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SHARES

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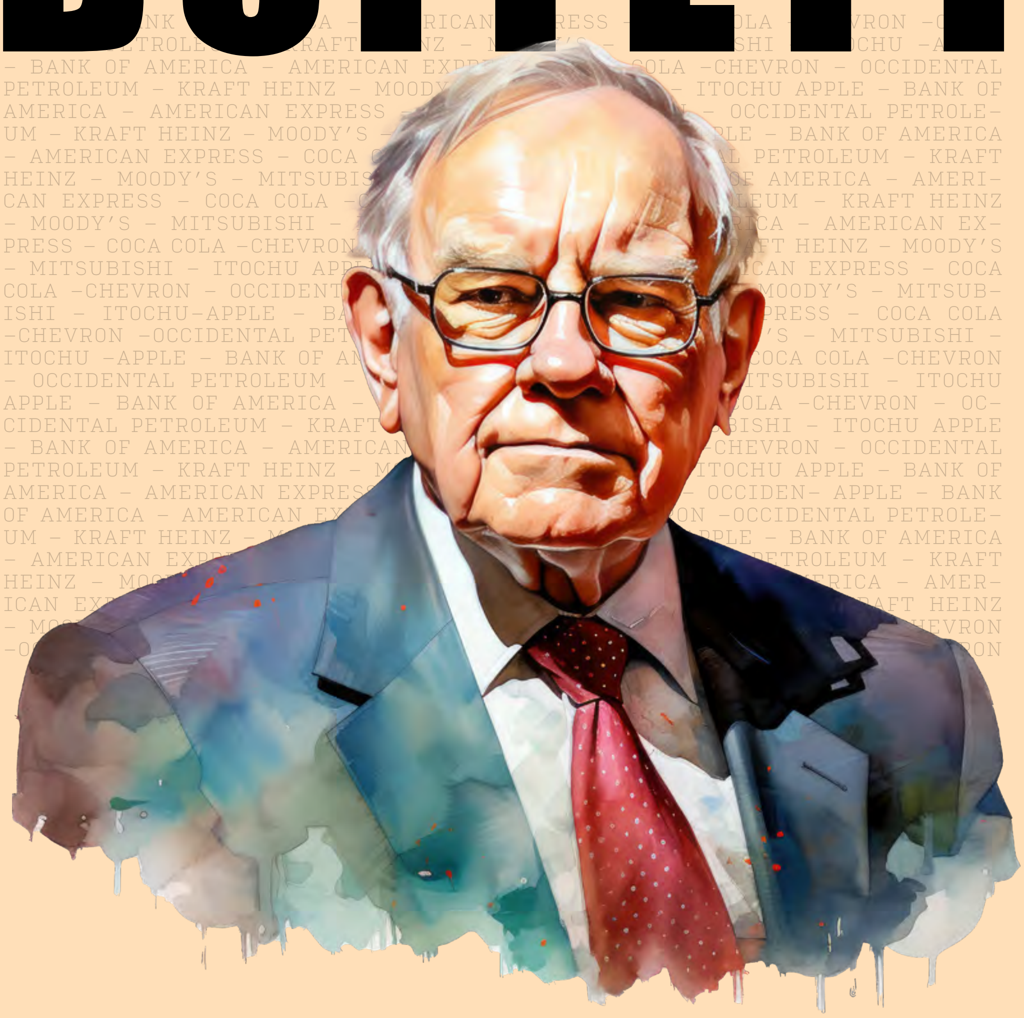
BEYOND BUFFETT



HOW IS BERKSHIRE HATHAWAY APPROACHING THE SUCCESSION AND DOES THE GREAT MAN HAVE ONE LAST BIG DEAL IN HIM?

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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:

Experian shares gain after revenue beat and raised guidance

Money transfer firm Wise ups growth guidance, so why have the shares fallen flat?

Ocado shares ripen following return to positive earnings

Card Factory succumbs to profit-taking despite strong Christmas sales

A unique investment philosophy

AGT
AVI GLOBAL TRUST

Nearly four decades of bottom-up fundamental investing.

Asset Value Investors (AVI) has managed the c.£1.3bn* AVI Global Trust (AGT) since 1985. The strategy over that period has been to buy durable growing companies held through unconventional structures and trading at a discount to estimated underlying net asset value. The strategy is global in scope, and we believe that attractive risk-adjusted returns can be earned through detailed research with a long-term mind-set.

The companies we invest in are durable businesses that are growing in value.

They are trading at discounted valuations.

We take an active approach to unlock and grow value.

AVI has a well-defined, robust investment philosophy in place to guide investment decisions. Our core portfolio of 25-35 listed companies gives us exposure to a concentrated-yet-diverse collection of attractive global businesses. This underlying portfolio is diversified across all sectors and geographies. Buying these companies trading at a discount to their net asset values provides a margin of safety. Our 14 strong investment team does in-depth research which forms the cornerstone of our active approach.

Once an investment has been made, we seek to establish a good relationship and actively engage with the managers, board directors and, often, families behind the company. Our aim is to be a constructive, stable partner and to bring our expertise – garnered over three decades of investing in asset-backed companies – for the benefit of all.

AGT's long-term track record bears witness to the success of this approach, with a NAV** total return well in excess of its benchmark.**

We believe that this strategy remains as appealing as ever and we continue to find plenty of exciting opportunities.

Discover AGT at www.aviglobal.co.uk

*As at 31 December 2023
**30JUN1985 - 31DEC2023 AGT NAV TR +11.8% vs MSCI ACWI +9.2% (annualised GBP returns)
Source: Morningstar

AVI
Asset Value Investors

After a dearth of IPOs last year, 2024 already looks more interesting

Three floats and a new issue should add some variety to the UK market

According to London Stock Exchange data there were just 23 IPOs (initial public offerings) in total on the UK market in 2023, only slightly more than half the number the preceding year and the lowest since the exchange started publishing records in 1995.

For the first time since the financial crisis just one company joined the market in the fourth quarter, and that was a new listing rather than an IPO, as **Chapel Down (CDGP:AIM)** moved from Acquis to AIM without raising fresh capital.

However, there are grounds for optimism, not least after the FCA (Financial Conduct Authority) proposed simplifying the listing regime to attract more companies to the UK.

So far, *Shares* understands there are already three companies on the 'launch pad' hoping to raise money from investors.

Air Astana, Central Asia's largest airline, is based in Kazakhstan and is looking to raise $120m (around £95 million) through a dual listing in its home country and London.

In a strange twist of fate, UK defence firm **BAE Systems (BA.)** owns 49% of the carrier. The stake, which cost the UK company $8.5 million in 2002, was part of an attempt to sell radar equipment to the Kazakh government, but the deal fell through under pressure from Russia.

Also aiming to impress is **London Tunnels**, definitely one of the quirkier firms to come to market.

The company's sole asset is 'a unique set of tunnels, owned by a British company, built by the British Government, for the defence of Britain, that can further enhance London's reputation as a leading tourist destination'.

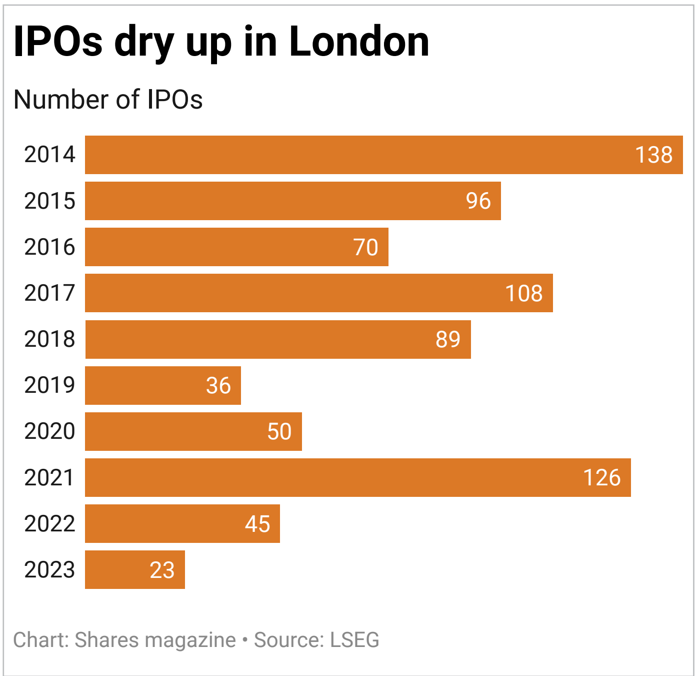
The idea that underground tunnels used to shelter from the Blitz might be a leading tourist destination sounds rather hopeful, but as AJ Bell investment director Russ Mould explains, the tunnels may have a special appeal.

'James Bond fans might be giddy at the prospect of seeing the inspiration for Q-Branch as the Special Operations Executive, a secret British World War II organisation, was located in the tunnels in the mid-1940s.'

Hoping to tickle investors' taste buds, food company **Microsalt** is making a third attempt to list on AIM, and finally not a new listing but a share issue in an unusual asset class may fire up a few investors.

Holding company **Tertre Rouge Assets (TRA)**, named after a corner on the famous Le Mans circuit, is offering investors the chance to own part of a portfolio of rare and exotic classic cars.

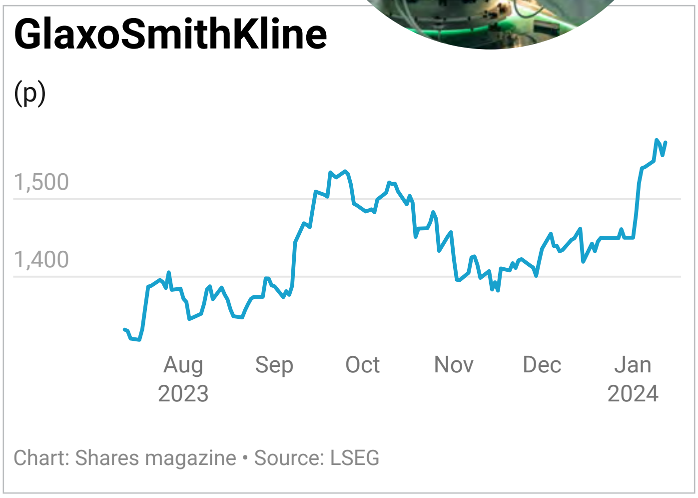
Among the firm's directors are former racing drivers David Coulthard, Mike Hakkinen and Alan McNish, who know a thing or two about life in the fast lane. [IC]



DISCLAIMER: AJ Bell referenced in the article owns Shares magazine. The author of this article (Ian Conway) and the editor (Tom Sieber) have an investment in AJ Bell.

Why the outcome of a pre-trial hearing could prove good news for GSK

Strong operational improvement at the drug maker has been masked by litigation worries



Shares in global bio-pharmaceutical firm **GSK (GSK)** have performed poorly in recent times, relatively speaking, lagging the FTSE 100 index by 4% and peer **AstraZeneca (AZN)** by a whopping 87% over the last five years.

Operationally there have been clear signs of improvement, with the company delivering strong trading updates throughout 2023 which saw the shares finally outperform both the blue-chip index and AstraZeneca.

Yet, while the business now appears to be performing better, the shares are still being held back by concerns over US litigation claims linking its heartburn drug Zantac with cancer.

However, there is an upcoming event which might have a big impact on the shares says Shore Capital healthcare analyst Sean Conroy.

In a recent research note, Conroy highlighted pre-trial hearings scheduled from 22 January to 25 January relating to around 80,000 Delaware cases as providing a clue to whether GSK is likely to make settlements in 2024.

The outcome of the hearings could have a big bearing on the performance of the shares, believes Conroy: 'Further clarity could support a material re-rating of the shares and we believe there remains a compelling risk-reward profile ahead of further updates on Zantac'.

"Further clarity could support a material re-rating of the shares and we believe there remains a compelling risk-reward profile ahead of further updates on Zantac"

To recap, GSK won a landmark case in December 2022 after a Florida Multi-District litigation federal court dismissed around 50,000 claims due to a lack of consistent scientific evidence that Zantac caused cancer.

In June 2023, GSK reached a confidential settlement in a California case which prevented it going to trial reflecting management's desire to 'avoid distraction related to protracted litigation in this case'.

Conroy estimates the shares currently discount a worse-case scenario equivalent to a settlement value of around $30 billion, which implies roughly 22% downside to his base case settlement.

Meanwhile, litigation experts at *Bloomberg* estimate a total settlement value for the Delaware cases, which represent the majority of claimants, of between $2.5 billion and $4 billion, with GSK bearing around 30% of the total as it is not the sole defendant.

Zantac became an over-the-counter heartburn treatment in the mid-1990s after GSK launched the drug on prescription in the early 1980s.

Other firms which subsequently sold Zantac and its generic equivalents and are also named as defendants in the litigation cases include US firm **Pfizer (PFE:NYSE)** and French drug maker **Sanofi (SAN:EPA)**.

Zantac sales were banned in 2019 after the discovery of a 'probable' carcinogen in the treatment.

Conroy estimates GSK shares trade on nine times his forecast for 2025 earnings per share, implying an unjustified 40% discount to its peers. [MG]

FCA to investigate commission deals in the UK motor finance market

Probe into customer claims could be 'as big as PPI' says expert

Having hammered the insurance industry for its practice of "walking up" renewal prices for existing car and home policyholders, the FCA (Financial Conduct Authority) has a new target in its sights – the motor finance market.

Firms which generate revenue from providing motor finance include **Close Brothers (CBG)**, **Inchcape (INCH)**, **S&U (SUS)** and **Secure Trust Bank (STB)**.

In 2021, the regulator banned commission models which gave motor dealers, finance providers and finance brokers an incentive to bump up customers' costs after its research found discretionary models had led to increased prices for consumers.

