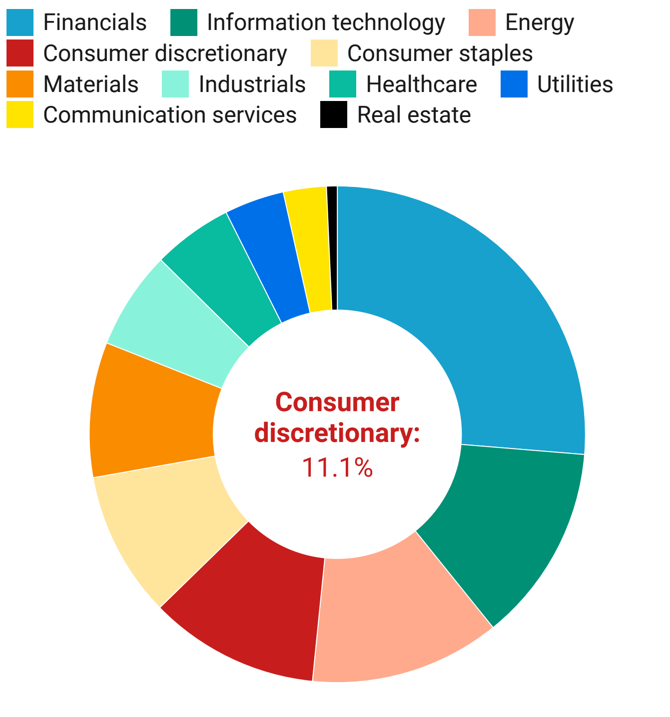


Chart: Shares magazine • Source: MSCI, 30 September 2021

Emerging markets: big overseas investment in India and earnings recovery

Three things the Franklin Templeton emerging markets team are thinking about right now

1. Foreign institutional investor (FII) flows into India: Investor flows turned positive in March following a recovery in the equity market, with $15 billion in inflows year-to-date through the end of July. India's ability to capture an increasing share of foreign institutional flows into emerging markets reflects an improvement in the market's risk-return profile. Factors include growth-oriented policy continuity, a reduction in inflation and the twin deficits (fiscal and current account balances), and increased spending toward infrastructure projects that increase capacity and productivity.

2. Earnings: Consensus expectations for the MSCI Emerging Markets Index reflect a 9% decline in earnings per share during the first half of 2023. The primary countries driving the earnings weakness are Taiwan, related to the semiconductor industry, and Brazil, related to the energy sector. Investors are expecting an improvement in the outlook for semiconductor demand to lead a recovery in the second half of 2023. These expectations are providing support to the MSCI Emerging Markets index, which gained 6.3% in July 2023.

3. Food prices: Following Russia's decision not to renew the Black Sea grain initiative with Turkey and the United Nations, the price of wheat increased 10% in July 2023. Prices of other agricultural commodities have also increased; Thai rice was up 10% and palm oil prices have increased 20%. In combination with the confirmation of the El Niño climate phenomenon in the second half of 2023, there are upside risks to emerging market inflation. We are monitoring this for signs it is impacting margins of companies in the consumer staples sector.

TEMPLETON EMERGING MARKETS INVESTMENT TRUST (TEMIT)

Porfolio Managers

Chetan Sehgal
Singapore

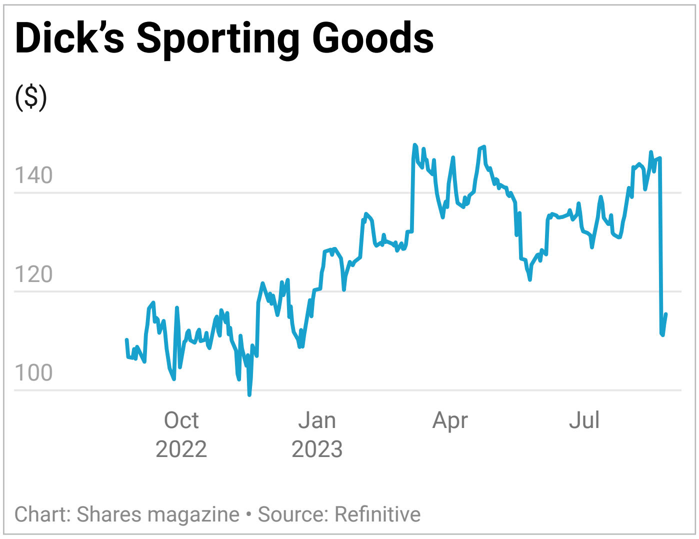
Andrew Ness
Edinburgh

TEMIT is the UK's largest and oldest emerging markets investment trust seeking long-term capital appreciation.

