

STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

VOL 26 / ISSUE 05 / 08 FEBRUARY 2024 / £4.49

SHARES

WE MAKE INVESTING EASIER



SMALL CAP
STARS
TO BUY TODAY



**Baillie Gifford
Positive Change Fund**

**Constructive
capitalism.**

**With your help it can
power positive change.**

A bold statement, but we truly believe that capital thoughtfully and responsibly deployed can be a powerful mechanism for change. Our **Positive Change Fund** seeks to identify high quality growth businesses who are providing solutions to global challenges. We think those businesses will prosper and flourish, at the same time delivering attractive returns to your portfolio. Want to help us power positive change?

Please remember that changing stock market conditions and currency exchange rates will affect the value of the investment in the fund and any income from it. Investors may not get back the amount invested.

Find out more at bailliegifford.com/positivechange

Baillie Gifford™
Actual Investors

Contents

NEWS

- 06 Blow-out US jobs report sends stocks higher despite implications for rates
- 07 Meta Platform's dividend call stuns the market
- 08 Ferrari gets into top gear to buck softer luxury goods trend
- 09 Elementis shares soar after receiving a preliminary bid from US fund
- 09 Tesla shares slide in 2024 as investors mull their next moves
- 10 Can British Gas owner Centrica continue to deliver?
- 11 Can Coca-Cola serve up another sparkling performance?
- 12 March rate cut off the agenda altogether after 'stunning' US jobs report

GREAT IDEAS

- 14 Why now is the time for investors to check out Burberry
- 15 For those seeking a better class of income, the Aristocrats look swell

UPDATES

- 17 AG Barr fizzes higher on earnings upgrade and there could be more to come

FEATURES

18 COVER STORY

5 small cap stars to buy today

The smaller businesses with big potential and why the time is right to invest

- 25 Do mergers and acquisitions actually add value for shareholders?

30 FUNDS

The bond funds to buy as the rate hiking cycle draws to a close

35 ETFs

How to play gold through exchange-traded products

38 EDITOR'S VIEW

How the WPP tortoise beat the S4 Capital hare

40 FINANCE

Mortgage rates have fallen, what does it mean for homeowners?

43 RUSS MOULD

What could the next general election mean for UK equities?

46 ASK RACHEL

I want to pay a lump sum into my pension but could I breach my annual allowance?

48 INDEX

Shares, funds, ETFs and investment trusts in this issue

18



38



40



43



Three important things in this week's magazine

1

Five small cap stars to buy today

As sentiment towards smaller companies improves, the *Shares* team has identified some attractive small cap opportunities.

2

Which bond funds should you buy?

After a torrid two years in which interest rates have soared, the outlook for bonds is improving and we highlight the best funds to choose.

3

Why big M&A deals seldom add value

Most large takeovers and mergers destroy value, yet companies continue to be seduced by 'bigger is better'. We look at why smaller deals are often a better option.

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:



Returning Renishaw optimism sees share price surge as best FTSE 350 performer



BP profits plunge but surprise \$1.75 billion buyback pleases investors



Middle East conflict weighs on McDonald's Q4 sales growth



Fundsmith Equity the most sold fund during January

A unique investment philosophy

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

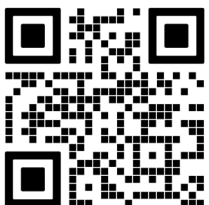
our active approach.

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

Past performance should not be seen as an indication of future performance. The value of your investment may go down as well as up and you may not get back the full amount invested. Issued by Asset Value Investors Ltd who are authorised and regulated by the Financial Conduct Authority.

Blow-out US jobs report sends stocks higher despite implications for rates

The Fed seems in no hurry to ease monetary policy

Markets often move in unexpected ways and Friday's (2 February) release of blow-out non-farm payrolls data was no exception.

The US economy added 255,000 jobs per month on average in 2023 and coming into the latest data for January the consensus was looking for the rate to slow to 180,000.

The actual number of 353,000 jobs created was even higher than the top end 290,000 forecast, while the unemployment rate remained steady at 3.7%. That means the unemployment rate has stayed below 4% for two years, the longest stretch in 50 years.

Not only is the labour market showing little signs of slowing, but the rate of wage growth also surprised to the upside with a year-on-year increase of 4.5% compared with 4.1% expected.

Economists estimate wage growth of 3% to 3.5% is consistent with an overall inflation rate running close to the Fed's 2% target.

Markets have priced in around six interest rates cuts in 2024 starting in March, although Fed chair Jay Powell served up some cold turkey at the latest FOMC meeting (31 January) by saying he didn't expect to have enough confidence in the slowing inflation data to start cutting rates next month.

With stronger-than-expected jobs data, higher wage growth and shorter odds of a March rate cut, investors might be forgiven for anticipating a negative reaction from equities.

After initially trading lower in the pre-market, the benchmark S&P 500 ended the day higher while

10-year treasury bond yields moved higher pushing back over 4%.

Investors may have been disappointed by the declining prospects for lower interest rates, but the resilience of the economy appears to trump this disappointment.

Richard Bernstein, chief investment officer of Bernstein Advisors, believes US earnings troughed last spring and he now sees signs of a new earnings upcycle which could herald double-digit growth.

That might seem like a problem for the Federal Reserve, but if earnings growth is accompanied by higher productivity it could happen without added inflationary pressure.

Data released on 1 February showed US worker productivity has exceed 3% annualised for the last three consecutive quarters.

BlackRock's global head of fixed income Rick Rieder told *Bloomberg* his base case for rate cuts has not been derailed by stronger than expected payrolls.