Its research also found firms often failed to give customers 'timely, relevant information' in order for them to make what it called 'more appropriate decisions', not just in the motor finance business but across the whole credit sector.

The FCA said it would look closely 'at any attempt by a motor finance firm to introduce a commission model that could lead to the same harm that we have sought to ban', while monitoring how well firms complied with the new rules including carrying out 'mystery shopper' point-of-sale exercises to measure lenders' control over dealer networks.

On 11 January this year the regulator said a high number of customers had complained to motor finance firms claiming compensation for commission deals arranged prior to the ban, but firms were rejecting most complaints because in their opinion they hadn't acted unfairly *based on the applicable legal and regulatory requirements at the time*.

However, in two new cases the Financial Ombudsman has upheld customers' complaints and some County Courts have also found in favour of complainants.

Therefore, the FCA is bringing to bear the full power of the Financial Services and Markets Act 2000 to review *all* historical commission arrangements across several firms and is pausing all complaints while it investigates.

Sheldon Mills, FCA executive director of Consumers and Competition, warned companies: 'If we find widespread misconduct, we will act to make sure people are compensated in an orderly, consistent and efficient way.'

> **"If we find widespread misconduct, we will act to make sure people are compensated in an orderly, consistent and efficient way"**

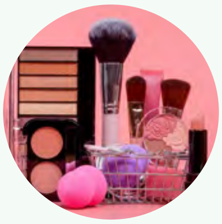
So far there seems to have been little reaction to the news in the financial press, but well-known consumer champion Martin Lewis has called it a 'huge announcement which may mean a pay-out for millions'.

On his back-of-the-envelope numbers, 'at the top end this could be PPI-type scale' says Lewis. *FT Advisor* puts the total industry costs of the PPI (payment protection insurance) scandal at £50 billion, with the big high-street banks bearing the impact for more than a decade.

Lewis believes compensation could be for the interest on the motor loan, the commission, or even the whole loan in some cases. [IC]

Warpaint shares continue to soar after strong trading update

Shares in the colour cosmetics supplier are up 132% over the past year



Value-focused cosmetics company **Warpaint (W7L:AIM)** can do no wrong in investors' eyes, it seems.

The shares hit a new-all time high on 12 January after the colour cosmetics supplier upgraded its full-year 2023 revenue guidance for the fourth time.

Warpaint is now forecasting full-year 2023 revenue of £89.5 million against previous guidance of at least £85 million.

Over 12 months the shares are up 132% compared with a 13% fall in the FTSE AIM All-Share index, and since floating in 2016 they have gained 213%.

Behind the dramatic share price rise is strong trading in the company's W7 and Technic brands and momentum across its business.

Analysts at Shore Capital commented: 'Trading since the interim results has proved strong, with broad-based outperformance across its retailer and geographic base (including gifting sales) further supported by excellent online momentum through November and December 2023.'

The analysts go on to say the company has 'considerable potential in Europe, the US and online.'

Warpaint has successfully tapped into the UK and international markets, and this shows no sign of abating with analysts impressed by its performance.

Further 'colour' on customer and channel dynamics is expected when Warpaint announces its preliminary results for the year to April 2024, when the group expects to post pre-tax profit of at least £18 million. [SG]

Burberry shares hit a new low after second profit warning

Slowdown in the luxury market continues as consumers tighten purse strings

Burberry (BRBY) has had a terrible start to 2024, although 2023 was hardly a vintage year for the British fashion house either.

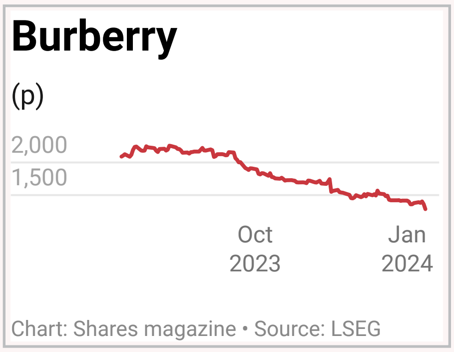
The company slashed its profit guidance due to a slowdown in demand for luxury purchases – its second profit warning in three months.

Burberry now expects adjusted operating profit for the year ending 30 March 2024 to be in the range of £410 million to £460 million, down from £553 million to £668 million.

The shares have lost 46% over the past year, and fell further on 15 January when US bank Goldman Sachs downgraded

the stock saying greater investment was required to deliver a sales turnaround.

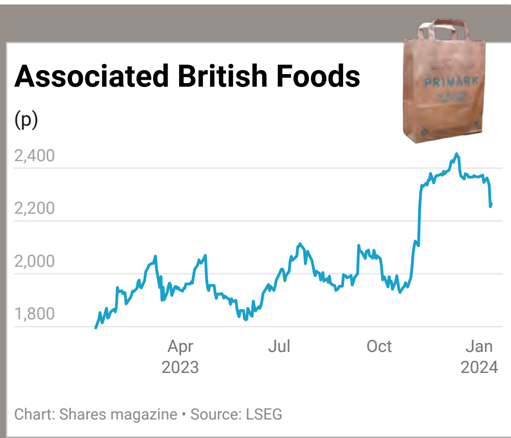
Cracks have clearly begun to appear in the luxury goods sector, with well-heeled consumers around the world coming under pressure from the rising cost of living, affecting even the biggest names in the business such as French champagne-to-perfume conglomerate **LVMH (MC:EPA)**.



Charlie Huggins, manager of the Quality Shares Portfolio at Wealth Club, commented: 'Chinese consumers are vital for the luxury sector, but spending from this cohort appears to be slowing. China's economy is struggling, with its real estate sector in a fine mess, and this appears to be filtering through to Chinese consumer sentiment.' (SG)

Why investors might expect a positive earnings surprise from Associated British Foods

Robust updates from value retailers offer a positive read-across for budget clothing chain Primark



Primark's Christmas trading performance, as well as management commentary around trading early in the new calendar year, will be the main focus when the discount fashion chain's parent **Associated British Foods (ABF)** next updates the market on 23 January.

With a tailwind from the cost-of-living crisis, value-focused retailers and discounters including German grocers Aldi and Lidl, bargain stores giant **B&M European Value Retail (BME)** and baker **Greggs (GRG)** have all issued robust Christmas updates so far, offering a positive read-across for cut-price clothing chain Primark.

Analysts will pore over the statement for an update on the resilience of the consumer as well as Primark's actions on markdowns over the peak period. The Christmas like-for-like sales performance from the jewel in the Associated British Foods' crown, which continues to expand in Europe and the US, will be of particular interest to investors as the value-focused fashion store was lapping tough prior year comparatives. Same-store sales were up 11% in the 16 weeks to 7 January 2023 with sales in the week leading up to Christmas Day 2022 reaching a new record.

Investors will also be eager to learn if cost pressures continue to ease for the Weston family-controlled foods-to-fashion conglomerate and whether grocery brands including Twinings, Ovaltine, Blue Dragon, Patak's, Jordans managed to sustain their momentum during the festive selling period. [JC]

What the market expects of Associated British Foods

	EPS	Revenue
Year to September 2024	173p	£20.75bn
Year to September 2025	188p	£21.66bn

Table: Shares magazine • Source: Stockopedia

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

22 January:
Watkin Jones
25 January:
Titon Holdings

INTERIMS

24 January:
Hargreaves Services, Van Elle Holdings
25 January:
IG Group, Newmark Security, Time Finance

TRADING ANNOUNCEMENTS

19 January:
4Imprint
23 January:
Associated British Foods, Premier Foods
24 January:
Computacenter, Palace Capital, PensionBee, easyJet, Quilter
25 January:
Intermediate Capital Group, Fuller Smith & Turner, Mitie, PPHE Hotel Group

All eyes on AI as Microsoft kicks off Big Tech earnings season

Copilot and Azure will be front and centre as Windows giant reports

Although financial companies traditionally signal the start of the US earnings season, next week is when the tech heavyweights begin reporting starting with **Microsoft (MSFT:NASDAQ)** on 23 January. Expect AI (artificial intelligence) to continue to dominate the commentary with all eyes on Copilot and Azure growth.

Microsoft has emerged as the top AI software story over the past year, with real-world AI applications being quickly embedded into the firm's product suite through Copilot, delivered over its cloud computing arm Azure, which has been closing the gap on cloud leader Amazon Web Services.

Microsoft shares closed the first

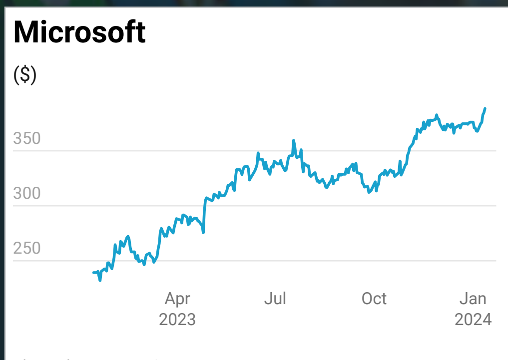


Chart: Shares magazine • Source: LSEG

calendar quarter of 2023 with a gain of 20%, going on to register a 57% increase over the full year, and another rampant start to this year would go down very well with investors.

In fact, last Friday, Microsoft overtook **Apple (AAPL:NASDAQ)** as the world's most valuable company in terms of market cap.

Analysts are forecasting earnings per share of $2.75 for the final quarter of 2023 against $2.32 the previous year, and revenue of $52.9 billion, while investors can expect plenty of optimism for the year ahead that could keep the shares moving higher.

The earnings consensus suggests growth is set to accelerate as the months tick by, as customer use cases and Microsoft income ramp up. [IC]

What the market expects of Microsoft

	EPS ($)	Revenue ($bn)
Q2 2024 forecast	2.75	52.9
Q3 2024 forecast	2.58	60.8

Table: Shares magazine • Source: Zacks Investment Research, Investing.com

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

19 January:
Schlumberger, Travelers, State Street, Fifth Third, Huntington Bancshares, Regions Financial, Comerica

22 January:
Brown & Brown, Equity Lifestyle, United Airlines, Zions, Crane NXT, Bank of Hawaii

23 January:
Microsoft, J&J, Procter&Gamble, Netflix, Verizon, Texas Instruments, General Electric, Logitech, Premier Financial

24 January:
Tesla, IBM, ServiceNow, AT&T

25 January:
Visa, Intel, T-Mobile US, Comcast, Union Pacific, Starbucks, Marsh McLennan, Dow, Southwest Airlines, United States Steel, American Airlines

UK Christmas retail sales likely to be a mixed bag and US GDP in focus

Evidence so far points to weakness in clothing and homeware spending

There isn't a great deal of UK economic news to look forward to over the next seven days, the highlight being official December retail sales due on 19 January.

If reports from supermarkets and high-street retailers are any guide, shoppers spent more freely on groceries than last year, and bought more items than usual, while general merchandise and clothing sales performed less well.

That seems to be backed up by the latest survey by consultants KPMG and the BRC (British Retail Consortium), which showed December retail sales up 1.7% against a 6.9% rise the previous year with both in-store and online non-food sales falling.

According to the BRC head of UK retail Paul Martin, 'The festive feel-good factor was lacking this year as many retailers faced a disappointing December with sales only up 1.7%. Christmas shoppers ditched clothing, jewellery and technology gifts, opting for beauty, health and personal care products, which, along with food and drink drove festive sales this year.'

Despite a slowdown in inflation, an upcoming cut in national insurance rates and some consumers having more money in their pockets this Christmas than last, 'the constant drip of economic challenges over the last two years has finally come home to roost' said Martin.

In the Eurozone, where the ECB is seen as likely to be the first central bank to start cutting interest rates, the focus will be firmly on consumer prices.

November's annual inflation figure of just 2.4% was better than forecast and the best reading since July 2021, so a lower figure for December could unleash animal spirits after a lacklustre performance for Eurozone stocks on the whole last year.

In the US, after December's inflation figure came in marginally above expectations, the next major test for the market will the durable goods data and fourth-quarter GDP reports on 25 January, where bad news economically-speaking is likely to be hailed as good news if it puts the chance of an early rate cut back on the table. [IC]

Macro diary 18-25 January 2024

Date	Economic Event	Previous Month
18-Jan	US December Housing Starts	1.56m
	US January Philly Fed Manufacturing Index	-10.5
19-Jan	UK December Retail Sales	0.1%
	Eurozone December CPI	2.4%
	US December Existing Home Sales	3.82m
	US January Michigan Consumer Sentiment	69.7
24-Jan	Euro-zone January Manufacturing PMI	44.4
	US January Manufacturing PMI	47.9
25-Jan	US December Durable Goods Orders	5.4%
	US Q4 GDP	4.9%

Table: Shares magazine • Source: Morningstar, central bank websites

Next Central Bank Meetings & Current Interest Rates

Date	Event	Previous
25-Jan	European Central Bank	4.5%
31-Jan	US Federal Reserve	5.5%
01-Feb	Bank of England	5.25%

Table: Shares magazine • Source: Morningstar, central bank websites

Buy this ETF for a low-cost play on unloved Chinese market leaders

This product should appeal to risk-tolerant investors eager for exposure to unloved Chinese equities

HSBC MSCI China UCITS ETF USD (HMCH)

BUY

Fund size: £480 million

China is one of the biggest contrarian calls for 2024, with tensions between the world's second biggest economy and the West on the rise over issues including access to the latest technology and the fate of Taiwan which is pivotal to the global semiconductor manufacturing industry.

In addition, concerns over the populous Asian nation's debt and its property sector, as well as a post-Covid economic rebound which has struggled to gain traction, are all reflected in the lowly valuations currently ascribed to Chinese stocks.