Danni Hewson: Insightful commentary on market issues

How shoplifting and organised crime is shrinking retail profits

The problem is now so bad that it is pulling down share prices



The cost-of-living crisis has left many of us wrestling with tight budgets. Difficult choices have had to be made and people have had to do without, not just things they want but also things they need.

Amidst that backdrop retail crime has risen considerably with thefts up by 27% across 10 of the UK's largest cities and even higher in some according to figures from the British Retail Consortium.

It's not just shoplifting; incidents of violence and abuse have nearly doubled from where they were pre-pandemic and organised theft, where gangs steal to order, is becoming a huge issue for retailers big and small.

John Lewis made headlines recently when it began offering free hot drinks to police officers, with the company's head of security Nick Juniper noting that just having a police car parked outside 'can make people think twice'.

Protecting staff has become a massive concern and bosses from both the John Lewis Partnership and the Co-op have written to the Home Secretary calling for tougher action on repeat offenders.

In the US retail crime has been labelled an epidemic with **Target (TGT:NYSE)** warning it expected to lose hundreds of millions to what it calls 'shrink' over this financial year.

Shrink covers a multitude of sins, from breakages to shoplifting, but basically, it's the difference between the goods that should be there and what's actually there.

More corporate earnings updates mention the issue and shareholders are now having to factor it into their own decision-making.

When **Dick's Sporting Goods (DKS:NYSE)** blamed the issue for a near-25% slump in second quarter profits, its share price plummeted and chief executive Lauren Hobart said, 'the impact of theft on our shrink was meaningful'.

JD Sports' (JD.) tactic of only displaying one shoe is a clever deterrent, but social media was full of pictures showing a sea of police gathered outside its flagship London Oxford Street site at the beginning of August as a 'mass shoplifting event' singled out the store, an event that had already set nerves on edge.

Retailers are spending additional cash on security staff, upgrading anti-theft measures and having more staff visible on the shop floor. But organised gangs in particular are determined and the level of violence being deployed is deeply concerning.

Easing inflation should help consumer confidence and a resilient jobs market should mean more people have the means to purchase what they need and some of what they want without having to resort to the black market.

But retailers, particularly smaller ones, are often seen as a soft target and with a vast online marketplace for goods to be potentially resold it's something that's becoming an increasingly big deal.

Find out how to build an investment portfolio with trackers

Passive funds including ETFs can be a straightforward and low-cost way to get into investing

Investing has transformed over the past several decades, and one of the key innovations driving this change has been the emergence of passive funds. Characterised by their low fees and simplicity, passive funds (including exchange-traded funds) provide investors with an effective way to gain diversified exposure to various asset classes and market themes. There are hundreds of tracker funds available to UK investors, so how exactly do you go about building a passive portfolio?

RISK, OBJECTIVES AND ASSET ALLOCATION

The first thing to think about is the amount of risk you want to take and what objectives you have for your investment. How much risk you wish to take will determine how much to invest in shares, and how much to invest in bonds.

An adventurous, younger investor might choose to invest 100% in stocks, whereas someone approaching retirement might feel more comfortable with a portfolio that is split 60% in favour of shares with 40% in bonds for some ballast to smooth out market volatility. You can then either populate your portfolio with individual stock and bond trackers, or you can simply buy a tracker fund which invests in both stocks and bonds.

Your objectives should also come into play and might determine whether a fully passive portfolio is right for you or not. If you're simply after growth, then a portfolio of index trackers is pretty straightforward to pull together.

But if you have specific needs, like a regular income stream, or you wish to invest in specialist areas which are not well served by tracker funds, like smaller companies, then you might need to consider active funds instead. There's no harm having a mix of active and passive funds in the same portfolio in any case.

REGIONAL EQUITY DIVERSIFICATION

This is the most difficult part of building a portfolio because there is no 'right' answer, unless you have a particularly reliable crystal ball which tells you which markets are going to perform best. There are a number of different approaches you can take to this conundrum.

The first is to simply allocate your money across the global stock market based on company and market size. This is effectively what a global tracker fund would do, so you could just buy one of these. The benefit of this approach is it's really simple, rebalancing isn't required as this automatically takes place, and your fund performance will roughly match up with the global stock market.