He believes core inflation is trending lower and the Fed will have to cut rates to reduce the real rate of interest as inflation decelerates. [MG]

Non-farm payrolls come in ahead of expectations for January

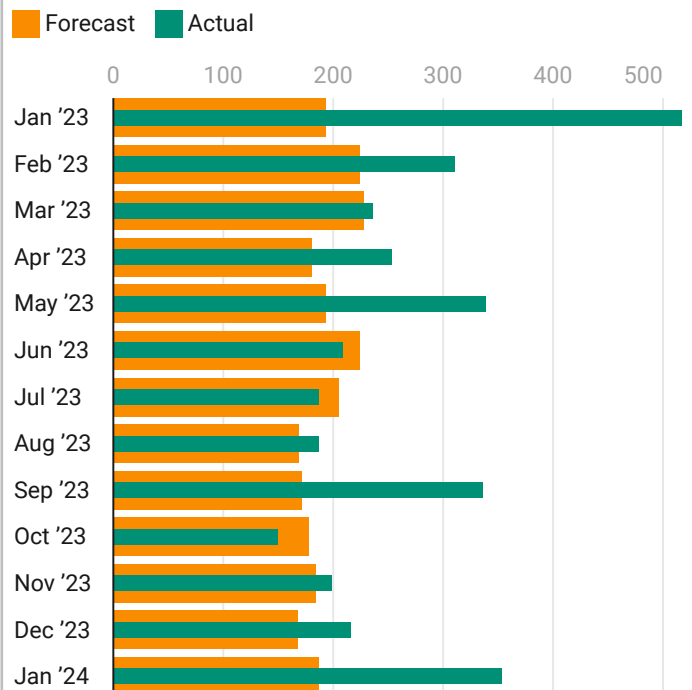


Chart: Shares magazine • Source: Forex Factory



Meta Platform's dividend call stuns the market

Facebook-owner sees biggest ever one-day market value surge

Shares of Facebook and Instagram-owner **Meta Platforms (META:NASDAQ)** soared as the social media company reported blowout fourth quarter results (1 February) that beat even the most optimistic projections and unveiled a maiden dividend.

By the end of the Wall Street session on 2 February, the stock had rallied more than 20% to record its highest close ever, at \$474.99. According to *Bloomberg*, that the rough \$200 billion one-day surge is the biggest in stock market history.

It represents a remarkable turnaround for Meta. It was only a couple of years back the social media giant suffered the single biggest one-day value destruction in stock market history, when an estimated \$250 billion was wiped off the firm's market cap.

But Meta has come a long way since then, dazzling shareholders with yet another impressive quarterly earnings report as the social media giant focuses on cutting back costs and shoring up billions in profits.

The fourth quarter 2023 numbers were impressive. It reported \$5.33 of earnings per share on \$40.1 billion revenues, figures that beat consensus estimates of \$4.96 and \$39 billion respectively. Revenues represented 17.6% growth over the previous quarter (to end September) and 24.5% year-on-year growth.

Yet, arguably, the outperformance did not shock investors as much as the surprise introduction of its first ever shareholder dividend. Meta said it would pay investors a quarterly dividend for the first time, announcing a payout of \$0.50 a share on 26 March. That comes after cash and equivalents swelled to \$65.4 billion at the end of 2023, from \$40.7 billion a year earlier. Meta also announced a \$50

billion share buyback.

It is perhaps this disciplined capital allocation that has most impressed investors during a period of stunning share price appreciation. In 15 months, the stock has soared from \$91, gains of more than 400%.

Analysts have now raised the question of whether Meta's emergence as a dividend payer will place greater pressure on other so-called 'Magnificent Seven' stocks to follow suit.

Apple (AAPL:NASDAQ), **Microsoft (MSFT:NASDAQ)** and even **Nvidia (NVDA:NASDAQ)** already pay dividends, while **Amazon (AMZN:NASDAQ)**, **Alphabet (GOOG:NASDAQ)** and **Tesla (TSLA:NASDAQ)** may be able to bat off these pressures so long as they are delivering above average returns on capital, currently calculated at 26%, 10% and 11% respectively.

Meta's return on capital is reported at 23.7%. [SF]

Meta Platforms

(\$)



Chart: Shares magazine • Source: LSEG

Ferrari gets into top gear to buck softer luxury goods trend

The company's iconic prancing horse logo is one of the most recognised symbols in the world

Luxury goods shares may have hit the skids in recent weeks on flagging demand in China and the cost of living crisis, but iconic Italian car maker **Ferrari (RACE:NYSE)** seems to go from strength to strength.

The shares hit new highs (2 February) after fourth-quarter sales topped analysts' estimates and full year profit surged 34% to €1.25 billion. News that seven-time Formula 1 world champion Lewis Hamilton will join from Mercedes in 2025 on a multi-year contract also gave investor sentiment a boost.

The rally in the share price means Ferrari's market value is closing in on €100 billion, making it more valuable than **Mercedes-Benz (MBG:ETR)**, **Porsche (PAH3:ETR)** and **Aston Martin Lagonda (AML)** combined.

Looking ahead, chief executive Benedetto Vigna commented: 'The record 2023 results, the ambitions that we have on 2024, together with the exceptional visibility on our order book allow us to look at the high-end of 2026 targets with stronger confidence.'

Ferrari's long-term ambitions include delivering EBITDA (earnings before interest, tax, depreciation and amortisation) of €2.5 billion to €2.7 billion by 2026 representing a margin on sales of between 38% and 40%.

The company generated €932 million of free cash flow in 2023 and has earmarked around €800 million for distribution to shareholders via dividends and share buybacks.

Ferrari shares have been on a remarkable ride gaining 58% in the last year and nearly 200% over the last five years, comfortably outperforming German luxury peers Porsche and Mercedes-Benz.

Only electric vehicle maker **Tesla (TSLA:NASDAQ)** has managed to keep pace with its shares



surging 787% over the last five years.

However, Tesla has moved into the slow lane of late with the shares earning the ignominious title of the worst performing stock in the S&P 500 over the last

nine months.

The Elon Musk-steered company has been cutting prices to lure back customers and compete with rivals which has impacted margins. Tesla missed Wall Street's earnings expectations (26 Jan) and warned growth in 2024 deliveries may be 'notably' lower than achieved in 2023.

Analysts have cut their earnings estimates with consensus now implying a small year-on-year decline.

Bad news seems to be mounting up for Tesla, with German newspaper *Handelsblatt* reporting this week software giant **SAP (SAP:ETR)** would no longer source fleet cars from Tesla due to late deliveries and price swings.

This follows a decision by rental car company **Hertz Global Holdings (HTZ:NASDAQ)** to slash the number of Tesla electric vehicles from its fleet. [MG]

Ferrari

(\$)

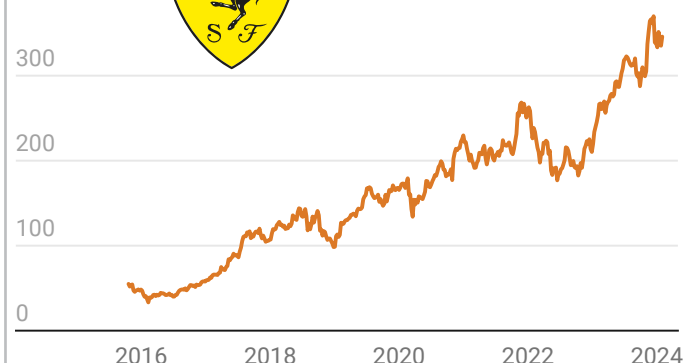


Chart: Shares magazine • Source: LSEG

Elementis shares soar after receiving a preliminary bid from US fund

News the board rejected the bid is unlikely to please activist investors

Shares in specialty chemicals maker **Elementis (ELM)** surged 12% to 139p at the end of January following a press report it had received a bid from a US private equity fund.