For risk-tolerant investors eager for exposure to this gargantuan emerging market and its exciting technology stocks with huge potential as the AI (artificial intelligence) era begins, this is as compelling an entry point as you're likely to get.

Chinese equities could take off like a rocket and re-rate from depressed levels as earnings momentum improves in the year ahead, thereby rewarding the bold.

One low-cost way to gain exposure is through the **HSBC MSCI China UCITS ETF USD (HMCH),** the cheapest exchange-traded fund tracking the MSCI China index with charges of just 0.28%. However, this product isn't for the risk-averse or those who dislike volatility, having delivered negative total returns of 26.5% and 46.8% over one and three years respectively. For the adventurous investor, however, this £480 million fund offers a high-octane play on the recovery potential

Chart: Shares magazine • Source: FE Analytics

of China, the domain of many market-leading companies.

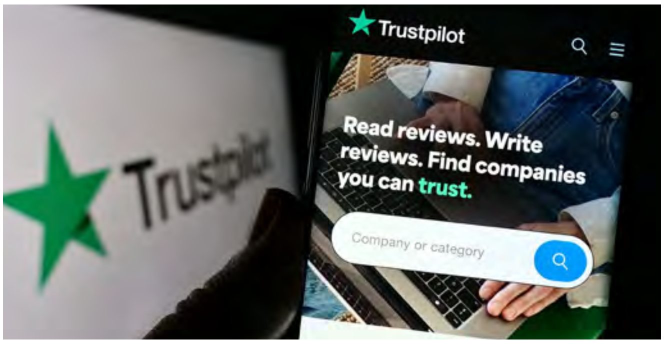
The ETF aims to track as closely as possible the returns of the MSCI China Index, which tracks the largest and most liquid Chinese stocks, replicating the performance of the underlying index in full. For the uninitiated, this means the fund buys every single index constituent, while the dividends in an ETF offering a 2.2% yield are distributed semi-annually.

As of 30 November 2023, the fund offered diversified exposure via 767 holdings with a very forgiving price to earnings ratio of 13.1 implying significant re-rating scope. Top 10 holdings included modestly-valued Chinese internet titans **Tencent (0700:HKG),** among the globe's highest grossing multimedia companies by sales, and **Alibaba (9988:HKG),** one of the world's largest retailers and e-commerce companies.

Prospective investors are also buying into the likes of **JD.com (9618:HKG),** a major competitor to Alibaba-run Tmall, not to mention **Baidu (9888:HKG),** which is China's answer to Google parent **Alphabet (GOOG:NASDAQ),** Chinese food delivery leader **Meituan (3690:HKG)** and insurance-to-banking behemoth **Ping An Insurance (2318:HKG).** [JC]

Trustpilot's re-rating has only just begun – buy the stock now

More muscle on margins is one of many reasons to back the business



Trustpilot
(TRST) Price: 161p

BUY

Market cap: £672 million

Investors may think they have missed the **Trustpilot (TRST)** boat after the shares have doubled in six months. Not so, in our opinion. *Shares* believes this re-rating story has only just started and the share price could easily surge past 200p this year and far higher over time.

To put this into context, when analysts at Berenberg and Peel Hunt began covering the stock in summer 2021, both saw the stock hitting 430p. While it has taken a little longer than originally hoped for Trustpilot to make a profit breakthrough, rapid progress is on the cards this year.

Trustpilot listed in London in March 2021 with a market capitalisation of £1.08 billion and a 265p share price.

Behind the stock's recent rally are repeated earnings upgrades and excitement surrounding the arrival in September of Adrian Blair as chief executive, the former global chief operating officer of UK food delivery firm **Just Eat (JET).**

Like many digital commerce businesses, Trustpilot's business grew rapidly during the pandemic. The platform now hosts more than 167 million consumer reviews of products and services across 714,000 websites. Thousands of businesses now turn to Trustpilot for customer transparency and the underlying consumer data analytics it provides to clients.

Crucially, this creates valuable network benefits. The more consumers that use the platform and share their own opinions, the richer the insights the company can offer clients. Done well, this creates a virtuous circle where consumers feel drawn to Trustpilot because it is where meaningful services are listed and reviewed, and the more consumers who use Trustpilot, the more businesses will feel they cannot afford not to be on the platform.

Independent survey data from Sirkin Research showed 87% of consumers in the UK and US found ads more trustworthy with the Trustpilot logo and star rating than without.

Annualised recurring revenues are running at £197 million, and Berenberg sees 44% adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) growth this year (to 31 Dec) against its analysts' long-term 30%-plus target.

The investment case is similar to **Rightmove (RMV)**, one of our *Great Ideas* last week, and **Auto Trader (AUTO),** both platform businesses which have consistently beaten the market for returns.

While fierce competition from the likes of New York-listed **Yelp (YELP:NYSE)** and others is a certainty, Trustpilot is already cemented in the minds of consumers and on balance it still looks like an exciting long-run growth story to us. (SF)

Trustpilot

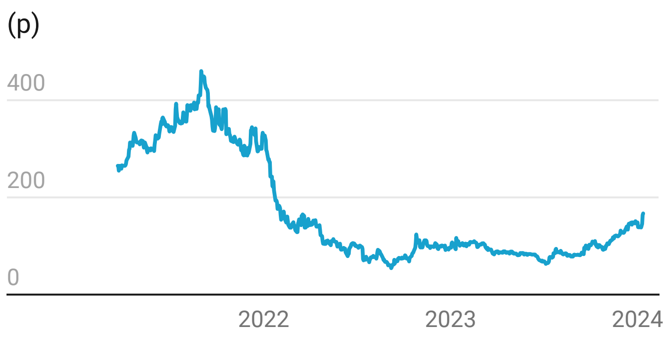


Chart: Shares magazine • Source: LSEG

We remain positive on Marks Electrical despite short-term headwinds

The business remains in good shape despite a temporary set-back

Marks Electrical

(MRK:AIM) 69.35p

Loss to date: 29.3%

In late August 2023 we said online domestic appliances and consumer electronics retailer **Marks Electrical (MRK:AIM)** had good growth potential driven by market share gains and geographical expansion.

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%.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

In a trading update on 10 January, the company said it experienced strong revenue growth in its third quarter to the end of December of 17.8% to £35.1 million taking year-to-date revenue up 22% to £88.9 million.

The firm also said it had continued to increase market share in online domestic appliances and consumer electronics. A strategic decision to keep delivery and installation services in-house resulted in record volumes during the peak trading period.

Unfortunately, that is where the good news ended. Economic uncertainty has led to consumers becoming 'highly price-conscious', resulting in pricing pressure and lower gross margins.

Despite action to control other costs, the firm said there would be a temporary but 'material' impact on full year profits. In addition, management cautioned on the speed of recovery in consumer buying patterns and therefore gross margins.

Analysts at Canaccord Genuity have reduced their 2024/25 EBITDA (earnings before interest, tax, depreciation, and amortisation) estimates by 38% and 28% respectively.

However, the broker remains constructive on the shares: 'We believe the long-term story remains intact, yet short-term the shares are likely to see pressure given the sizeable downgrades.'

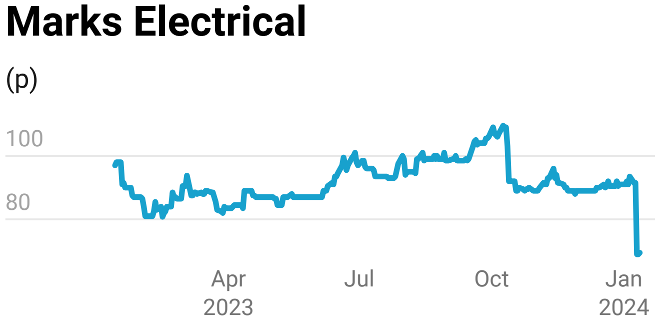


Chart: Shares magazine • Source: LSEG

WHAT SHOULD INVESTORS DO NOW?

It is disappointing to see a profit warning, but macroeconomic headwinds are beyond management's control and the business continues to take market share and maintain excellent customer service levels as reflected in an industry leading Trustpilot score of 4.8.

Despite current headwinds, the business remains profitable and has net cash on the balance sheet. The long-term story is intact and we remain positive on the shares. [MG]

Whitbread looks to offer plenty more upside for patient investors

Revenue and earnings are rising nicely while the assets look undervalued

Whitbread
(WTB): £36.75

Gain to date: 9%

We recommended buying into hotel and leisure group **Whitbread (WTB)** in June 2023 as revenue, earnings and dividends were already well above their pre-pandemic levels but the shares had yet to recover.

In addition, bookings were on an improving trend not just among holidaymakers but also business travellers and we were watching corporate developments.

Press talk suggested Whitbread was looking to sell part of its UK pub and restaurant division, which typically earns a lower margin than the hotels, while a private deal for Travelodge suggested the core Premier Inn business was significantly undervalued.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

The group posted strong results for the six months to September, with revenue up 17% on what was already a robust performance in the prior year and up 55% on the same six-month period before the pandemic.

Chief executive Dominic Paul called the results 'outstanding', rewarding investors with a 40% hike in the interim dividend and an extension of the share buyback programme.

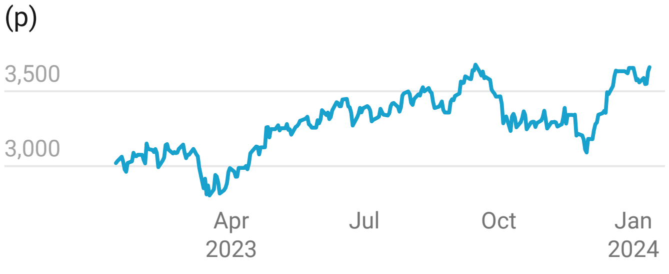


Chart: Shares magazine • Source: LSEG

Paul also said the group saw the undersupply of quality UK hotel accommodation extending to at least 2028 due to the closure of so many operators due to the pandemic.

The positive momentum in first-half bookings and revenue continued into the third quarter, with the firm reporting 'robust demand' in the UK driving high occupancy levels and strong pricing.

While there was no change to current-year guidance, for the coming year the company said the supply situation in the UK still looked favourable and it had a strong forward booked position as well as a plan to offset cost inflation – which has slowed sharply to just 3% to 4% - with operational cost savings.

Finally, although there has been no word on disposals, the recent sale of 66 Travelodge hotels for £210 million – 50% above the value suggested last summer when US hedge fund GoldenTree was looking to offload the chain – suggests even more valuation upside for Whitbread's estate.

WHAT SHOULD INVESTORS DO NOW?

We would sit tight as we expect Premier Inn UK to continue posting solid quarterly numbers, while 2024 should see Whitbread's German operations start to contribute to group earnings after a lengthy period of building momentum, and the valuation still looks attractive. [IC]

Should investors be concerned by Fundsmith Equity's five year underperformance?

The best managers fail to match the market around a third of the time

Terry Smith delivered disappointing news last week (9 January) after he revealed his flagship equity fund **Fundsmith Equity Fund (B41YBW7)** had underperformed the MSCI World Index for a third successive year.

Moreover, the fund's cumulative total return now lags the global benchmark over five years.

As Smith points out in his annual letter, outperforming the market or even making a positive return every year is not something investors should expect.

So, what should investors do with this news, if anything at all, and how should they think about investment performance in a wider context? This feature introduces and analyses some key pointers.

Looking through a long-term lens Fundsmith has been an unmitigated success story.

Since inception in November 2010, the fund has handily beaten the index by delivering an annualised total return of 15.3% per year which means Smith has turned a £1,000 investment into almost £6,500 today.

The fund remains the best performer since inception among the 165 funds which sit in the Investment Association Global sector.

Not only has the fund bested the index, it has done so with lower share price variability returning about 63% more than the index per unit of price volatility.

Smith has built a loyal fanbase which has seen the fund's assets swell to over £24 billion, so converts are unlikely to be too concerned.

As Laith Khalaf, head of investment analysis at AJ Bell points out: 'All active managers are of course prone to periods of underperformance, especially those like Fundsmith which have a distinct investment style and run a concentrated portfolio.

This is especially true when market leadership is as narrow as it was in 2023.'

For new investors considering an investment in the fund the calculus may be slightly different. Some may view the underperformance as an opportunity to get ahead of a potential bounce back to form.

Others may view the soft patch as a red flag which may be enough to prevent them taking the plunge.

The reality is nobody knows how the next five or 10-years will play out. Statistically, past investment performance has no relation to future performance.

WHAT IS SPECIAL ABOUT THREE YEARS?

This begs the question, what is so special about fund managers that they need to prove their worth over one or three years?

As the managers of the **Overstone Global Equity Income Fund (FUND:B75K5L9)** commented in their recent 2023 review: 'A year is the time it takes the Earth to complete one orbit around the Sun. Important if you are planting a crop; less so if you are appraising the performance of a long-term investment strategy.'

In 2022, the fund – which like Fundsmith Equity takes a long-term approach and holds a concentrated list of stocks - lagged the benchmark by 20%, whereas last year it beat the index by 17%. 'Same approach, same process, very different outcomes – simply based on where one anchors a starting point', add the managers.

Another illustration of the peculiar effects of using fixed dates relates to US investment manager Bill Miller at Legg Mason Capital Management.

Between the early 1990's and 2000's, Miller's fund outperformed the S&P 500 for 10 consecutive years. A book was written on the era called 'The Man Who Beats the S&P' by Janet Lowe.