The downside of this approach is it will lead to a portfolio that's heavily exposed to the US stock market, as that's where the biggest companies are.

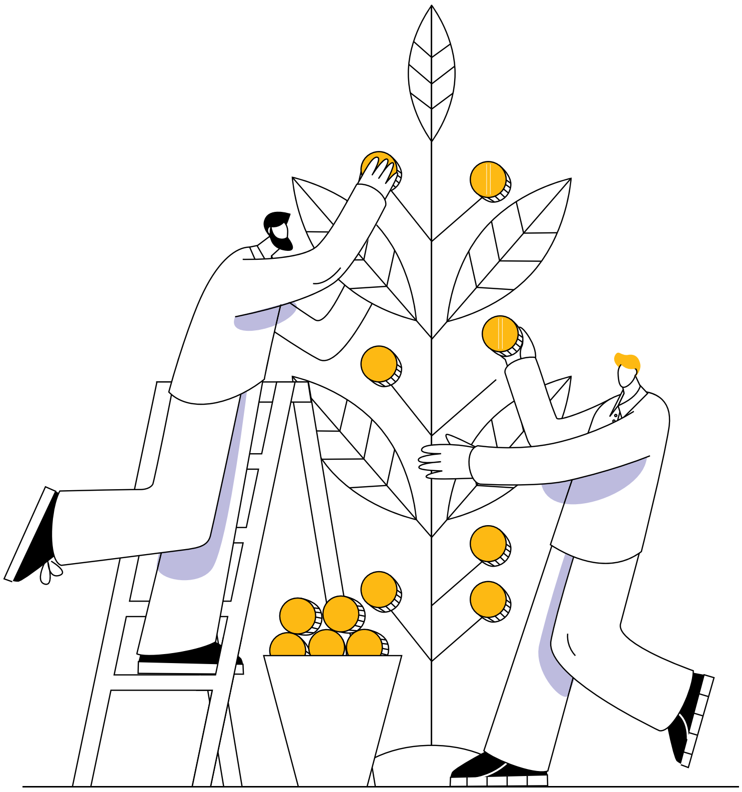
An alternative, slightly more active approach would be to invest a fifth of your portfolio in each of the major regional markets: the US, UK, Europe, Japan and emerging markets. This adds some balance in terms of where your risk and reward is coming from, and you can use it as a baseline for making active regional allocation decisions if you so wish, boosting exposure to one area you have confidence in at the expense of another you think is a bit of a dog's dinner.

HOW TO PICK THE RIGHT INDEX

Once you've decided the overall shape of your portfolio in terms of asset classes and regions, it's time to pick funds to fit into each of the slots. There are several things to look out for, but the top three are the index being tracked, the tracking difference, and charges. The index being tracked normally takes care of itself when picking plain vanilla index trackers, which will follow broad market indices. At the margins there may be some decisions to be made, in the UK whether to invest in a fund that tracks the FTSE 100 or one which follows the wider FTSE All Share, for example.

You might also have a bit more research to do if you are investing in more niche or thematic trackers, where the indices are less well known, in which case you should familiarise yourself with how the index is constructed so there are no nasty surprises along the way.

The tracking difference is the performance differential between the passive fund and the index it is tracking. You want this to be as small as possible, though bear in mind there will always be



a bit of a wedge because of fund charges, and this will widen the longer the time period you look at. You can find the tracking difference by looking at performance on the fund's factsheet, which should be set against the index.

LAST BUT NOT LEAST… CHARGES

Charges are always important, but perhaps particularly so with passive funds. If a tracker is doing its job correctly, it will underperform the index each year by the level of fees it levies. The cheapest UK tracker fund costs just 0.05% per year, while the most expensive charges more than 1%. Because there should be no difference in performance before charges, the latter is simply feathering the nest of the fund provider rather than investors.

Over the last 10 years the most expensive fund has turned £10,000 into £16,336 after charges, but it would have been worth £17,999 in the cheaper tracker. Which one to choose is as close as you will get to a no-brainer.