The shares eventually hit a new 12-month high of 142.4p after it was revealed New York based firm KPS Capital Partners had submitted an offer of 160p per share in December.

However, the Elementis board rejected the offer as it was holding out for 180p according to newswire



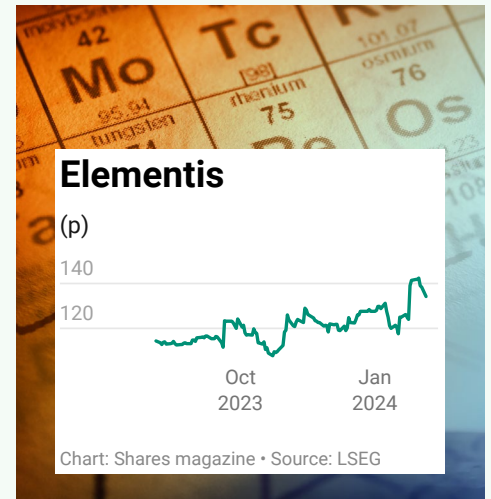
Reuters, causing KPS to walk away.

This isn't the first time the group has received offers: in 2020, it was approached by US company Mineral Technologies, and in 2021 by **Innospec (IOSP:NASDAQ)**, one of its industry peers.

Over the past few months there has been considerable pressure on the Elementis board from major shareholders disappointed with the firm's performance, and 9.8% stakeholder Franklin Mutual

Advisers urged the firm just last month to find a buyer, so the news that it had a bid and rejected it is not likely to sit well.

On a positive note,



fourth-quarter trading was ahead of expectations and analysts at Jefferies have recently flagged upside potential in the firm's operating profit margin. [SG]

Tesla shares slide in 2024 as investors mull their next moves

Electric car company's stock has lost more than 25% already this year

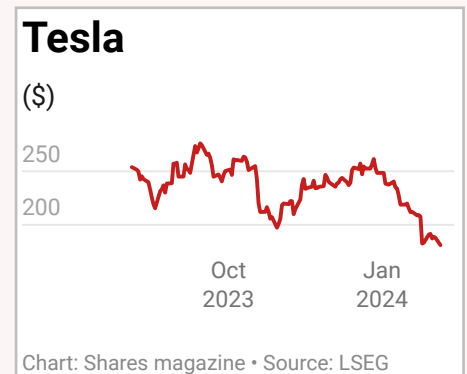
It has been sorry start to the year for Elon Musk and the thousands of loyal **Tesla (TSLA:NASDAQ)** shareholders. January alone has seen the stock lose 25% of its value, wiping nearly \$200 billion off its market cap as the electric car maker continues to grapple with increasing competition, eroded profit margins and consumers thinking twice about big-ticket purchases like a new car.



According to *Sharepad*, Tesla is the second-worst performing stock in the S&P 500 over the past month and it sits squarely bottom of the pile among the Nasdaq 100.

This is despite beating delivery expectations in the last quarter of 2023, reported in early January.

There were already simmering doubts about Musk's 20% delivery growth target for 2024, a target that he has now admitted will be tough to achieve, while in the fourth quarter of 2023 it was overtaken as the biggest volume EV



seller in the world by China's **BYD (002594:SHE)**.

With Musk having seen his share award package from 2018 ruled out by a Delaware court into the bargain, these are tumultuous times for Tesla. Most of last year's 100% gains have now been completely wiped out and shareholders' loyalty is again being tested. Many will undoubtedly stick for the long haul, but how many will twist has become an awkward question. [SF]

Can British Gas owner Centrica continue to deliver?

The utilities firm may face political pressure due to households' high energy costs

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

15 February:
RELX, Centrica



FIRST-HALF RESULTS

14 February:
Dunelm

15 February:
MJ Gleeson

TRADING ANNOUNCEMENTS

9 February:
Bellway, S&U

14 February:
Severn Trent



Investors in British Gas owner **Centrica (CNA)** will be watching closely to see if it can hit forecasts against a normalised energy price backdrop when it reports full year results on 15 February.

Analysts are forecasting earnings per share for the full year ending 31 December of 30.5p.

In July 2023, the firm reported first half revenue up 60% to £16.5 billion due to higher energy prices. The company also reported a statutory pre-tax profit of £6.4 billion, as opposed to a loss of £1.1 billion for the first six months of 2022.

At the same time Centrica announced a green focused investment strategy with annualised investment building to between £600 million and £800 million out to 2028, an extension to its share buyback programme by £450 million to £1 billion and a 33% increase in dividend to 1.33p per share.

What the market expects of Centrica

	EPS	Revenue
2023	30.5p	£31.7bn
2024	18.9p	£27.9bn

Table: Shares magazine • Source: Stockopedia

This generosity to shareholders has been underpinned by the dramatically improved picture on earnings and cash flow for the company as energy prices surged in the wake of Russia's invasion of Ukraine. Strong operational performance from its gas production, nuclear and gas storage assets has also helped.

Since the end of the pandemic, shareholders have enjoyed substantial gains in the share price, over the past year the stock is up 38%.

Centrica could come under political pressure as households continue to struggle with falling energy bills. The company has said it is 'committed' to supporting vulnerable customers facing wider inflationary pressures and high energy bills.

Since the start of 2022, it has committed £100 million to vulnerable customers. [SG]

Centrica



Chart: Shares magazine • Source: LSEG



Coca-Cola



Chart: Shares magazine • Source: LSEG

Can Coca-Cola serve up another sparkling performance?

The soft drinks leviathan’s leading brands are helping it ‘win in the marketplace’

Investors will be thirsting for another serving of good news when beverages behemoth **Coca-Cola (KO:NYSE)** reports earnings for the fourth quarter and full year to December 2023 on 13 February before the opening bell on Wall Street.

Consensus calls for a year-on-year rise in fourth-quarter sales and earnings from \$10.1 billion and \$0.45 to \$10.7 billion and \$0.48 respectively.