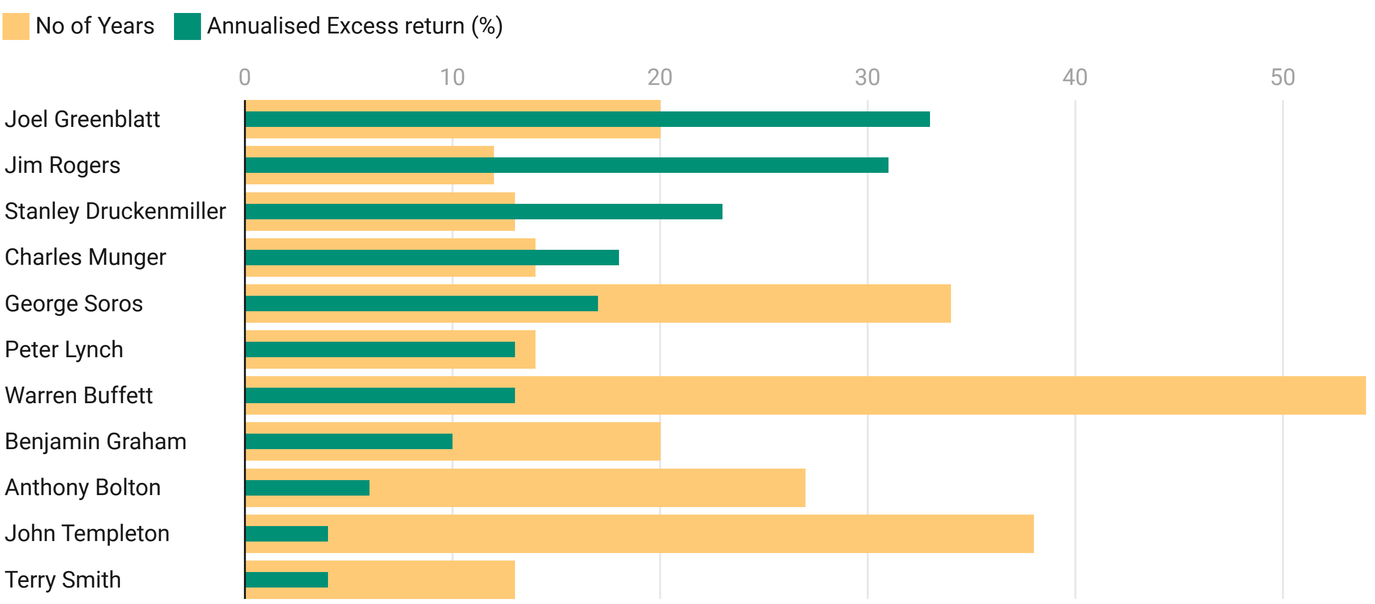
While much was made of this phenomenal run, Miller himself downplayed the result as a quirk of the calendar and pointed out that if the start and end dates been moved by just a few days, his phenomenal winning streak would not have happened.

Interestingly, Fundsmith Equity outperformed the MSCI World Index for 11 consecutive years following launch in November 2010 (ignoring the two months to 31 December 2010).

SUPERINVESTORS

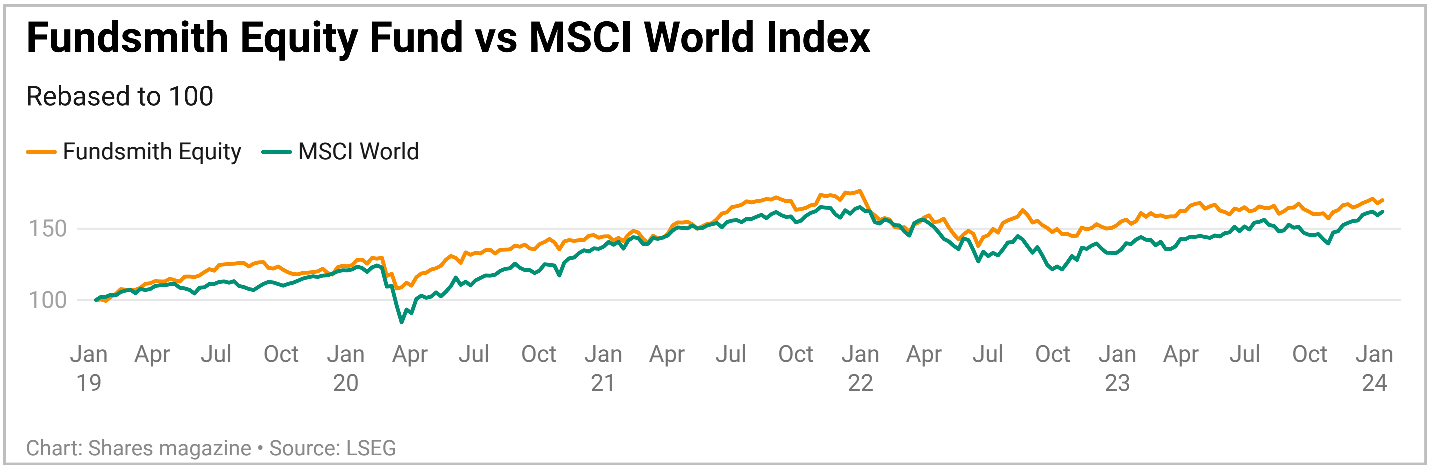
In 1984, Warren Buffett wrote an article for the Columbia Business School magazine *Hermes* entitled 'The Superinvestors of Graham-

Approximate excess return versus the S&P 500 Index (with dividends reinvested) of top investors



Terry Smith's excess performance is against the MSCI World Index rather than the S&P 500

Chart: Shares magazine • Source: Frederik Vanhaverbeke.



and-Doddsville'.

In it he presented and discussed the investment performance of some of his peers who had been taught by the legendary Benjamín Graham and who all invested using value principles learned from Graham and Dodds' seminal book 'Security Analysis'.

Over periods ranging from 13 years to 28 years, the group outperformed the market by between 8% and 17% per year.

To recall, Fundsmith has outperformed the market over the past 13 years by around 4% per year, so these investors performed two times to four times better albeit under very different market conditions and time frames.

What is striking about these superinvestors is that they *all* suffered significant underperformance at some point along the way to building spectacular long-term track records.

On average, they underperformed around a third of the time they managed money (the range is 7.1% to 42%). The worst three-year underperformance (peak to tough percentage loss) saw one manager fall almost 50% behind the benchmark.

In this regard, Fundsmith Equity compares very well. It has underperformed in only three out of 13 years which is equivalent to 23% of the time.

The fund is around 12% behind the benchmark over three years and around 7% behind over five years according to FE data as of 8 January 2024.

Eugene Shahan, who graduated from the Columbia Business School, wrote an article on Buffett's findings and his 'superinvestors' in 1986.

Shahan observed: 'In today's environment, they would have lost many of their clients during their periods of underperformance. Longer term, it would have been the wrong decision to fire any of those money managers.'

Shahan summed up the dilemma well: 'It may be another of life's ironies that investors principally concerned with short-term performance may very well achieve it, but at the expense of long-term results.'

EVEN THE EXPERTS GET IT WRONG

Academic studies looking at the investment decisions of pension plan sponsors show that managers tend to get fired after a three-year period of underperformance and hired after strong periods of outperformance.

One study in 2006 by Amit Goyal and Sunil Wahal of the University of Lausanne and Arizona State University concludes: 'Using a matched sample of firing and hiring decisions, we find that if plan sponsors had stayed with fired investment managers, their excess returns would be larger than those actually delivered by newly hired managers.'

In conclusion, trying to assess the skill of an investment manager by past performance is fraught with jeopardy and generally not the best idea. It is far more important to focus on the investment philosophy adopted and the processes implemented.

DISCLAIMER: AJ Bell referenced in the article owns Shares magazine. The author of this article (Martin Gamble) and the editor (Ian Conway) have an investment in AJ Bell. Ian Conway also has an investment in Fundsmith Equity.

By **Martin Gamble** Education Editor

BEYOND BUFFETT

HOW IS BERKSHIRE HATHAWAY APPROACHING THE SUCCESSION AND DOES THE GREAT MAN HAVE ONE LAST BIG DEAL IN HIM?

An investor blessed with Nostradamus-like predictive powers who put money to work with **Berkshire Hathaway (BRK.B:NYSE)** in 1964 and held the shares until 2022 would have enjoyed a gargantuan overall gain of 3,787,464% in terms of per share market value, leaving the stellar 24,708% return from the S&P 500 index with dividends included for dust.

Under the direction of legendary investor Warren Buffett and his co-manager for six decades Charlie Munger, the company's per-share market value grew at a compound annual rate of around 20% over that period compared with 10% per year for the S&P 500 index.

But as the well-worn disclaimer goes, past performance is no guide to future returns. Following the death of Buffett's long-term business partner Munger in late November 2023, a mere

33 days short of his 100th birthday, it is the future of Berkshire Hathaway, a beacon of investment management revered for its long-term strategy and high rate of return, that concerns investors now.

Keith Ashworth-Lord, manager of the **CFP SDL UK Buffettology Fund (BF0LDZ3)** which uses Buffett's name and pursues the quality-focused 'Business Perspective Investing' approach championed by the 'Sage of Omaha' and Munger, describes the latter's death as 'truly an epoch-making event'.

Munger had been Buffett's right-hand man for six decades, during which they forged their reputation as the world's supreme investors. It was Munger who steered Buffett away from what he had learned from Ben Graham, buying dirt-cheap 'cigar butt' shares with a view to selling at a fair value, and towards buying quality businesses at fair prices and then holding them for the very long term. Munger also earned the nickname 'the Abominable No-Man' for his capacity to correct and occasionally contradict Buffett, so his influence on the 'Oracle of Omaha' shouldn't be understated.

But the big question on everyone's lips is how Munger's passing might change Berkshire Hathaway and the way it is managed. After all, Buffett is now 93, a ripe old age for a chief executive, and as the world's greatest living investor recently conceded: 'I feel good, but fully realise I am playing in extra innings.'

THINKING THE UNTHINKABLE - BERKSHIRE BEYOND BUFFETT

Ashworth-Lord's take is that 'nothing much will change, at least in the medium term. The culture of long-termism and shareholders-as-owners is so embedded.

'It is in the company's DNA,' he says. His main worry is 'the toll it might take personally on Warren, who must feel bereft'. In terms of the future beyond the Buffett era, Ashworth-Lord stresses that plans are in place for Howard Buffett, one of the great man's sons, to become the non-executive chairman with Greg Abel, currently the head of Berkshire's energy business, to run the operating business, and Ajit Jain to oversee the insurance operations. Tod Combs and Ted Weschler will continue as investment managers of Berkshire's portfolio of marketable securities.

Abel is seen as the next Berkshire Hathaway chief executive, concurs Nick Brind, co-manager of investment trust **Polar Capital Global Financials (PCFT)**, adding: 'It is almost impossible to imagine Berkshire Hathaway after Buffett has gone but

Berkshire Hathaway - top 10 holdings

Company	Ticker	Value ($000)	Percentage of portfolio
Apple	AAPL:NASDAQ	156,753,093	50.0%
Bank of America	BAC:NYSE	28,279,487	9.0%
American Express	AXP:NYSE	22,618,800	7.2%
Coca-Cola	KO:NYSE	22,392,000	7.1%
Chevron	CVX:NYSE	18,590,066	5.9%
Occidental Petroleum	OXY:NYSE	14,541,501	4.6%
Kraft Heinz	KHC:NASDAQ	10,954,355	3.5%
Moody's	MCO:NYSE	7,799,843	2.5%
Davita	DVA:NYSE	3,412,114	1.1%
HP	HPQ:NYSE	2,634,739	0.8%

Holdings as of 30 September 2023. Date filed 16 November 2023.

Table: Shares magazine • Source: Berkshire Hathaway Q3 2023 13F

WHY BERKSHIRE HATHAWAY MATTERS

An American multinational headquartered in Omaha, Nebraska, Berkshire Hathaway was founded in 1839 as a New England textile manufacturer but underwent a drastic restructuring into a conglomerate starting in the mid-1960s under the leadership of Buffett and Munger.

Today, this $800 billion cap's main business and source of capital is insurance, from which it invests the float in a broad portfolio of subsidiaries and equity positions. Present-day Berkshire Hathaway is one of the largest companies in the US employing several hundred thousand people through its railroad, manufacturing, retailing, energy, confectionery and insurance businesses. Berkshire's insurance brands include auto insurer GEICO and reinsurance firm Gen Re; its railroad interests include **Burlington Northern Santa Fe (BNSF)**; utilities and energy interests include **Berkshire Hathaway Energy (BHE)**, and its other businesses span everything from manufacturer Precision Castparts to housing company Clayton Homes, flooring distributor Shaw Industries, clothing brand Fruit of the Loom and iconic candy shops chain See's, to give just a flavour.

Buffett's corporate creation is 'basically a microcosm of the US economy and that was one of the reasons why I decided to put Berkshire Hathaway, which was run by people that I liked and respected immensely, into Buffettology', says Ashworth-Lord. 'If you look at the operating businesses you've got the railroad in there, the power generation and distribution businesses, a whole host of manufacturing businesses in various nooks and crannies of the economy and the retail and consumer-facing businesses. And that's aside from the fact that Berkshire is probably best known for its insurance activities, which provide all the nice moolah to invest.'

Oakglen's Lamond explains that Berkshire Hathaway has amassed 'a diversified portfolio of investments' bringing exposure to technology, banking, insurance, communications, energy and consumer staples. 'Over the last few decades, Berkshire has accumulated substantial positions in these companies which has ensured it has oversight of the management of these investments. This has ensured Berkshire has been able to influence how the companies have been run.'