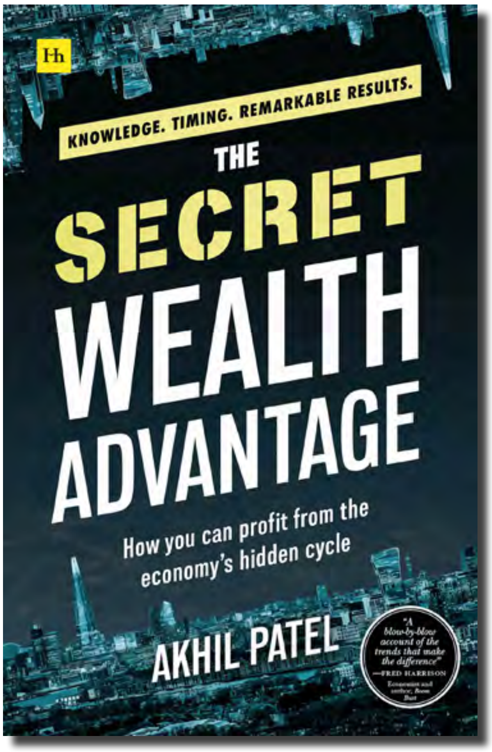
By **Laith Khalaf**
AJ Bell Head of Investment Analysis

Why understanding the property cycle is crucial to growing and preserving your personal wealth

The Secret Wealth Advantage could be the most important book you read this year

It may sound like a bold claim, but Akhil Patel argues his book, *The Secret Wealth Advantage*, can not only help readers anticipate periods of boom and bust but also tell them what to buy and sell when the time comes.

The book presents a socio-economic history of the commercial property cycle and its influence on the economy as a whole, together with a well-articulated argument that without an understanding of that cycle we are almost certainly doomed to repeat the booms and busts of the past.



The author provides plenty of food for serious thought, from the works of some of the greatest economists of the last couple of centuries to the inside story of the collapse of the Soviet Union and the rise to power of Vladimir Putin.

Yet the book is also highly readable, with plenty of vivid accounts from ancient Rome via the great crash of the 1920s, the Japanese land boom of the 1980s and the great financial crisis, to modern-day Gaza and, much closer to home, London Bridge, of the ups and down of the property market and ultimately the importance of 'the law of economic rent'.

The book divides the cycle into four stages: the start; the mid-cycle, which includes an interim peak followed by a mild recession or set-back; the boom, culminating in the summit; and the crash, after which the whole process begins anew.

At each stage, Patel lays out what readers should consider, from the private investor to the business owner and the professional landlord.

Each cycle is facilitated by a new technology – in the past this has included railways, electricity, the personal computer, the internet and the smartphone. Today, we have generative AI (artificial intelligence).

Second, each cycle sees the unveiling of mega-projects which are destined to fail – in 1980s Japan it was the mile-high Millennium Tower designed to be built in Kobe, which never was.

Today, we have The Line in Saudi Arabia, a giga-project 'which defines what cities of the future will look like' according to its promoters. A 'cognitive' linear city, 500 meters high and 200 meters wide, stretching 170 kilometres and built entirely under mirrored glass, The Line is expected to house 9 million people and run on 100% renewable energy.

Whether your interest is in markets or property, this book offers food for thought and lessons in time for the next cycle.