Back in October, the Atlanta-based drinks giant behind Coca-Cola as well as the Sprite, Costa and Topo Chico brands, delivered better-than-expected third-quarter revenue and earnings as the positive momentum seen in the first half flowed into Q3.

Organic sales fizzed up 11%, and following another period of market share gains Coca-Cola raised its full year organic revenue growth guidance from between 8% and 9% to the 10%-to-11% range.

‘We delivered an overall solid

quarter and are raising our full-year top line and bottom line guidance in light of our year-to-date performance,’ explained chief executive James Quincey. ‘Our leading portfolio of brands, coupled with an aligned and motivated system, positions us to win in the marketplace today while also laying the groundwork for the long term.’

Investors will be hanging on Quincey’s every word when it comes to inflation and pricing trends around the world as well as the benefits of artificial intelligence on Coca-Cola’s innovation and marketing. The performance of zero sugar variants will be under scrutiny too, given investors’ concerns over the potential impact of weight-loss drugs on consumers’ thirst for calorific drinks. [JC]

What the market expects of Coca-Cola

	EPS	Revenue
Q4 forecast	\$0.48	\$10.66bn

Table: Shares magazine • Source: Investing.com

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

9 February:

PepsiCo, Enbridge, Global Payments, Telus, Fortis

12 February:

Arista Networks, Cadence Design, Waste Management, Monday.com, Lattice, ZoomInfo, Avis, Vornado, Teradata

13 February:

Coca-Cola, Shopify, Airbnb, Moody’s, Zoetis, Ecolab, Welltower, Biogen, Restaurant Brands, Hasbro, LYFT

14 February:

Cisco, Analog Devices, Manulife Financial

15 February:

Applied Materials, Deere&Company, Southern, Digital, DoorDash, Pool, Dropbox, US Foods, Procore Technologies, Texas Roadhouse, Shockwave Medical, Air Lease, Nova

March rate cut off the agenda altogether after 'stunning' US jobs report

Attention likely to centre on inflation and retail sales reports

In our previous issue we predicted the market would take its cue from the central banks' rhetoric regarding future interest rate cuts,



and suggested there may be some volatility around the US payroll figures.

Sure enough, both the Bank of England and the Federal Reserve batted away any suggestion rates might come down early with Fed chair Jerome Powell going so far as to say they would stay 'higher for longer if needed' given the strength of US consumption.

Also true to form, the non-farm payroll figures caught the market off-guard with the addition of 353,000 new jobs in January against consensus expectations of a 180,000 increase.

As one investor put it, if Jerome Powell had killed all hope of a March rate cut then the jobs number well and truly buried it.

As well as slashing their March bets, traders reduced the odds of a May cut with the attention now turning to the US January inflation data due on 13 February and in particular the 'core' figure which strips out more volatile food and energy prices.

Likewise, odds of an early cut in UK rates have lengthened and all eyes will be on the consumer and industrial inflation numbers on 14 February.

Finally, the UK fourth-quarter GDP (gross domestic product) number on 15 February will show whether or not the economy grew in the last three months of 2023 – the current consensus is it shrank slightly – while US January retail sales figures released the same day will be closely watched by the Fed as well as economists to see whether US consumers are still feeling upbeat. [IC]

Macro diary 8 February to 15 February

Date	Economic Event	Previous Month
13-Feb	UK December Unemployment Rate	4.2%
	German ZEW Economic Sentiment	15.2%
	US January Small Business Optimism	91.9%
	US January Consumer Price Index	3.4%
	US January Core CPI	3.9%
14-Feb	UK January Consumer Price Index	4.0%
	UK January Core CPI	5.1%
	UK January Producer Prices (Input)	-2.8%
	Eurozone 4Q GDP	0.1%
15-Feb	UK Q4 GDP	-0.1%
	UK December Construction Output	0.9%
	US February Philadelphia Fed Manufacturing Index	-10.6%
	US January Industrial Production	1.0%
	US January Retail Sales	5.6%

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

Next Central Bank Meetings & Current Interest Rates

Date	Event	Previous
07-Mar	European Central Bank	4.5%
20-Mar	US Federal Reserve	5.5%
21-Mar	Bank of England	5.25%

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

Cut through with conviction

Available in an ISA

FIDELITY INVESTMENT TRUSTS

Truly global and award-winning, the range is supported by expert portfolio managers, regional research teams and on-the-ground professionals with local connections.

With over 450 investment professionals across the globe, we believe this gives us stronger insights across the markets in which we invest. This is key in helping each trust identify local trends and invest with the conviction needed to generate long-term outperformance.

Fidelity's range of investment trusts:

- Fidelity Asian Values PLC
- Fidelity China Special Situations PLC
- Fidelity Emerging Markets Limited
- Fidelity European Trust PLC
- Fidelity Japan Trust PLC
- Fidelity Special Values PLC

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trusts are listed on the London Stock Exchange and their price is affected by supply and demand.

The investment trusts can gain additional exposure to the market, known as gearing, potentially increasing volatility. Investments in emerging markets can more volatile than other more developed markets. Tax treatment depends on individual circumstances and all tax rules may change in the future.

To find out more, scan the QR code, go to [fidelity.co.uk/its](https://www.fidelity.co.uk/its) or speak to your adviser.





Why now is the time for investors to check out Burberry

Shares in the rainwear-to-leather goods seller won't stay this cheap for long

Burberry
(BRBY) £12.94

BUY

Market cap: £4.6 billion

Slowing luxury demand and two profit warnings in three months have left **Burberry (BRBY)** firmly out of fashion with investors. Shares in the British luxury brand have lost around 50% and 30% of their value over one and five years respectively. Given the old stock market adage about profit warnings coming in threes, *Shares* concedes there is some danger we have gone too early.

However, we believe the risk/reward balance is favourable with the trench coat-to-tote bag purveyor's sell-off overdone and too much doom and gloom priced into a stock which is cheap relative to its own history.

Potential positive catalysts include an eventual recovery in key luxury market China and the possible reintroduction of VAT-free shopping for wealthy tourists visiting the UK, in the gift of chancellor Jeremy Hunt, which would boost Burberry's domestic sales.

Tougher luxury market conditions are a headwind, yet Burberry is pulling self-help levers

Burberry

(p)



Chart: Shares magazine • Source: LSEG

including elevation of the brand to raise margins closer to those of rivals including **LVMH (MC:EPA)** and **Hermes (RMS:EPA)** and pushing ahead with revenue-enlivening store refurbishments.