And then of course there is Berkshire's investment portfolio including its largest single holding, **Apple (AAPL:NASDAQ)** – Buffett has said Apple is 'probably the best business I know in the world' – as well as **Bank of America (BAC:NYSE), American Express (AXP:NYSE)**, **Coca-Cola (KO:NYSE)** and **Chevron (CVX:NYSE)**, market leaders with the economic 'moats' beloved by Buffett. Other positions include **Kraft Heinz (KHZ:NASDAQ), Amazon (AMZN:NASDAQ), Diageo (DGE)** and Chinese electric vehicle maker **BYD (002594:SHE).**

Through its National Indemnity subsidiary, Berkshire Hathaway also has interests in five Japanese trading firms, namely Itochu, Marubeni, Mitsubishi, Mitsui and Sumitomo, the biggest of Japan's so-called 'sogo-shosha' or general trading companies. Buffett has likened this quintet to Berkshire Hathaway itself, since they have diversified portfolios with long-term investments and a focus on value and cash flow.

we would not expect any major changes to the way the business is run. The management of the investment portfolio is less clear albeit it is assumed that Ted Weschler and Tod Combs who currently manage a not insignificant percentage of the portfolio will be heavily involved.'

Also weighing in is Will Lamond, investment director at Oakglen Wealth. 'Greg Abel is expected to take over the reins at Berkshire when Buffett finally stands down,' Lamond informs *Shares.* 'The Sage of Omaha was recently quoted in an interview with *CNBC* that Abel, "Does all the work and I take the bows – it's exactly what I wanted." The more pressing question is how and who will Abel be supported by in his role, and will there be another Charlie Munger-type figure?'

Like Ashworth-Lord, Lamond would be surprised to see many changes in how Berkshire Hathaway is run or how it invests. 'The management team have all been handpicked by Buffett and the late Munger and have been in place for several years. I suppose the best way of looking at it, is if it isn't broke, why try to fix it?'

COULD BUFFETT DO ANOTHER BIG DEAL?

At the last count, Berkshire Hathaway was sitting on a record $157 billion cash pile thanks to the mountains of cash generated by its operating businesses and following investment portfolio share sales. Given the conglomerate's formidable firepower for acquisitions, might Buffett, who remains highly active for a man of his years, have one big deal left in him?

Could Unilever be a potential target?

Could potential targets include Marmite-to-Magnum ice cream maker **Unilever (ULVR)** for instance? After all, back in 2017 Buffett was involved in the ultimately aborted bid for the FTSE 100 group from **Kraft Heinz (KHC:NASDAQ)**. Or might Berkshire be interested in buying **Diageo (DGE)**, the Johnnie Walker maker whose shares are currently nursing a profit warning-induced hangover?

Lamond says the enormous cash pile 'has been well reported and in certain investment circles has been a detractor to the investment case for Berkshire. One would be foolhardy to totally discount a mega deal being struck but it is more likely Berkshire will

> **"The culture of long-termism and shareholders-as-owners is so embedded."**

Berkshire Hathaway in numbers

Berkshire Hathaway Class B	
Share price	$367.7
Market cap	$803.2bn

Berkshire Hathaway Class A	
Share price	$558,855
Market cap	$803.2bn

Table: Shares magazine • Source: Google Finance

HOW TO BUY BERKSHIRE HATHAWAY

Berkshire Hathaway is a stock with defensive attractions given its ownership of large insurance businesses able to offset its more economically-sensitive businesses. And as Brind points out, the company is rated AA by S&P and Aa2 by Moody's, reflecting the strength of its balance sheet.

Analysts at Morningstar believe that owing to its diversification and lower overall risk profile, Berkshire offers 'one of the better risk-adjusted return profiles in the financial-services sector (and remains a generally solid candidate for downside protection during market sell-offs). We remain impressed by Berkshire's ability in most years to generate high-single-to-double-digit growth in book value per share, comfortably above our estimate of its cost of capital.'

Ashworth-Lord assures *Shares* that Berkshire has been 'a tremendously successful investment for the fund, because not only have we had quite a rise in local currency terms but we've had the benefit of cable.' He'd be a happy holder beyond Buffett since the succession is 'well in place and the culture is so ingrained in these guy that we don't need to worry about them going off at a tangent'. Combs and Weschler have been 'long bedded in as investment managers and been given more and more responsibility. I think you can see their impact in investments like Apple, which were probably their origination.'

Investors interested in buying the shares can, in theory, choose between Class A stock (BRK.A) and Class B stock (BRK.B). The main difference between the two classes is their price: as of 10 January 2024, the Class A shares were trading at $558,855 per share with the more affordable Class B shares changing hands for $367.70.

Class A is the original stock, known for its astronomical price per share, whereas the lower-priced Class B shares, issued in 1996 to enable smaller investors to nibble at the Berkshire pie, carries lower voting rights.

The Class A shares can be converted into an equivalent amount of Class B shares any time a Class A shareholder wishes to do so. The conversion privilege does not exist in reverse. Class B shareholders can only convert their holdings to Class A by selling their Class B shares and then buying the equivalent in Class A.

Another option is to purchase exposure through funds and investment trusts. At 5.18% of the portfolio, the conglomerate is the fourth biggest position in the **CFP SDL UK Buffettology Fund (BF0LDZ3)** and a top 10 holding in the **BlackRock US Dynamic (B87XJQ6)**, **Schroder US Equity Income Maximiser (B87XJQ6)** and **WS Canlife North American (B73N327)** funds.

In the investment trusts space, **JPMorgan American (JAM)** holds the stock in its top 10, as does the Brind and George Barrow-managed **Polar Capital Global Financials.**

'In terms of the valuation, we were guided by price to book value which is exactly what Warren does,' adds Ashworth-Lord. 'I always think it is worth looking at Berkshire Hathaway if it gets below a discount to book value of 10% to 15%. We're not there at the moment, but if I was looking to buy more, I might just wait for a bad day on Wall Street because Berkshire is going to go down with it. You'll get your opportunity.'

Compounded annual gain – 1965 to 2022

Chart: Shares magazine • Source: Berkshire Hathaway

Overall gain – 1964 to 2022

Chart: Shares magazine • Source: Berkshire Hathaway

continue to accumulate positions in companies such as **Occidental Petroleum (OXY:NYSE),** which remain underappreciated by the market. Also, Berkshire has a progressive share buyback program in place that allows management to buy back shares if the company trades below its internally set intrinsic value.'

Polar Capital's Brind says: 'A sustained downturn that is of sufficient duration to allow Buffett to deploy the cash in supporting or acquiring a decent sized business would make it much more likely but even during the financial crisis there was no one single huge deal as it was spread across a number of businesses. Having said that it was shortly followed by the acquisition of BNSF in 2009/10 so you never know.'

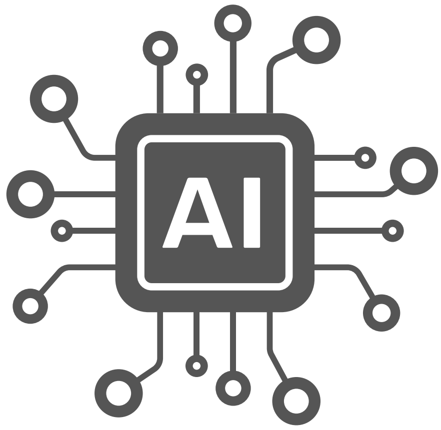
Ashworth-Lord insists Buffett won't be rushed into anything and it is a case of 'finding a deal that is big enough to move the dial and comes at a price that makes business sense for Buffett.

'I can tell you from experience that he does not overpay. But if a deal does present itself, I've no doubt whatsoever he will do it.'

The general consensus on Berkshire Hathaway is that the shares could plunge when Buffett finally shakes off his mortal coil. Yet Ashworth-Lord doesn't think the price will crater: 'You'll have the venture capitalists swarming round it like flies round a honeypot. But if Berkshire Hathaway were to tank, look at all that lovely cash on the balance sheet to start buying back shares. The company could mount a massive share buyback at a knockdown price and if that were to come to pass, it could well be Buffett's best-ever deal from beyond the grave.'

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

How fund managers plan to respond to the artificial intelligence theme in 2024



AI stocks made impressive gains last year but were they just a flash in the pan?

There is no question the dominant theme in stock markets last year was AI (artificial intelligence), in particular generative AI.

In an interview with *Time* magazine last June, Sam Altman – the former chief executive of OpenAI, whose ChatGPT product has been at the forefront of the AI trend – said he believes the technology will 'transform the way people work and the way people learn. It's going to transform the way people interact with the world. In a deep sense, AI is the technology that the world, that people have always wanted'.

So, for the final part of our survey, we thought we would ask fund managers what impact AI might have on their portfolios and their stock picks for the year ahead.

HOW WILL AI IMPACT YOUR INVESTMENTS IN 2024?

George Ensor

R&M UK Listed Smaller Companies Fund (B1DSZS0)

'While we don't underestimate the impact AI is going to have, the market has been very quick to decide on which companies are winners and which are losers. We expect the answers are going to be more nuanced and take time to be realised. There are obvious productivity opportunities for many companies as well as risks from new AI-enabled competitors.'

Julian Bishop

Brunner Investment Trust (BUT)

'AI is already everywhere and will only grow in importance with time as the broad shift towards information technology continues. On a personal level, I'm hoping **Microsoft's (MSFT:NASDAQ)** forthcoming AI 'Copilot' for Office 365 will help me better summarise company meeting notes and reduce the time needed to construct financial models – two examples of its many purported uses. AI will also generate business for IT implementation firms, and further boost demand for semiconductors, where we have several holdings we think will benefit.'

Jean Roche

Schroder UK Mid-Cap Fund (SCP)

'AI has been around financial markets for 10 years now and is in use to a greater or lesser degree in many products and services. It's just been re-badged and democratised. Last Christmas I was learning to write witty poems about my kids with the help of Chat GPT, now we have our own "AI sandbox" at Schroders, called Genie, which helps me to be more efficient in how I read annual reports, for example. Some would liken AI models to very well-qualified and resilient graduates with boundless energy – dangerous if left to pick stocks on their own, but if guided well, can help experienced investors make more informed decisions.

'Looking across our top 15 holdings, I see multiple beneficiaries of AI – either users of or suppliers to this growth industry, for example **Computacenter (CCC)**, **Man Group (EMG)**, **Oxford Instruments (OXIG)** and **Spectris (SXS)**.'

Kartik Kumar,

Artemis Alpha Trust (ATS)

'AI will shape business dynamics for the next decade, but the impact over the next year is hard to predict. Unlike the internet, I think it is more likely to be an enabling technology than a disruptive one. The long-term potential benefit to financial services seems underappreciated. These companies have significant customer-facing and support functions where cost could be reduced through automation.'

Stephen Yiu

Stephen Yiu, Blue Whale Growth (BD6PG78)

'This year portfolio companies such as **Nvidia (NVDA:NASDAQ)** have benefited enormously from the proliferation of AI and its democratisation through the development of services such as Chat GPT, Adobe Firefly, and DALL.E, amongst others.

'We see "the AI revolution" as a long-term theme, the importance of which should not be underestimated. Where digital transformation was the story of the past decade, the AI revolution is where we see the majority of growth coming in 2024. As global titans, such as **Microsoft (MSFT:NASDAQ)** and **Meta (META:NASDAQ)**, embrace AI, the quality growth opportunities are incredibly exciting. The portfolio is invested accordingly.'

James Henderson

Henderson Opportunities Trust (HOT)

'AI has been totally overhyped this year in the same way that hydrogen was a couple of years ago. AI will become hugely important, just as hydrogen will, but it will take time. The market wants these things to happen much quicker than is possible in reality.'

William Tamworth

Artemis UK Smaller Companies Fund (B2PLJL5)

'With any exciting new technology there is the risk its impact can be over-estimated in the short term. We believe the potential negative impacts of AI have in some instances been overstated – for example, in the case of digital publisher **Future (FUTR)** or enterprise translation provider **RWS (RWS),** which also has its own leading machine translation offer. Some companies are already using AI to make their businesses more efficient – we expect more of this but it will be a relatively gradual process.'

Guy Anderson

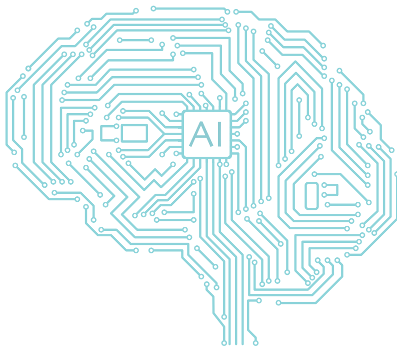
Mercantile Investment Trust (MRC)

''This theme has captured imaginations this year, and the long-term potential of AI is not to be underestimated. Although we would urge a degree of caution, there are some pockets of the market where we are already seeing genuine transformation. Our investments in **Bytes (BYIT)** and **Softcat (SCT)** could benefit as their corporate and public sector customers start to adopt generative AI solutions.'

Charles Montanaro

Montanaro UK Smaller Companies (MTU)

'There are several companies in the portfolio which may benefit from advances in AI. **Kainos (KNOS)**, an IT services company, is harnessing the power of generative AI to make its own software engineers more efficient, while also winning AI-related projects with customers. **Bytes Technology (BYIT),** a leading software reseller in the UK, stands to benefit via its partnership with **Microsoft (MSFT:NASDAQ)**, as the tech giant rolls out CoPilot features across its Office suite. **XP Power (XPP)**, a provider of power supplies, sells to manufacturers of equipment used to produce semiconductors, and thus may indirectly benefit from an increase in manufacturing capacity required to make more AI chips.'



Simon Barnard

Smithson (SSON)

'While there will be a limited impact on our portfolio companies in the coming year, in the long term we expect AI to help reduce costs and produce new products. Many of our companies already use some form of AI combined with machine learning to process data, while others such as **Verisk Analytics (VRSK:NASDAQ)**, the US insurance data company, are starting to research the potential uses of generative AI to offer new products.'