By **Ian Conway** Companies Editor

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Growth & Innovation

tinyBuild

INCLUDES COMPANY PROFILES, COMMENT AND ANALYSIS

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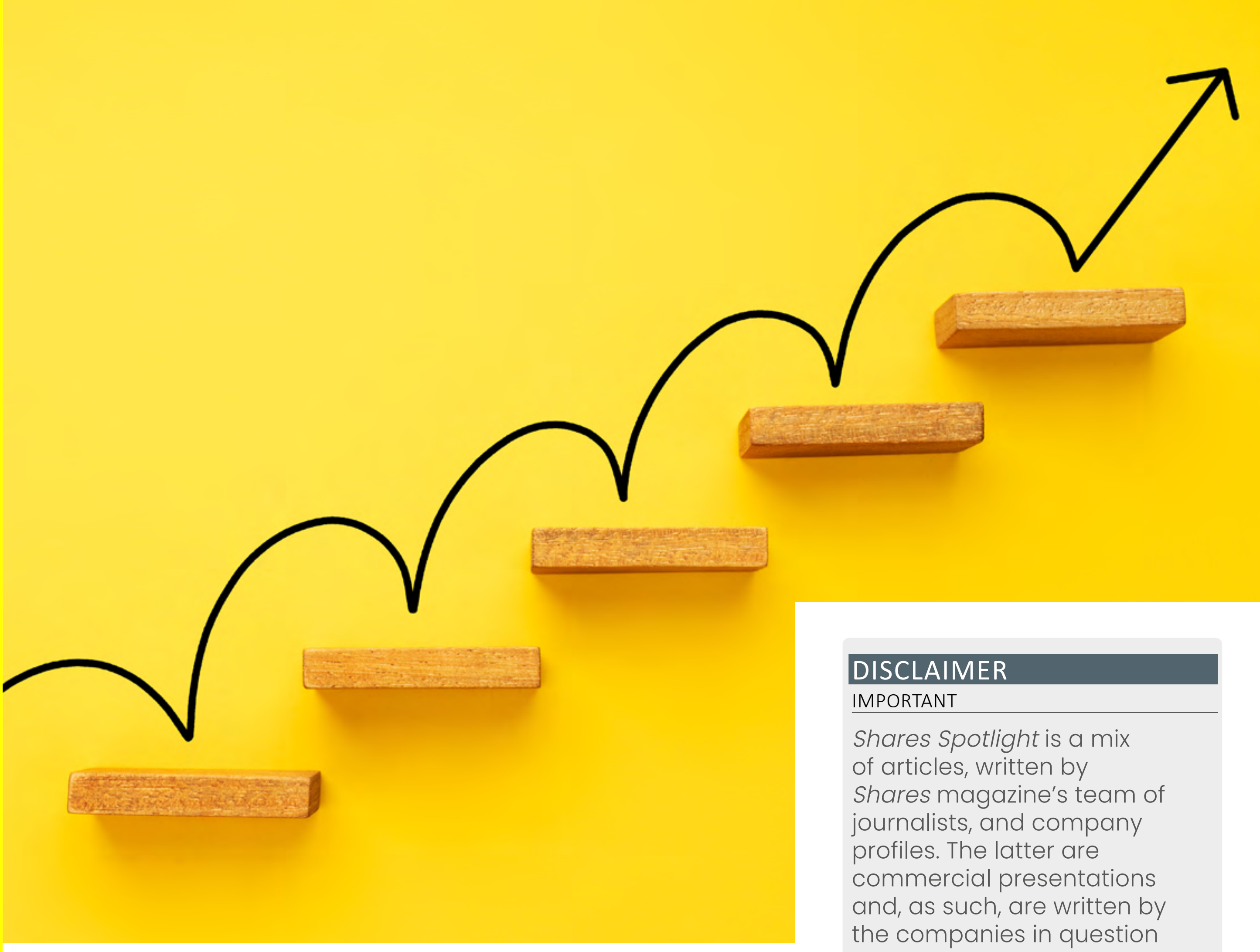


Introduction

Welcome to *Spotlight*, a bonus report which is distributed eight times a year alongside your digital copy of *Shares*.

It provides small caps with a platform to tell their stories in their own words.

The company profiles are written by the businesses themselves rather than by *Shares* journalists.

They pay a fee to get their message across to both existing shareholders and prospective investors.

These profiles are paid-for promotions and are not independent comment. As such, they cannot be considered unbiased. Equally, you are getting the inside track from the people who should best know the company and its strategy.

Some of the firms profiled in *Spotlight* will appear at our investor webinars and live events where you get to hear from management first hand.

Click here for details of upcoming webinars and events plus how to register for free tickets.

Previous issues of Spotlight are available on our website.

DISCLAIMER

IMPORTANT

Shares Spotlight is a mix of articles, written by *Shares* magazine's team of journalists, and company profiles. The latter are commercial presentations and, as such, are written by the companies in question and reproduced in good faith.

Private equity trusts provide exposure to unquoted growth companies

Not all smaller companies join the stock market but there are means of gaining exposure

This article is based on a report produced by Edison Investment Research, other [thematic research](#) is available.

Private equity (PE) has established itself as an important asset class for institutional investors globally (to which they often allocate around 5%-15% of their portfolios), as it provides access to actively managed, attractive companies not accessible through public markets.

Investors can gain exposure to private equity by investing in a number of listed entities that invest in private companies globally. We calculate that these companies delivered a compelling weighted average net asset value (NAV) per share total return of close to 15% pa over the 10 years to end-2021 in sterling terms and are trading at wider than usual discounts to NAV.