TRUE FASHION ICON

For the uninitiated, Burberry is the FTSE 100 constituent whose competitive strengths include its unmistakable brand – the iconic Burberry check and Equestrian Knight Device pay homage to its heritage - which confers pricing power upon the business, not to mention an extensive luxury distribution footprint and a cash-generative business model.

The £4.6 billion cap is now refocusing on 'Britishness' under chief executive Jonathan Akeroyd, who has a strong track record of building luxury brands and driving profitable growth, and new designer Daniel Lee. Despite its FTSE 100 status, the company still has a long growth runway ahead with plans to broadly double sales of leather goods, shoes and women's ready to wear products and grow outerwear revenues by around 50% in the medium term. In addition, Burberry has yet to reach its full potential in e-commerce.

That said, sales growth is decelerating with the recent boom in luxury spending normalising and even well-heeled shoppers becoming more selective in the face of cost-of-living pressures. This backdrop is proving more challenging for mono-brands such as Burberry and more manageable for the likes of LVMH, a multi-brand conglomerate which sells products at higher price points, although this is reflected in Burberry's discounted valuation.

VALUATION TOO CHEAP TO IGNORE

On 12 January 2024, Burberry downgraded its year-to-March 2024 adjusted operating profit guidance from around £550 million to the £410 million to £460 million range after Christmas sales fell flat against the backdrop of slowing luxury demand. Retail revenue fell 7% to £706 million in the 13 weeks to 30 December 2023 and comparable store sales were down 4%, although there were encouraging signs within the sales mix.

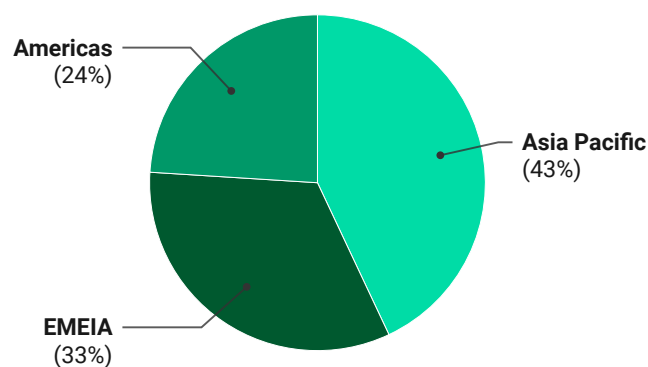
While Burberry suffered sharp sales declines in the Americas and South Korea, sales in mainland China, a vital market for luxury goods, rose 8% and were 9% ahead in Japan, where the consumer has an appetite for British brands. China is struggling, but Burberry will be a prime beneficiary of any near-term recovery in the world's second-biggest economy once it filters through to consumer sentiment.

Meanwhile, its ambitious new management team has set itself a medium-term goal of increasing sales to £5 billion, up from £3.1 billion in full year 2023, and lifting adjusted operating margins to 20%.

Downgraded consensus estimates point to EPS (earnings per share) of 81.5p and a 51.5p dividend for the current financial year, rising to 84.7p and 53.1p respectively for the year to March 2025.

BURBERRY STILL HAS A RUNWAY FOR GROWTH

FY23 revenue by region



EMEIA = Europe, the Middle East, India and Africa

Chart: Shares magazine • Source: Burberry

FY23 revenue by product

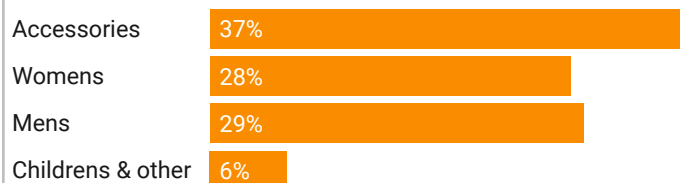


Chart: Shares magazine • Source: Burberry

Analyst coverage for Burberry



Chart: Shares magazine • Source: Stockopedia

Based on these forecasts, Burberry trades on a 2024 PE (price to earnings) ratio of 15.9 falling to 15.2 times on next year's numbers, a massive discount to a recent 2021 PE high approaching 40 times, and investors are being paid to wait for the recovery via an attractive 4% dividend yield. If the market doesn't ascribe a fuller rating to Burberry before long, a luxury rival or private equity player could pounce with a bid, and a premium-priced one at that, since attractive acquisition targets in the luxury industry are few and far between. [JC]

For those seeking a better class of income, the Aristocrats look swell

Only companies with an unblemished record are allowed in this ETF

SPDR S&P US Dividend Aristocrats UCITS ETF

(USDV) Price: £54.30

Assets: £3 billion

BUY

Social media giant **Meta Platforms (META:NASDAQ)** is making waves across the pond with news of a maiden dividend but for investors seeking not just a reliable source of income from the US but one that is actually guaranteed to *grow* each year, the **SPDR S&P US Dividend Aristocrats UCITS ETF (USDV)** is the ideal investment.

The fund is based on the S&P500 Dividend Aristocrats, a select group of companies which have all increased their payout every year for at least the last quarter of a century.

If an Aristocrat company cuts or even just holds its dividend unchanged for a year, it exits the index and the clock is reset.

SPDR S&P US Dividend Aristocrats top holdings

Company	Weight (%)
3M	3.3
Reality Income	2.8
IBM	2.4
Target	2.2
Southern Co	1.9
Kenvue	1.8
T Rowe Price	1.8
Abbvie	1.8
Meditronic	1.7
Kimberley-Clark	1.7

Table: Shares magazine • Source: State Street SPDR

SPDR S&P US Dividend Aristocrats

(P)



Chart: Shares magazine • Source: LSEG

The index was created in May 2005, and unlike the S&P 500 itself is equally weighted so each constituent is rated the same, without bias, and the basket is rebalanced at the start of every quarter.

Constituents must have a float-adjusted market cap of at least \$3 billion as of the rebalancing date and a minimum daily liquidity of \$5 million.

To ensure diversification, there must be a minimum of 40 stocks (today it stands at exactly 100) and no single sector can account for more than 30% of the index weight.

Since 1926, dividends have contributed nearly a third of total equity returns and the index is designed to capture *sustainably rising* dividends as well as capital growth potential.

As you would expect, the index looks very different to the underlying S&P 500 – for example, it doesn't include any of the 'Magnificent Seven' tech giants, even though **Microsoft (MSFT:NASDAQ)** is the biggest index payer in real terms, handing \$22.3 billion to shareholders last year, and **Apple (AAPL:NASDAQ)** is the third-biggest payer with \$14 billion in dividends.