Stuart Gray

Alliance Trust (ATST)

'Although it has huge potential to boost productivity, we are wary of much of the hype surrounding AI. As with the internet bubble 20 years ago, it could take several years before the clear AI winners emerge.

'While we do have exposure to AI today, through **Microsoft (MSFT:NASDAQ)** for example, our stock pickers are playing it company by company rather than as a portfolio theme. The key will be which companies are able to use AI to improve their efficiency or customer offerings and outperform their competition.'

Richard Penny

Crux UK Smaller Companies (BQV37J7)

'We own shares in **FD Technologies (FDP:AIM)** whose KX Systems subsidiary has just launched a product KDB.AI. KX Systems sells database products which are very good at handling high-volume and very fast streams of data, and on various metrics, are significantly superior to other solutions. These capabilities are very important for training AI systems such as Chat GPT and using vector databases such as KDB. AI can avoid the need for GPU-type products, which have propelled **Nvidia (NVDA:NASDAQ)** to significant highs.

'The UK market has a very different attitude to growth and FD Tech shares have been punished for the investment and shortfall in profits and now trade close to £10 having been £22 earlier this year. The revenues for this business are c£65 million and we believe it can grow by 30% to 40% over the next three to five years. The company has sales partnerships with AWS, Microsoft Snowflake and Databricks. We believe this business is currently valued c1x this year's sales, and that the shares should benefit from a multi-year growth in revenues and a more generous US style valuation metric which can be between five and 15 times revenues.'

James Harries

STS Global Income & Growth Trust (STS)

'It is hard to predict exactly how AI will impact our portfolio and markets more broadly in 2024. There is much excitement (hype) embedded in valuations and expectations currently which may actually recede somewhat in the coming months.

'This may lead to a resurgence in the performance of more defensive but currently overlooked areas of the market. This is descriptive of our quality focused, conservatively managed portfolio and should benefit our relative performance.'

Helen Steers

Pantheon International (PIN)

'We have already seen the application of AI in some portfolio companies, for example in customer interactions through chatbots, or content generation in graphics for entertainment. Venture Capital comprises just 3% of the portfolio, so direct exposure to AI is limited, but we expect a wider spectrum of applications to come out of this area as significant tools for better productivity and efficiency are developed in the coming years. Our portfolio is focused on asset-light, high margin and less labour-intensive businesses, which we believe are well placed to benefit from AI in the future.'

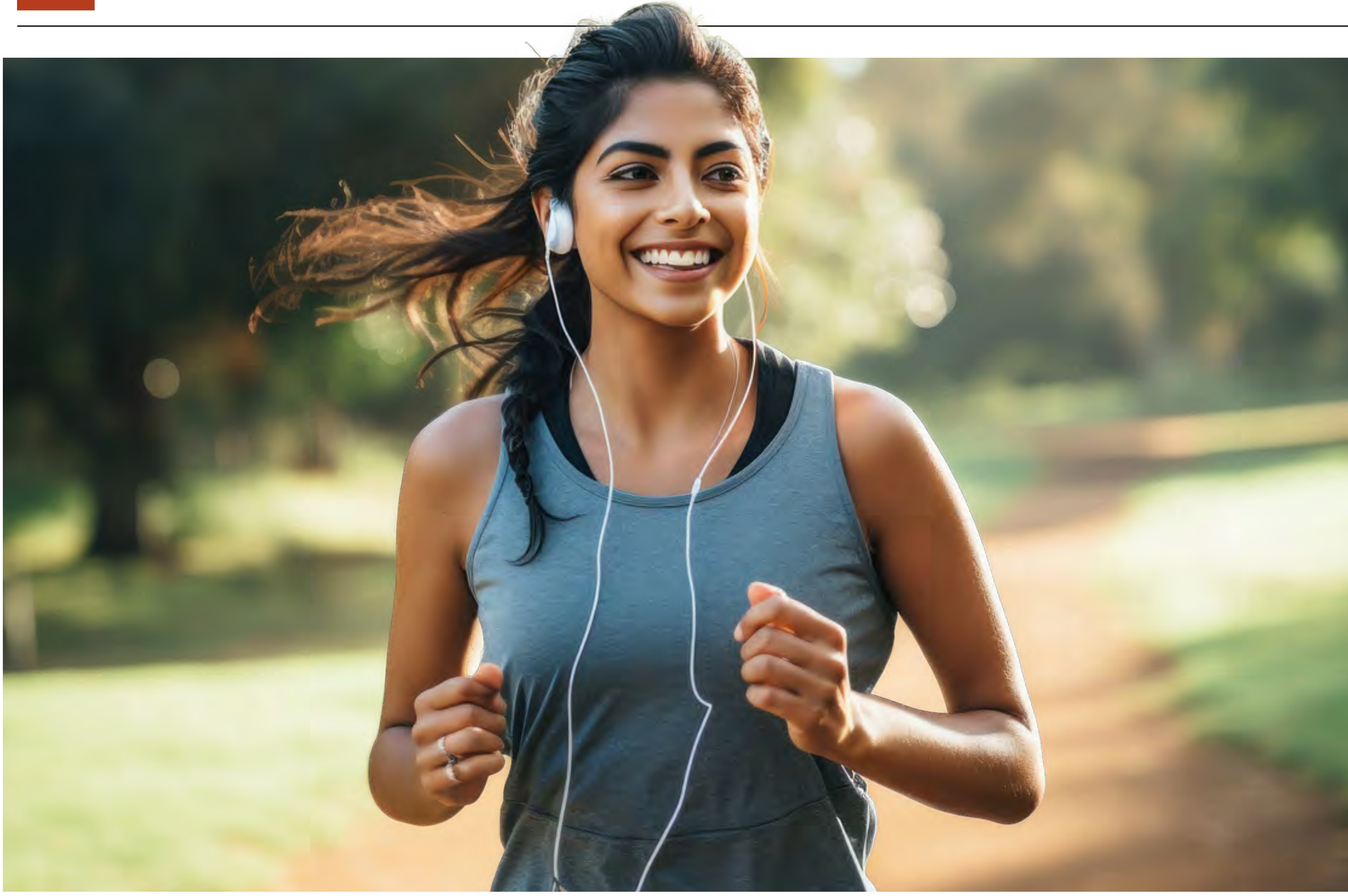
Thomas Moore

Aberdeen Equity Income (AEI)

'It's probably too early to say with any great confidence which company will be the key winner in the advent of artificial intelligence (AI). All the companies we invest in are doing the due diligence of how AI will impact them and their efficiency.

'Take **Speedy Hire (SDY)** for example a UK-based tools and equipment hire business. The company is looking at how they can improve their operational efficiency, so they have teamed up with an AI specialist to improve their efficiency to make sure they have the right products in place to meet customer demand. In addition to this companies have been telling us that they can use AI to control costs.'

By **Ian Conway**
Deputy Editor



Diversification is key to the streaming service's success in 2024 and beyond

The firm has made its share of blunders with content in the past

Media company **Spotify Technology (NYSE:SPOT)** primarily generates cash from streaming music to listeners digitally, and judging by its third-quarter results, where total revenue grew 11% on the previous year to $3.4 billion, business is good for the Swedish-based firm.

Subscribers and non-subscribers are able to listen to millions of songs from a variety of genres from indie, rock and pop to classical music on Spotify's vast library, which also includes podcasts.

Spotify offers a free service, which is ad-supported but with lower audio quality, and a premium subscription service with better audio quality, no adverts and the ability to download songs.

In the third quarter, Spotify grew its premium subscriber numbers by 16% year-on-year to 226 million, two million above the company's expectations.

This rise was despite Spotify increasing its prices in the US, UK and 50 other markets last July by 10%. Its standard monthly subscription for UK customers now stands at £10.99 per month rather than £9.99.

The company told subscribers at the time the rise was to 'invest in and innovate our product offerings and features', which it has done by unveiling new personalised experiences for users and tools for 'creators' like artificial intelligence (AI) voice translation for select podcasts, an expanded AI DJ to 50 markets and a tool to help artists promote music releases.

BALANCING ACT

Although Spotify is generating healthy revenue through its increased subscriber numbers and advertising, the company has mounting costs to the music industry.

According to a company presentation, as of

2022, Spotify's total pay-outs to the music industry were approximately $40 billion in both recording and publishing royalties.

Yet the company has come under increasing criticism for how little it pays musicians, which is on average between $0.003 and $0.005 per stream.

This year, Spotify is introducing a significant change to the way it calculates recorded royalties meaning tracks must have reached at least 1,000 streams in the previous 12 months to generate royalties on the platform.

This change in strategy, the company said in a blog post, will ensure that each of the tracks streamed will earn more.

BAD RAP

The firm has also come in for a fair amount of criticism over its podcasting strategy, where errors of judgement have resulted in job cuts.

During the pandemic, the company invested heavily in podcasting to build its audience but ended up overpaying for content. For example, the company spent more than $2 million per episode for a dozen podcasts featuring Prince Harry and Meghan Markle.

Last December, Spotify announced the departure of chief financial officer Paul Vogel. Just days after the firm announced a further 1,500 job cuts, Vogel cashed in $9.3 million worth of shares.

Laying off 17% of the workforce may not be an unusual move for a tech company, and in fairness the big beasts of the sector were all doing it – **Meta**

Spotify Forecast

Forecast	2023	2024
Revenue (Euros)	13,306	16,036
Revenue Growth %	13.5	20.5
Operating Income	-332	288
Operating Margin %	-2.5	1.8
Adjusted EBITDA (millions)	87	710
Adjusted EBITDA Margin %	0.7	4.4
Earnings Per Share (Diluted)	-2.19	0.71
Adjusted EPS Growth %	-0.1	-132.4
Price/Earnings	-73.3	226.1
Price/Book	15.9	14.9
EV/EBITDA	338.1	41.6
Free Cash Flow Yield	-0.2	1.6

Data as of 24 October 2023

Table: Shares magazine • Source: Morningstar Valuation Model.

WHAT DO INVESTORS LIKE ABOUT SPOTIFY?

Spotify has many high-profile investors, including **Scottish Mortgage Investment Trust (SMIT)** which has owned a 1.9% stake since 2015 because it believes the company is 'reshaping the music industry'.

The trust's managers argue Spotify has created a platform 'where artists can own copyright and be heard by new listeners, while fans get more choice and closer relationships with artists'.

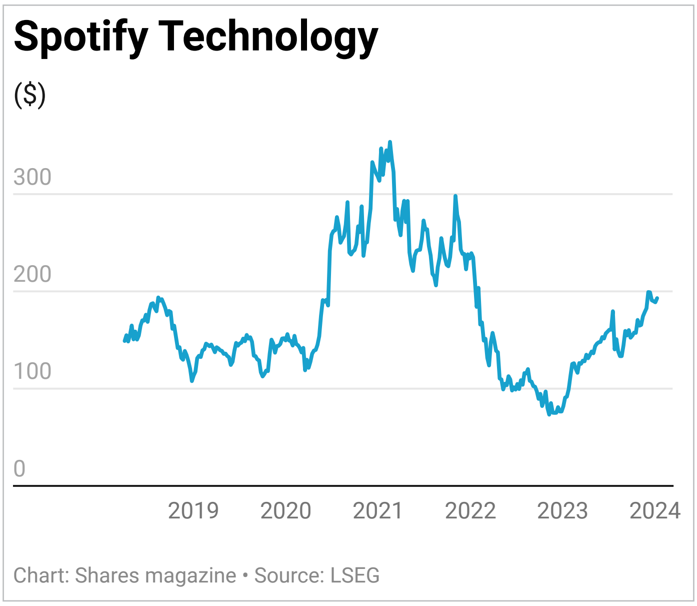
The firm has become an industry leader by 'making music a constant companion and creating machine-generated personalised playlists. Exponential growth in podcast production is also increasing user engagement', add the managers.

Just as Steve Jobs was considered pivotal to the early success of **Apple (AAPL:NASDAQ)**, so Spotify's co-founder and chief executive, 40 year-old billionaire Daniel Ek, is seen as integral to the Swedish firm's success.

'Ek is thinking on a universal scale for Spotify; he wants to put it in front of every single person on the face of this universe who's interested in music. He is also committed to making it possible for creators to live off their art', say the managers.

Platforms (META:NASDAQ) cut an additional 10,000 jobs in March, **Amazon (AMZN:NASDAQ)** laid off 9,000 workers and **Alphabet (GOOG:NASDAQ)** shed 12,000 jobs globally in 2023 with more redundancies announced this month.

When asked about the timing of Vogel's departure, Daniel Ek simply said 'over time we've concluded that Spotify is entering a new phase and needs a new CFO with a different mix of experiences.'



MONEY MAKER

To make a sustainable profit in the long term, Spotify has to keep a lid on costs and innovate to fend off competition from Apple, Alphabet and Amazon, all of which offer their own music streaming services.

Ali Mogharabi, senior equity analyst at Morningstar, notes: 'Unlike Spotify, these firms don't rely solely on streaming music or podcasts to drive profitability and can potentially run at breakeven or even as loss leaders while monetising users via other products and services.

'It might also be harder for Spotify to steal share from these competitors over time, as Apple Music and Apple Podcast listeners are probably entrenched with other Apple products, Amazon Music with Echo and so on.'

However, Moghrabi is upbeat about the company saying Morningstar has raised its projections: 'We now anticipate a higher user count and wider margins given the strengthening of Spotify's flywheel, resulting in a $183 fair value estimate, up from $170, a level at which the stock is trading currently after nearly a 10% jump in reaction to the firm's quarterly results.'