A BROADENED INVESTMENT UNIVERSE

Broadening the investible equities universe PE managers are flexible in terms of selecting the most promising (sub) sectors of the economy and can therefore focus on companies benefiting from transformative, secular trends such as digitalisation and automation, changing consumer preferences with respect to nutrition, ageing society, leisure and learning or decarbonisation. This flexibility is because they typically have vast deal origination networks and are not limited by any pre-defined sector allocation restrictions and consider the public equity market as a broad reference point rather than strict benchmark.

At the same time, businesses increasingly opt to stay private for longer, while the number of listed companies has not been expanding in recent years. Consequently, qualified investors ignoring PE potentially miss out on an attractive investment universe, especially in the small and mid-cap range.

ACTIVE OWNERSHIP SUPPORTING ATTRACTIVE RETURNS

While relatively high leverage remains an inherent part of PE investment strategies, which results in incremental investment risk, particularly as interest rates increase sharply, the industry has matured over the last few decades and PE managers have focused increasingly on the operational improvement of portfolio holdings. PE's active ownership model is often facilitated by extensive in-house experts (value creation teams) with a hands-on approach to improving the value of private companies (both organically and through M&A) based on a well-tested playbook. Accordingly, sector expertise is becoming a key differentiator within the industry

PE constitutes a compelling addition to a listed equities exposure as it broadens the investable equities universe in terms of attractive subsectors and companies. While PE's long-term outperformance of public markets has been the subject of fierce debate for many years (especially for post-2005 vintages in the US), 2 some most recent studies suggest that PE returns may indeed have been ahead of public equities.

US PE (as measured by the Cambridge Associates' US Private Equity Index, covering buyout and growth equity funds) delivered a 10 and 20-year horizon pooled return (net to LPs) to end-2021 of c 18.5% and c 14.7% pa respectively, which is ahead of the returns of the modified public market equivalent (mPME) indices calculated by Cambridge Associates based on listed US small caps (c 14.3% and c 9.9% respectively), as well as the mPME index based on the MSCI All Country World Index (c 13.0% and 8.7% gross return respectively).

Similarly, Cliffwater (an independent investment adviser and asset manager) recently estimated that PE allocations of US state pensions delivered an 11%

return a year (net of fees) over the 21 years to end-June 2021 compared to 6.9% a year for public stocks (defined as 70% US equities, including both large and small caps, and 30% non-US equities represented by the MSCI ACWI ex US Index).way as any other listed equity (though in some cases subject to an investor having access to the LSE's Specialist Fund Segment), they represent a liquid investment with a low minimum ticket size.

These listed PE companies are evergreen vehicles without a specified maturity (though they may be subject to continuation votes) and thus provide investors with flexibility in terms of the holding period. They are normally closed-end investment funds or public limited companies (rather than open-end funds), that is structures that are aligned with the illiquid nature of PE.

VALUE CREATION THROUGH AN ACTIVE OWNERSHIP MODEL

The PE industry has matured over the last 30 to 40 years, with more emphasis on operational improvements to drive returns. In The Advantage of Persistence, published in February 2008, the Boston Consulting Group and IESE Business School outlined four eras of PE development:

- Leverage (1980s) – when leverage accounted for roughly half of the value realised by PE companies followed by c 31% from multiples arbitrage and only 22% from operational improvement.
- Multiple expansion (1990s) – when multiple arbitrage accounted for 46% of value versus 32% leverage and 22% operational improvement.
- Earnings growth (2000s) – when operational improvement became more important as a source of realised returns (36%), with multiples arbitrage at 39% and leverage at 25%.
- Operational improvement (which started in 2010s) – when improvements to a company's underlying operations took over as the major source of value uplift. PE funds normally acquire controlling or at least 'influential' minority stakes in private companies, which allows them to foster positive strategic and operational changes of its portfolio holdings.

While it is difficult to precisely estimate what part of the generated returns are attributable to PE's active ownership model, we consider it a distinct advantage of PE investment companies over most public equity funds (as well as passive minority investments in private companies). This applies especially to PE companies with internal value creation teams, which prove useful during both economic expansion and downturn.

Private equity trusts trade at big discounts

Trust	Discount / premium (%)
NB Private Equity Partners	-31.16
HgCapital Trust	-21.41
HarbourVest Global Private Equity	-42.68
CT Private Equity Trust	-29.77
Dunedin Enterprise	-10.49
Oakley Capital Investments	-32.65
abrdn Private Equity Opportunities	-42.6
Princess Private Equity Holding	-26.88
ICG Enterprise Trust	-43.35
Pantheon International	-39.22
JPEL Private Equity	-39.31

Table: Shares magazine. Source: Association of Investment Companies, 25 August 2023 www.tinybuild.com

Video games developer tinyBuild pursues a diversified IP-driven strategy

Global video games publisher and developer **tinyBuild (TBLD:AIM)** has a unique strategy that balances IP (intellectual property) ownership and a well-diversified portfolio of over 80 titles.