Even so, the Dividend Aristocrats ETF yields 2.28% compared with 1.39% for the S&P500, so there is a reasonable uplift in income, with a 0.35% ongoing charge.

Over the last decade the ETF has generated an average total return of 11.15% against 12.62% for the benchmark, although that figure is somewhat distorted by the outperformance of big tech stocks in 2023, when the benchmark produced a total return of 20.82% while the ETF managed just 4.61%. [IC]

AG Barr fizzes higher on earnings upgrade and there could be more to come

Soft drinks business looks in rude health as it confirms succession plans

AG Barr
(BAG) 550p

Gain to date: 13.5%

We flagged Scottish soft drinks maker **AG Barr (BAG)** in August 2023 arguing the company was not being given sufficient credit by the market for its sales momentum. We highlighted the strength of its portfolio of brands including Irn-Bru and Rubicon.

WHAT HAS HAPPENED TO SINCE WE SAID TO BUY?

We were on the money when we flagged 'the scope for further upgrades' as the company boosted guidance for the 12 months to 31 January 2024 in a 1 February trading update – with the notable detail that costs have stabilised. Prior to that, in October 2023, the company announced the £12.3 million acquisition of the Rio tropical drinks brand – a deal which was funded out of existing net cash.

Commenting on the company's strong trading, Liberum analyst Anubhav Malhotra says: 'Cost inflation has returned to normal levels and the supply chain capex program is on track, with the group now having more confidence and visibility of delivering margin benefits from the program. We see scope for more [upgrades] as we see potential for faster revenue growth and faster margin recovery over the next two years.'

The company has also announced a replacement for longstanding and well-regarded chief executive Roger White who steps down at the end of April.



AG Barr

(p)



Chart: Shares magazine • Source: LSEG



Saga (SAGA), Superdry (SDRY) and Co-op alumni Euan Sutherland is taking over. Significantly, he has served for eight years on the board as non-executive director at AG Barr peer **Britvic (BVIC)**. White is on hand until the end of July to help smooth the transition.

WHAT SHOULD INVESTORS DO NOW?

While the stock has enjoyed decent gains and now trades on 15 times forecast earnings for the year to January 2025, we remain fans and continue to expect more earnings upgrades over the medium term. A strong balance sheet, with Liberum forecasting year-end net cash of around £50 million, provides AG Barr with the wherewithal to pursue further accretive acquisitions. [TS]



SMALL CAP STARS TO BUY TODAY

The smaller businesses with big potential and why the time is right to invest

By The Shares Team

Even today's market giants started out small. **Microsoft (MSFT:NASDAQ)** may now be the world's largest company with a \$3 trillion valuation which rivals the GDP of some major global economies but it began life as a start-up founded by Harvard College drop-out Bill Gates and his childhood friend Paul Allen. Few then would have predicted its global domination today.

While we are not expecting the names discussed in this article to enjoy the same stratospheric trajectory it does illustrate the inherent appeal of small caps, which, thanks to their scope to grow, can generate outsized returns if you invest in the right ones.

On the flipside, because smaller companies are less well established, have less diversified businesses and often more precarious financial positions, you do need to have a reasonable tolerance for risk if you are going to invest in the small cap space.

Another dynamic which is supportive to UK smaller companies, in particular, is valuation. The high interest rate environment and a broader reduction in risk appetite has helped create a negative backdrop and, with UK equities out of

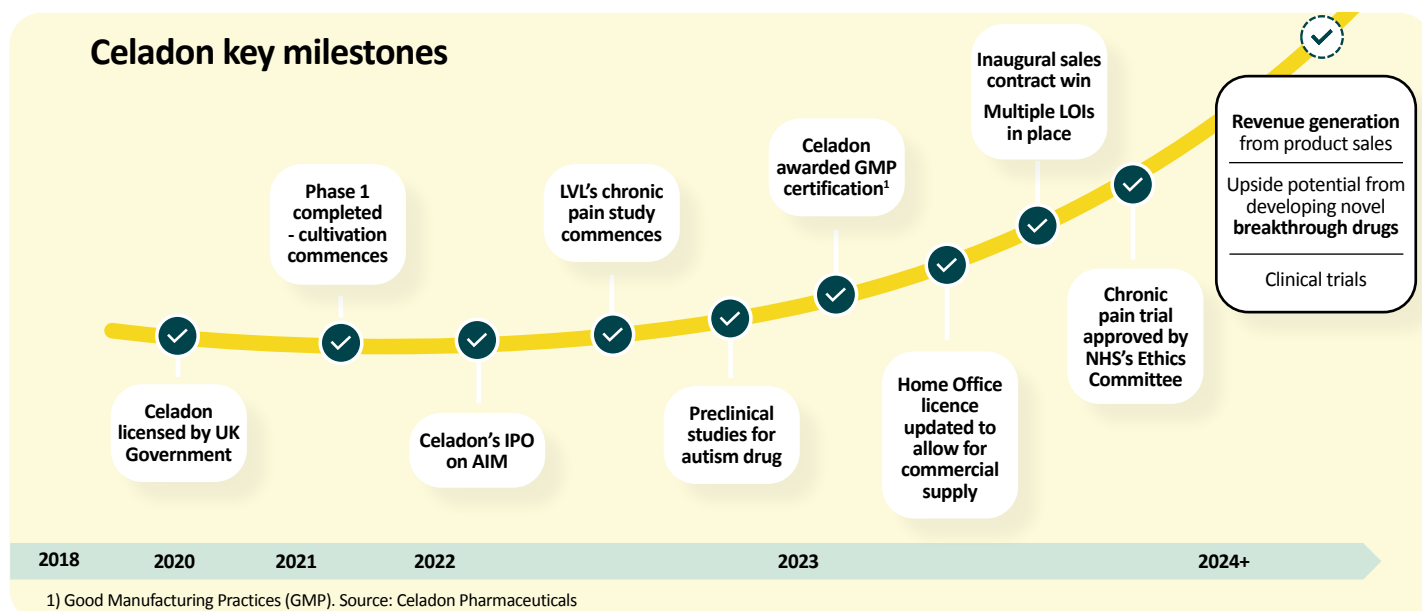
favour more generally, smaller companies listed in London have struggled. The FTSE AIM All-Share index is down 18% over the last five years against a 50.1% advance for the FTSE All-World index.