"Spotify is leveraging AI across its platform. Coupled with audiobooks rolling out to premium subscribers, we believe the company has several opportunities to drive engagement and eventually stronger monetisation"

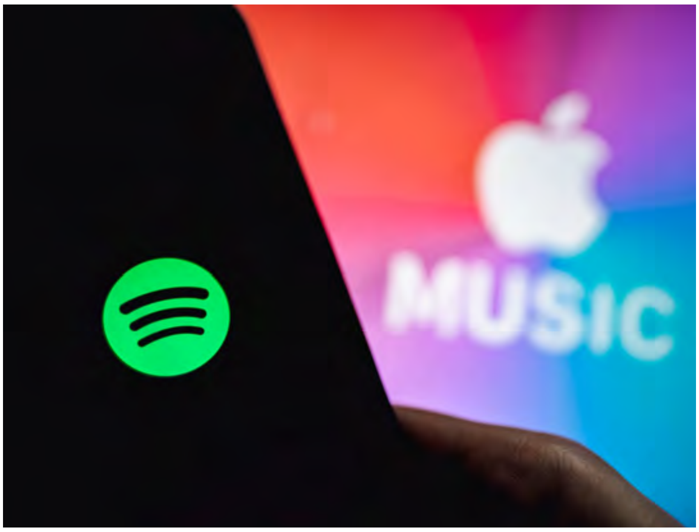
Over the past year, it's fair to say Spotify shares have performed well having gained 129%.

Justin Patterson, equity research analyst at KeyBanc Capital Markets, is also upbeat about the firm's prospects.

'Spotify is leveraging AI across its platform. Coupled with audiobooks rolling out to premium subscribers, we believe the company has several opportunities to drive engagement and eventually stronger monetisation.'

In the long term, if Spotify can invest in more services and tools for artists then the company may be able to attract artists away from record labels and toward independent distribution, which may allow it to pay lower royalties over time.

Diversification into different content is also key for Spotify over the next 10 years, for example video which will attract more users and advertisers.



By **Sabuhi Gard** Investment Writer

Bitcoin excitement builds again but it is not a credible store of value

Cryptocurrency gets boost as SEC approves ETFs in the US tracking spot prices

Bitcoin is having another moment in the sun on the back of the decision by the US SEC (Securities and Exchange Commission) to greenlight exchange-traded funds which track the cryptocurrency.

There is no doubting the significance of this move. It will make it easier and potentially cheaper for investors, though crucially only those across the Atlantic for now (of which more later), to invest. Mainstream asset managers like BlackRock and Fidelity are getting involved.

The SEC was at pains to dismiss any sense it was endorsing Bitcoin with this move but this is likely to be ignored. There is no doubt this a further step towards the mainstream for crypto.

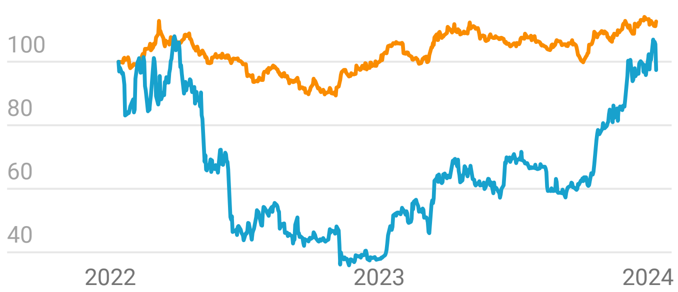
Bradley Duke, chief strategy officer at exchange-traded product provider ETC Group commented: 'The approval of the US spot Bitcoin ETFs by the SEC and also the Hong Kong Securities Commission announcement that it too will approve spot Bitcoin ETFs, goes far to legitimise Bitcoin as an investable global asset.

'Here in Europe, we have had secure and efficient spot Bitcoin ETPs for over three-and-a-half years and we are spoiled for choice with the range of physically backed Crypto ETPs available including many different single-asset Crypto ETPs as well as broad market index products.'

Duke draws an important distinction here: current Bitcoin instruments in Europe are exchange-traded products as opposed to exchange-traded funds. This, without getting too much into the weeds, is an important distinction. ETFs in Europe have to meet diversification criteria and if that's not possible then ETPs are the obvious solution.

ETC Group launched BTCetc - Bitcoin ETP back in June 2020, which is now Europe's largest physically backed Bitcoin ETP and trades on several European exchanges. In 2021, the Financial Conduct Authority banned the sale of exchange-traded products containing 'unregulated transferable cryptoassets', arguing they had no inherent value, were widely volatile, rife with financial crime and did not fulfil any kind of planning need for investors. Interestingly, Vanguard has banned US investors using its platform from buying Bitcoin ETFs.

Gold vs Bitcoin



Rebased to 100

Chart: Shares magazine • Source: LSEG

Bitcoin is a divisive topic. Detractors, and there are plenty of them, will line up to denounce it as a Ponzi scheme while fans argue it will revolutionise the world of money.

This author has more sympathy, though not much, for the latter argument than the suggestion of Bitcoin as a store of value to rival gold. Gold is a physical asset with a long history as a safe haven and while the price can experience some volatility, ranging between current levels above $2,000 per ounce and lows below $1,700 over the last two years, Bitcoin has ranged from $16,000 to its current $42,660 over the same period.

Anything with this level of volatility cannot be sold as a credible 'store of value'. Blockchain, the infrastructure underpinning Bitcoin, could prove more interesting in the long term. It is a verifiable electronic ledger for recording transactions and tracking assets in a business network, which could be anything from a tract of land to a key piece of intellectual property.

There are several exchange-traded funds which look to provide exposure to blockchain as a theme – the largest of which is **Invesco CoinShares Global Blockchain (BCHS)** with an ongoing charge of 0.65%.

WATCH RECENT PRESENTATIONS

India Capital Growth Fund (IGC)
Gaurav Narain, Co-Head of Equity

India Capital Growth Fund (ICGF) is a closed ended Investment Company, listed on the main board of the London Stock Exchange. It follows a bottom-up long-term investment approach focused on India's small and midcap market with a concentrated portfolio of around 30 holdings. ICGF is managed by Ocean Dial, a single country focused asset management company investing directly into India.

Trident Royalties (TRR)
Adam Davidson, CEO

Trident Royalties (TRR) plan to rapidly establish itself as a diversified mining royalty and streaming company, providing investors with exposure to base and precious metals, bulk materials (excluding thermal coal) and battery metals.

Schroder Japan Trust (SJG)
Masaki Taketsume, Portfolio Manager

Schroder Japan Trust (SJG) aims to achieve long-term capital growth by investing in a diversified portfolio of 50-60 of the best quality but undervalued companies in Japan.

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Falling interest rates could trigger new wave of takeovers

London-listed mid- and large- cap stocks could be targets in 2024

A big increase in the average takeover premium in 2023 highlights how parts of the UK stock market continue to be undervalued. The average bid premium for UK stocks in 2023 was 51% against 37% in 2022 and 43% in 2021, according to analysis by AJ Bell.

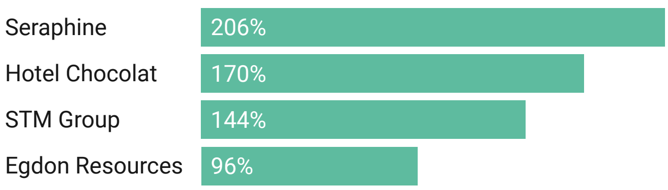
Most London-listed takeovers last year involved small-cap firms. Buyers were a mixture of private equity firms or industry players looking to buy rivals to gain scale or to get a foot in the door in a new sector or geography.

The lack of large-cap deals means takeovers were not a contributing factor to the performance of the UK's flagship index, the FTSE 100. Indeed, none of the 2023 London-listed takeovers involved FTSE 100 companies and only three FTSE 250 companies received a bid.

Yet this situation could change if interest rates start to fall. Private equity firms flourished during the extended period of low interest rates, borrowing money cheaply to buy companies and using their cash flow to help pay off the debt. The sharp rise in interest rates over the past two years has made debt financing more expensive and multi-billion pound or dollar transactions harder to stomach.

With signs that interest rates may have peaked and central banks could begin cutting in 2024,

Biggest bid premiums for UK-listed takeovers in 2023



NOTE: The bid premium represents the extra amount of money the acquirer is paying to buy the company versus its market valuation on the day before the bid went public.

Chart: Shares magazine • Source: AJ Bell, company announcements

we could see private equity firms go after bigger targets, particularly as many are sitting on significant amounts of cash (also known as 'dry powder' in the industry). We might also see large industry players make opportunistic bids for similar-sized rivals.

WHICH COMPANIES MIGHT BE TARGETS?

Reckitt (RKT) and **Unilever (ULVR)** are ones to watch as potential large-cap takeover targets. Both are companies that investors feel have lost their way and are now trying to get back on track.

Advertising agency **WPP (WPP)** could also be a takeover target given share price weakness and an undemanding valuation, trading on 7.8 times forward earnings and an EV to EBITDA (enterprise value to earnings before interest, tax, depreciation and amortisation) ratio of 8.9 times.
However, concerns over the global economy in 2024 could throw icy water on the idea that someone would try and buy WPP in the near-term as earnings are likely to come under pressure if clients scale back promotional activity.

Analysts have touted diversified miner **Anglo American (AAL)** as a potential takeover target for someone like **Glencore (GLEN)**, after the firm saw its market value shrink by 39% in 2023 due to operational setbacks, weaker commodity prices and downgraded production guidance.

While there is merit to this line of thinking, the mining sector has a history of buying at the top and not at the bottom. Miners show a tendency to only want to do deals when everything is going well, rather than risk spending money when key commodity prices are flat or falling as they are at present.

FOUR COMMON THEMES

There were four common themes among UK takeovers last year and we could expect similar trends in 2024.

1. The acquisition enables the buyer to expand into a new country

That is the rationale behind CoStar's £100 million bid last year for property portal OnTheMarket. The purchase price is tiny compared to CoStar's own $36 billion valuation but strategically interesting as it gives the buyer a foot in the door in the UK market and the opportunity to try and take market share from **Rightmove (RMV)**. CoStar is a big player in the US and this acquisition could give Rightmove and UK peer Zoopla sleepless nights.

2. Opportunistic bid following share price weakness in a rival

Mars pounced on **Hotel Chocolat (HOTC:AIM)** while its shares were depressed, offering a large premium to the market price to buy the business.

3. Private equity firms think about the bigger picture when buying undervalued companies

Buy-out firms often use the acquired business as a roll-up vehicle to make acquisitions in a certain sector or tap into a network of contacts to help improve the acquired company.

For example, Brookfield is in the process of buying London-listed **Network International (NETW)** and has indicated a desire to merge it with another payments group it majority-owns called Magnati.

4. The buyer takes the view the target would be better under private ownership

One of the downsides of being a listed company is constantly being in the spotlight. Investors are judging every move, and that can be a distraction if a business is going through a challenging period and wants to focus on the recovery.

For example, Apollo just bought Wagamama-owner Restaurant Group and believes it is better away from public markets. Restaurant Group has suffered mixed fortunes in recent years – its posh pubs arm and Wagamama have been successful while there have been troubles elsewhere. The share price was incredibly volatile when Restaurant Group was a listed entity, but Apollo is taking a long-term view and believes it can get the business back on track under private ownership.

WHO MIGHT BE BOUGHT IN 2024?

The following three stocks have the right qualities to be takeover targets:

Entain

Chart: Shares magazine • Source: LSEG

FTSE 100 member **Entain (ENT)** has significant scale in the gambling industry, but setbacks have hurt the share price and it now has a caretaker chief executive. If ever there was a time for vultures to circle the business and pounce with an offer, it's now.

The company is one of the world's largest sports betting and gaming groups and scale matters in this industry. It owns big brands including Ladbrokes, Coral, Eurobet and STS.

Entain trades at 974p, having suffered a disastrous few years. An aggressive acquisition spree attracted widespread criticism and more recently it agreed a deal with the Crown Prosecution Service to pay £585 million in relation to a bribery investigation linked to its former Turkish business. Chief executive Jette Nygaard-Andersen quit in December 2023 and non-executive director Stella David has replaced her on an interim basis.

The logical buyer is **MGM Resorts (MGM:NYSE),** its partner in the US, which previously offered to buy Entain for the equivalent of £13.83 per share in January 2021. That same year **DraftKings**

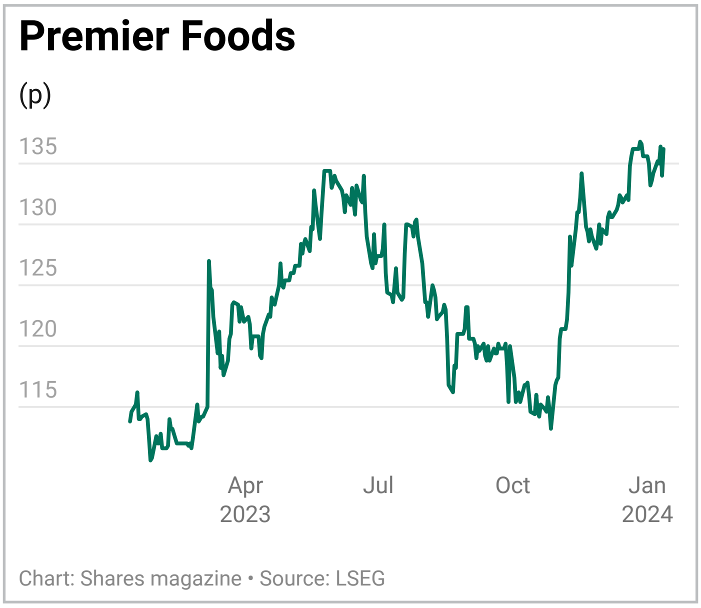
(DKNG:NASDAQ) also tried to buy the business, proposing to pay as much as £28 a share.