Founded in 2013 and floating in 2021, tinyBuild is headquartered in the US with over 400 staff, and operations across the Americas, Europe, and Asia. Its geographic diversity enables tinyBuild to source high-potential IP and skilled development resources in the most advantageous locations.

The founder and CEO, Alex Nichiporchik retains a 37.8% stake in the company, which demonstrates his confidence in its prospects. This is an alignment of interests with investors when it comes to value creation.

LONG-TERM VALUE CREATION

The formula for value creation adopted by tinyBuild is simple and relies on two pillars. One pillar is maximising returns through IP ownership. When a game is successful, the Company and developers share the future upside and can immediately expand the franchise without the need to renegotiate contracts. The other pillar is minimising risk through a well-diversified portfolio of back catalogue games and new titles, across different genres, audiences and price points.

Over the course of 2021 and 2022 tinyBuild stepped up investments on larger titles, with development budgets of $1-5 million, and focusing on Game as a Service opportunities. This is a proven strategy as shown by the 1.9 times average return on investment achieved by the three large-budget games launched in 2022.

As new titles fall into the back catalogue, smaller investments can generate relatively steady and predictable sales at a lower risk. This means returns will continue to grow over time, with some games having their best ever year in terms of revenue, years after their original launch.

The main reason behind tinyBuild's extended revenue life cycle is a franchise approach to its IP. The blueprint is based on the success of how the *Hello Neighbor* IP was enriched by multiple titles across different genres. Moving from the original linear story line in *Hello Neighbor* to the multiplayer spin-off called *Secret Neighbor*, the user-generated content variation of the game, *Hello Engineer*, and finally the open-world sequel *Hello Neighbor 2*. The title has been ported to different platforms and the IP extended to books, graphic novels and, more recently, an animated series.

Alongside launching new games, tinyBuild has a number of monetisable events every year. These events include games updates, new platform launches, downloadable content, and sequels. One example is *Punch Club 2*, a highly anticipated

Summary of competitors

Company	Business type	Top franchises	% of revenues from own IP	% of revenues from back-catalogue	Number of titles in portfolio
tinyBuild	**Developer - Publisher**	**Hello Neighbor, Streets of Rogue, Totally Reliable Adventure Park, Graveyard Keeper**	**77%**	**80%**	**80+**
Devolver Digital Games	Publisher & Developer	Serious Sam, Shadow Warrior, Enter the Gungeon, Reigns, Hotline Miami**	Estimated to be 22% (Based on 24 titles own-IP at end of-FY22)	45%	109
Embracer Group	Holding Company	The Lord of the Rings, The Hobbit, Tomb Raider, Deus Ex, Legacy of Kain, Thief, Risk of Rain, Star Trek	61% (For PC/Console games)	53% (For PC / Console games)	850% Owned or controlled franchises
Frontier Developments	Developer of self-published titles*	Elite Dangerous, Planet Coaster, Planet Zoo, Jurasic World Evolution, F1 Manager	Not disclosed but uses a mix of own-IP and licensed-IP	67%	16
Keyword Studios	Services	N/A	N/A	N/A	N/A
Team 17	Publisher & Developer	Worms, Hell Let Loose, Gold with your Friends, Simulator series, Overcooked	41%	76%	110+

**Also publishes games developed by selected studios under its Frontier Foundry games label. **All own IP except for Hotline Miami*

Source: Company information based on last set of annual R&A and Progressive Equity Research

sequel, and the porting of *Potion Craft* on Nintendo and PlayStation in 2023. Other new titles in development, include *Broken Roads, Critter Cove, FEROCIOUS, Kill it with Fire 2, Level Zero, Pigeon Simulator, RAWMEN, Sand, Slime 3K*, and *Stray Souls*.

INVESTMENT OPPORTUNITY

In June 2023, tinyBuild appointed a new CFO and lowered consensus expectations, mostly due to a smaller contribution from platform deals, and a weaker contribution from two subsidiaries. Platform deals are when distribution platforms, such as Sony, Microsoft, or Nintendo, pay a fixed amount for exclusivity or to include a game in a subscription service.