Stuart Widdowson, the manager of **Odyssean Investment Trust (OIT)**, which invests in a concentrated portfolio of well-researched smaller companies, notes this beginning to change. He says: 'Typically the first asset class to see good capital gains when the interest rate cycle turns are government bonds then it cascades into corporate bonds and then high yield bonds. Then the first element of equities that moves tends to be small cap and UK small caps look pretty interesting [on a global basis].'

'You don't need that much new money to come in to move share prices very materially. We don't know what is going to change sentiment but we don't think it's too far away.'

To tap into a change in the prevailing mood music around smaller companies, *Shares* has identified five small cap stars which offer a mix of value and growth. Read on to discover our selections.

Celadon key milestones



Celadon Pharmaceuticals (CEL:AIM) 84.8p

Market cap: £55.2 million

BUY

AIM-quoted **Celadon Pharmaceuticals (CEL:AIM)** is in a great way to play the fast-growing medical cannabis market as it exploits its first mover advantage in a highly regulated market.

Celadon has built a high-tech indoor hydroponic growing facility in the Midlands covering 100,000 square feet with a replacement cost of £65 million.

The company is one of only two firms in the UK and 10-15 worldwide to have been awarded GMP (Good Manufacturing Practice) certification.

It has also secured a Home Office license which allows it to commercially supply EU-GMP medical grade cannabis.

Management has made rapid progress in securing commercial manufacturing contracts signing deals worth a combined £30 million in revenues over three years.

Analyst Alex Brooks at Canaccord Genuity estimates the company can generate a healthy 70% gross margin on sales.

In addition, Celadon has received approval from the NHS's Research Ethics Committee to roll-out a non-cancer chronic pain clinical trial for up to 5,000 patients.

It is the first UK large-scale trial that will provide robust and reliable data on treating chronic pain

with cannabis-based medicines. Just as importantly for shareholders the NHS approval allows the company to charge fees.

Brooks estimates the company could generate revenues of up to £18 million with an EBITDA (earnings before interest, tax, depreciation, and amortisation) of around £4 million at full capacity.

The European medical cannabis market is forecast to grow eight-fold over the next five years according to industry consultant Prohibition Partners generating annual sales of €3.2 billion.

Demonstrating keen interest from investors, the company raised £1 million of new equity in October and £2 million in December to fund expansion. Celadon also has a £7 million lending facility.

Although there are above average risks in investing in smaller companies operating in new markets, Celadon has demonstrated great acuity and execution. [MG]



Celadon Pharmaceuticals

(p)

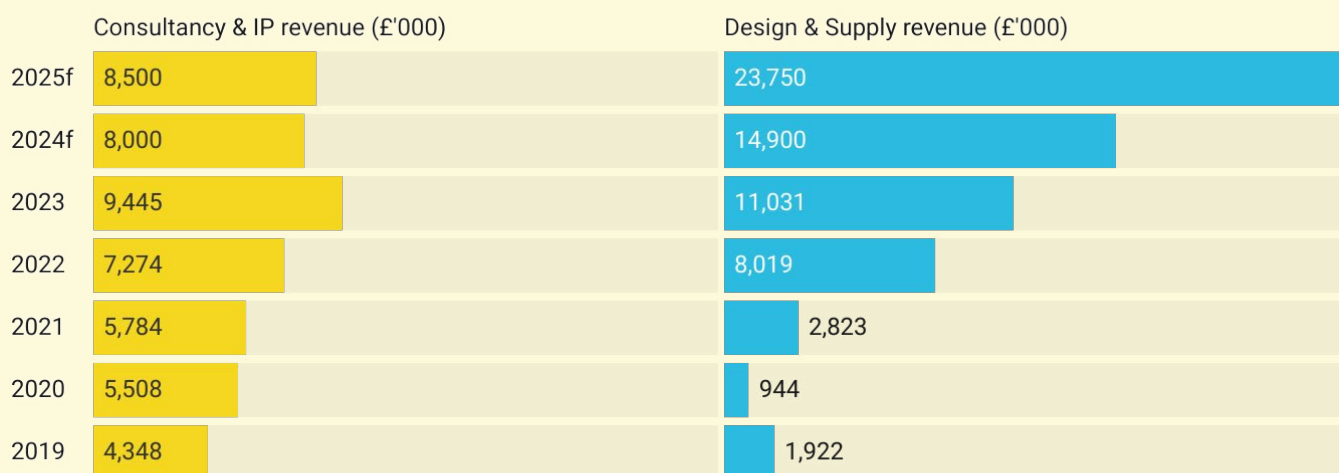
200

0

2019 2020 2021 2022 2023 2024

Chart: Shares magazine • Source: LSEG

EnSilica's shift to chip design



f = forecast revenue

Chart: Shares magazine • Source: EnSilica, Allenby Capital

EnSilica
(ENSI:AIM) 44p

BUY

Market cap: £35 million

The UK listed chip space has been eaten alive by M&A over the past few years but recently a handful of new ambitious smaller companies have breathed new life into the sector. One of them, Oxford-based **EnSilica (ENSI:AIM)** has, we believe, exciting potential.

With roots in intellectual property creation and consultancy, it has emerged as a fabless

ASIC chip designer. ASICs (Application Specific Integrated Circuits) are chips whose end use is very specific and complex, and often requires bespoke functionality.

Set up in 2001 by former Nokia, Hitachi and Siemens engineer Ian Lankshear, EnSilica designs customised chips used in automotive, general industry, satellite communication and healthcare sectors. For example, carmakers use its chips to make vehicles handle the road more smoothly, manufacturers install them in factory robots, health firms deploy them for diabetic patches.

Customers include global corporations and original equipment manufacturers to technology start-ups, although it is cagey about naming names, probably because of non-disclosure clauses. It joined the LSE's junior AIM market in May 2022 at 50p per share, having to ride out relatively stormy market conditions.

If EnSilica shares are to rally three things need to improve, or show solid signs of improvement; sales growth momentum, operating margin expansion and return on capital. Sales velocity is already showing promise. Comparing the periods 2019 to 2021 (to end May), 2021-23, and forecasts for 2023-25, revenues increased 37%, 138% and 57%.

As for margins and return on capital (how efficiently it converts sales into profits, and how well it uses cash to make profit), both are coming from very low bases of 4% and 3.8%, so assuming sales momentum continues and running costs can be managed well, there should be scope for significant gains here.