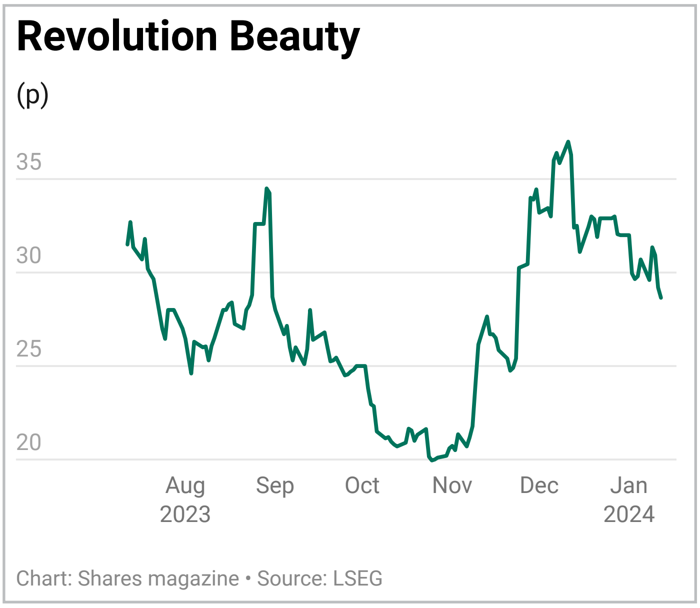
The company's shareholder register includes three activists who could push for a sale or break-up of the business. They would no doubt seek the highest possible price, so if we do see a new takeover approach don't expect the first bid to be the winning one.

A selection of UK stocks receiving takeover bids in 2023

Company	Price before announcement (p)	Offer (p)	Bidder	Premium
City Pub	99.00	145.00	Young's	46%
Dechra Pharmaceuticals	2776.00	3875.00	EQT & ADIA	40%
DWF	65.50	100.00	Inflexion	53%
Finsbury Food	89.00	110.00	DBAY Advisors	24%
FireAngel Safety	2.10	7.40	Intelligent Safety Electronics	252%
Fulham Shore	10.50	14.15	Toridoll	35%
Hotel Chocolat	139.00	375.00	Mars	170%
Hurricane Energy	6.53	12.50	Prax	91%
Medica	160.00	212.00	IK Investments	33%
Network International	243.60	400.00	Brookfield	64%
Numis Securities	204.00	350.00	Deutsche Bank	72%
OnTheMarket	70.50	110.00	CoStar	56%
Restaurant Group	48.35	65.00	Apollo Global	34%
Rotala	42.00	63.50	Directors	51%
Round Hill Music	0.69	1.15	Concord	67%
ScS	169.00	280.00	Poltronesofa	66%
Seraphine	9.80	30.00	Mayfair Equity Partners	206%
Shanta Gold	12.65	13.50	ETC	7%
Smart Metering Systems	680.00	955.00	KKR	40%
Smoove	44.00	54.00	Digcom	23%
Sureserve	90.00	125.00	Cap10 Partners	39%
Ten Entertainment	310.00	412.50	Trive Capital	33%
Tribal	52.30	74.00	Ellucian	41%

Table: Shares magazine • Source: AJ Bell, Company announcements





Mr Kipling maker **Premier Foods (PFD)** was the subject of two takeover bids (at 52p and 60p) from US spice maker **McCormick (MKC:NYSE)** in 2016, both of which it rejected on valuation grounds. Since then, the business has transformed itself and it now looks ripe for takeover interest once again.

Japanese food group **Nissin (2897:TYO)** already owns 24.27% of the business, having formed a strategic partnership at the same time as it rejected the McCormick bids. Premier Foods distributes Nissin's Soba and Cup Noodles products in the UK, and its Batchelors Super Noodles use Nissin's noodle manufacturing expertise.

In recent years, Premier Foods has gone from being a zombie company drowning in debt to one that is reinvesting its surplus cash into product innovation and marketing. This has significantly de-risked the investment case.

While the current share price of 132p is more than double McCormick's offer in 2016, it is important to consider some companies are happy to pay a higher price for acquisitions if they are not having to deal with baggage. Moreover, Premier Foods's shares are not expensive at 9.9 times forecast earnings and 7.2 times EV to EBITDA.

Noodle-focused Nissin might seem the logical buyer given its existing stake, yet Premier Foods is a broader business involved in cooking sauces, cakes and meal kits. That suggests a more diverse food company might be a more realistic acquirer.

Revolution Beauty (REVB:AIM) struggled to win over investors after joining the stock market in 2021 and share price weakness created an opportunity for **Boohoo (BOO:AIM).** The latter bought a strategic stake in Revolution Beauty in 2022, building on an existing sales relationship. Now holding 27.13% of the shares, Boohoo could feasibly acquire the remainder of the business.

A disagreement over leadership is now in the past after Boohoo won a battle to replace certain senior directors at Revolution Beauty. The latter recently agreed a settlement with former chair Tom Allsworth regarding various issues, and the final piece of the jigsaw would be former chief executive Adam Minto agreeing to pay the group a sum a money to settle allegations he breached his fiduciary duties to the retailer. Talks are ongoing and assuming they conclude amicably, don't be surprised if Boohoo pulls the trigger on a full takeover.

Boohoo wants to be bigger player in the beauty market so there is logic to owning Revolution Beauty. It could save money over the long term by getting rid of Revolution Beauty's stock market listing and running the two companies on one platform. Allsworth and Minto each own 15.35% of the target company and might welcome a cash exit to start something new.

DISCLAIMER: AJ Bell referenced in the article owns Shares magazine. The author (Daniel Coatsworth) and editor (Ian Conway) of this article have an investment in AJ Bell.

By **Daniel Coatsworth**
AJ Bell Editor in Chief and Investment Analyst

How to benefit from higher rates in your Stocks and Shares ISA

Discover why these tax-efficient wrappers can be a good way to protect your interest

As interest rates have risen over the last two years, cash products have grown in popularity, especially Cash ISAs which allow you to receive your interest tax-free. But it's actually perfectly possible to benefit from higher interest rates within a Stocks and Shares ISA too, as it's not just cash accounts at the bank which pay interest.

As with a Cash ISA, your interest in a Stocks and Shares ISA is protected from income tax, so you don't have to hand over any of the return your money is generating to the taxman. Here are some of the investments available within a Stocks and Shares ISA which are now enjoying better returns because of higher interest rates.

MONEY MARKET FUNDS

Money market funds saw rising demand from Stocks and Shares ISA investors in 2023. These are funds which invest in cash-like instruments, predominantly short term deposits with banks, and short-term loans to governments, banks and large companies. Some of these loans take place for as short a period as overnight. Money market funds typically have very low levels of volatility, which makes them an appropriate choice for more cautious investors.

Investors probably picked these funds in 2023 because they are low risk yet were offering very respectable yields as interest rates rose, in sharp contrast to the prior decade. The chart below shows the return from the average money market fund last year was 4.66%, though past performance is no guarantee of future returns. The yields offered by these funds are variable, and depend on short term interest rates, but clearly these are now much higher than they were in the 2010s.

Total return of average money market fund %

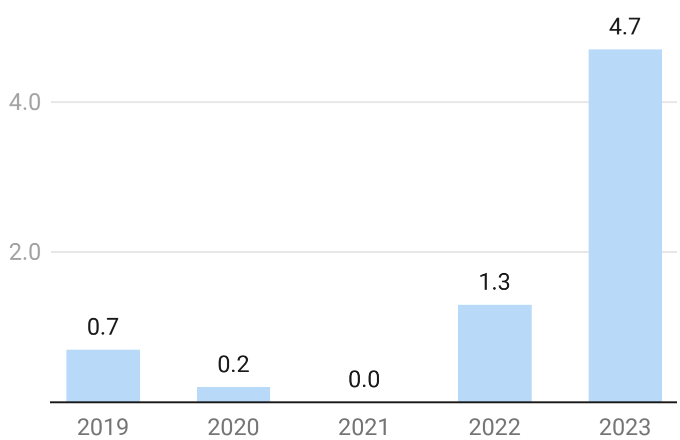


Chart: Shares magazine • Source: Morningstar

BOND FUNDS

Bonds are basically an IOU, whereby investors lend money to governments and companies in exchange for a set rate of interest with capital to be repaid at a set date in the future. For many years the rate of interest paid by bonds was uninspiring, causing some to describe government bonds as 'return-free risk'. But that's all changed. Since interest rates have risen, it's now possible to pick up pretty appealing yields from bond funds.

Bond funds can and do fluctuate in value, and if interest rate expectations rise, you can expect to see bond prices fall. Clearly fluctuations in valuation does mean there is some risk, but bonds can actually lower the volatility of your portfolio as a whole if you are also holding shares. That's because bonds, especially government bonds, tend to move in the opposite direction to share prices, so if you hold both in your portfolio, you should get a smoother ride.

INDIVIDUAL GILTS AND CORPORATE BONDS

Investors can also buy individual government bonds and corporate bonds instead of a bond fund if they wish. Last year at AJ Bell we saw an uptick in the number of investors using individual gilts to park large sums of money and lock into higher interest rates, presumably as an alternative to moving into cash.

Gilts are loans to the UK government, and it's pretty certain you will get your loan repaid, along with the interest promised, as there's a very, very low chance of the UK Exchequer defaulting on its debt obligations.

This is probably why investors with large sums of money have been using them, as bank deposits are only covered by the Financial Services Compensation Scheme up to a maximum of £85,000 if their bank goes bust. Corporate bonds are considered less safe because they are loans to companies, which are deemed more likely to default on their obligations than, for instance, the UK government.

The price of bonds fluctuates on the market, but there will be a maturity date for each bond, at which point you will get the maturity value of the bond back, unless there is a default. The maturity value, also called the par value, may be more or less than you paid for it, depending on the price you bought in at.

Many bonds are currently trading at below their par value, in which case the return you can expect back between now and maturity is a combination of interest payments and capital gains. Individual bonds can be a bit tricky to get your head around, so this approach is probably best left to more experienced investors or those who are willing to roll up their sleeves and delve into the nitty gritty.

MULTI-ASSET FUNDS

Multi-asset funds are another potential beneficiary of higher interest rates. These funds invest across a range of assets including shares, property, commodities, bonds and cash. These last two asset classes are now offering much higher interest rates, which will be a boost to the fund managers running these funds.

Multi-asset funds come in a range of risk profiles to suit investors with different appetites for volatility, so the amount of exposure you can get to bonds and cash ranges from very low to very high. These funds are useful for investors who want a mix of assets in their portfolio but want a professional fund manager to pick and choose what to invest in.

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

Ask Rachel: Your retirement questions answered

Where is the best place to put the money I'm saving on my National Insurance contributions?

We look at the changes to the rules and the options for savers

I work as a technical consultant in an air freshener company and earn £30,000 a year. I am single, aged 24 and live at home with my parents.

I'm delighted the government has cut my national insurance contributions as it means I may have a bit more money in my pay packet this month. But before I go spend it, should I be saving it and if so what should I save it in?

I have joined my employer's pension scheme, and I set up a lifetime ISA last year.

Jacob

Rachel Vahey,
AJ Bell Head of Public Policy, says:

Successive Chancellors have tried to win political favour by including big announcements in their Budget or Autumn Statement speeches – often referred to as 'pulling a rabbit out of the hat'.

Last November, Jeremy Hunt used his speech to cut national insurance contribution rates for both employees and the self-employed, giving a welcome boost to workers' pay packets.

From 6 January, the national insurance rate for employed people was cut from 12% to 10%, in a move that is estimated to cut taxes for 27 million working people.

For someone like you, an employed person on a £30,000 salary, this will save around £350 a year, while anyone earning more than the £50,270 threshold will save the maximum of £754 a year.

The Government will also cut rates for self-employed workers, but that won't come into effect until 6th April this year. At that point the Class 2 band of National Insurance will be abolished, saving self-employed workers £179.40 a year at current rates. And the rate for Class 4 contributions will be cut from the current 9% to 8%.

While £350 more a year isn't to be sniffed at, it isn't a fortune and could easily disappear meeting the rising cost of living such as on increasing food prices or energy costs.

But, if you're able to do so, you could use the extra money in your pay packet to double down on those New Year's resolutions to get your finances sorted. If you haven't made any resolutions yet, now is a good time.

The first call is to pay down any debt. The next is to build up a buffer fund to help with any financial emergencies – financial advisers usually recommend holding between three- and six-months' worth of salary. But if these two aims are ticked off then the extra money could be saved. If left alone, compound interest can work its magic to turn that small amount into a reasonably-sized sum.

For example, by keeping the same take home pay,

an employed person with a £30,000 income could build up another £3,100 over the next six years by saving £350 in a Lifetime ISA (assuming that annual amount increases by 2% each year, investment returns are 4% after charges, and they are within the Lifetime ISA subscription maximum of £4,000 a year so can receive their government 25% bonus).

That could help with a future first house purchase. But if not, the money can stay in the Lifetime ISA and be taken out in full from age 60. Take it out earlier and there will be penalty of 25%.

If you save into a different type of ISA, you will be able to get your money out when you want, with no penalty, but you won't get the benefit of a government bonus on the amount you invest.

Alternatively, the money could be saved into a pension where it will get a boost from basic rate tax relief generating an extra £16,000 pension pot over 20 years (again assuming it increases each year by 2% and the investment return is 4% after charges).

It's always worth checking with employers and your pension scheme that you can pay this extra amount into your pension. Depending on the pension scheme, it's even possible that if you pay a bit more your employer might do so as well.

You can't get hold of your pension money until age 55 (increasing to age 57 by 2028). You will be able to take 25% of it as a tax-free lump sum, and the rest will be taxed as income.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

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