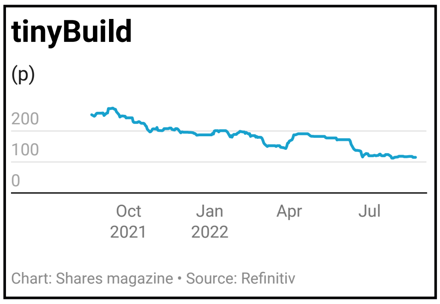
Core revenue from direct sales to consumers continues to grow strongly. tinyBuild is fully focused on organic growth and the track record over the past five years (CAGR 2017-22) demonstrates impeccable execution and resilience: 41% CAGR in net game revenue, 65% for adjusted EBITDA (net of amortisation of development costs) and 66% in adjusted cash from operations (adjusted EBITDA minus changes in net working capital).

tinyBuild is also in a strong financial position. Net cash at the end of December 2023 is expected to be $10-20 million plus a large credit facility completely undrawn.

WELL SET FOR THE FUTURE

With an expanding, increasingly diverse portfolio of its own IP titles, tinyBuild is looking forward to the contribution of new larger budget games scheduled to launch in 2024 and 2025. tinyBuild's goal is to deliver high-quality games across multiple platforms and expand them into evergreen franchises.

Further information can be found here.



Best performing AIM shares in 2023

Company	Year-to-date performance (%)	Sector
Plexus	268	Oil, Gas and Coal
Glantus	248	Industrial Support Services
Empire Metals	236	Precious Metals and Mining
RTC	215	Industrial Support Services
Ovoca Bio	172	Pharmaceuticals, Biotechnology and Cannabis Producers
Celadon Pharmaceuticals	167	Pharmaceuticals, Biotechnology and Cannabis Producers
Star Phoenix	163	Oil, Gas and Coal
B90	157	Travel and Leisure
Scirocco Energy	150	Oil, Gas and Coal
Kooth	135	Software and Computer Services
Inspecs	127	Medical Equipment and Services
OptiBiotix Health	115	Pharmaceuticals, Biotechnology and Cannabis Producers
Biome Technologies	115	Chemicals
Mycelx Technologies Corp	113	Waste and Disposal Services
Vast Resources	106	Precious Metals and Mining
Craven House Capital	100	Investment Banking and Brokerage Services
Hummingbird Resources	97.1	Industrial Metals and Mining
Yu Group	94.1	Gas, Water and Multi-utilities
Edenville Energy	93.2	Industrial Metals and Mining
Ilika	89.7	Electronic and Electrical Equipment

Table: Shares magazine. Source: SharePad, data to 25 August 2023

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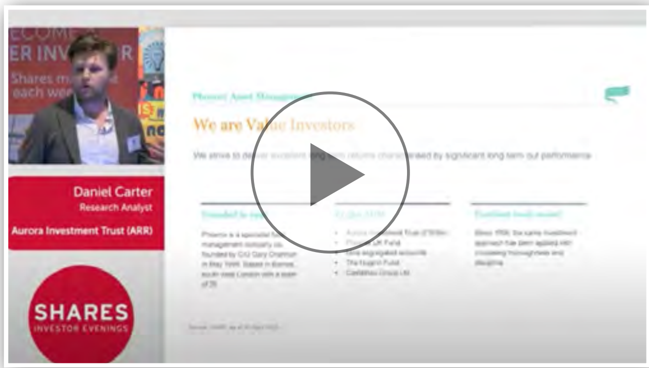

Aurora Investment Trust (ARR)
Daniel Carter, Research Analyst

Aurora Investment Trust (ARR) aims to be long-term value investors, known for the depth of their research. The Trust runs a concentrated portfolio, typically holding between just 12 and 20 investments, predominantly listed in London.

Custodian Property Income REIT (CREI)
Richard Shepherd-Cross,
Investment Manager

Custodian Property Income REIT (CREI) offers investors the opportunity to access a diversified portfolio of UK commercial real estate through a closed-ended fund that seeks to provide an attractive level of income and the potential for capital growth.

Manolete Partners (MANO)
Steven Cooklin, CEO

Manolete Partners (MANO) is a specialist insolvency litigation financing company. We fund or buy insolvency claims. We work with Insolvency Practitioners and their lawyers to maximise returns to creditors.

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