EnSilica

(p)



Chart: Shares Magazine • Source: LSEG

For example, **Texas Instruments (TXN:NYSE)**, one of the world's leading ASIC chips designers, has operating margins of around 25% and returns on capital of 40%.

Small caps can be accident prone with unpredictable sales cycles, and it is likely that EnSilica will need extra growth funding down the line, even after raising £1.56 million in December 2023.

Potential investors will need to accept these risks, but if you do, we believe there could be a real gem of a business here using a business model that has worked for UK chips companies in the past, such as CSR and Wolfson Microelectronics, which were both taken over for large premiums. A buyout in the longer run may well be on the cards for EnSilica, if management can execute successfully enough. [SF]



go on to build houses, industrial, logistics or retail warehouse assets and renewable energy projects.

After a flat first half of 2023, activity has picked up significantly among the housebuilders and commercial activity is also increasing.

Finally, Hargreaves owns 49.9% of the equity in – but the right to 86% of the earnings from – HRMS, a raw materials business in Germany which trades industrial materials, makes carbon and recycles ferrous metals.

Using a sum-of-the-parts valuation approach, we believe the business is worth around 800p per share, nearly 70% more than its current market value and slightly above the 770p figure achieved by analysts at Singer Capital Markets using a similar process.

We estimate the services business is worth around £100 million or 300p per share, the land business – where the assets are held at book cost – is worth another £100 million, or 300p per share, and the German unit has a book value of £67 million or 200p per share, excluding any profits generated.

Obviously realising this value will take time, but in the meantime, investors have the comfort of a fully covered 36p annual dividend which equates to a 7.5% yield. [IC]

Hargreaves Services

(HSP) 475p

BUY

Market cap: £155 million

Hargreaves Services 800p sum of the parts valuation



Source: Shares magazine

Whereas some of the other companies in this feature are mainly about growth, **Hargreaves Services (HSP)** is an asset-backed income play.

The firm has a core infrastructure services business, a land business and a large stake in a German industrial materials business.

The bulk of its revenue comes from the infrastructure side where it provides earthworks, mechanical and electrical services to major water and electricity companies, as well as working on HS2.

It is also a preferred partner to **Balfour Beatty (BBY)** on the Lower Thames Crossing project, and it is the only contractor on site at the Sizewell C nuclear power plant in Suffolk.

The land business owns large former brownfield sites which it upgrades and sells to developers, who

Hargreaves Services

(p)



Chart: Shares magazine • Source: LSEG

Kistos

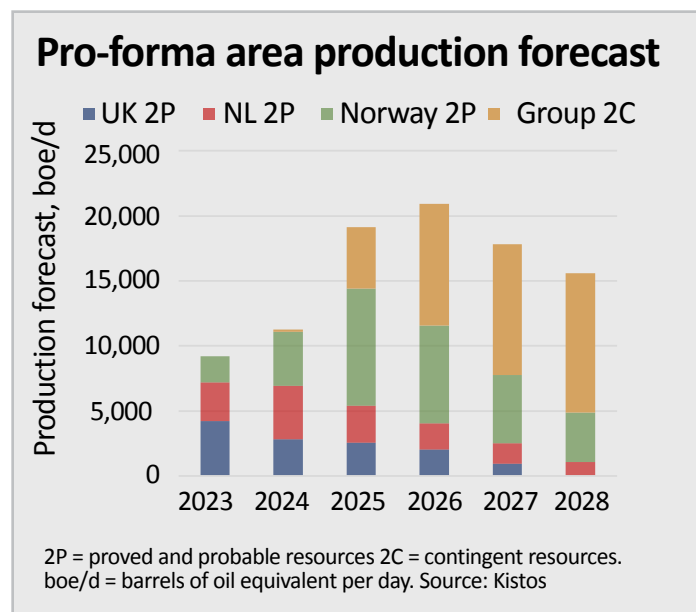
(KIST:AIM) 143p

Market cap: £118.5 million



received regulatory approval for the development of the Victory gas field. As it plugs into existing infrastructure, including Kistos' co-owned Shetland gas plant, this could extend the life of the company's own oil and gas assets in the area, reduce costs and potentially delay decommissioning.

Kistos demonstrated its financial strength by paying down a little under €80 million worth of Dutch bonds early in December, which will reduce interest costs. It closed out 2023 with cash and 'near-cash' of €275 million (though net debt of €73 million according to investment bank Berenberg). Based on forecasts from Berenberg the company is expected to generate free cash flow of nearly €150 million in 2025 as new assets come on stream. This should provide the firepower for further M&A and is more than the current market value of the business. [TS]



Kistos

(p)



Chart: Shares magazine • Source: LSEG

If **Kistos (KIST:AIM)** had its way it may well not have been a small cap by this point. It had hoped a merger with **Serica Energy (SQZ:AIM)**, which it tried and failed to pull off in 2022, would have been a ticket to Main Market status and a place in the FTSE 250.

Having absorbed its failure to get that deal over the line, some other operational disappointments, and a significant drop in the high gas prices which followed Russia's invasion of Ukraine, the shares have been marked substantially lower by the market.

This has created what looks a pretty compelling opportunity for risk-tolerant investors to buy a company with enviable balance sheet flexibility, scope for significant growth in free cash flow from its existing portfolio and ambitions to target further deals in the northern European energy space.

The company is run by Andrew Austin, who may be familiar to followers of the sector from his previous ventures – including Rockrose Energy (taken over in July 2020 in a £243 million deal).

Kistos' current producing assets are based in the Netherlands and, in line with the company's strategy of delivering hydrocarbons with lower accompanying emissions, the platform on its core Q10-A field is powered through wind and solar generation.

The company is also developing assets in Norway and to the west of Shetland. It received a boost in the latter region when **Shell (SHEL)**

Victorian Plumbing

(VIC:AIM) 87.9p

BUY

Market cap: £286.9 million

Victorian Plumbing



Chart: Shares magazine • Source: LSEG

Investors seeking to tap into a growth stock with a sizeable total addressable market, scope for earnings upgrades and attractive income credentials should buy the UK's leading bathroom retailer **Victorian Plumbing (VIC:AIM)**. Admittedly, the £286.9 million cap operates in a competitive market with rivals ranging from **Kingfisher (KGF)**-owned B&Q to Homebase and **Wickes (WIX)**, but this pure-play online retailer benefits from channel shift, a wider product range than rivals limited by store space and its high own-brand mix. Headwinds could



turn into tailwinds this year as falling inflation and interest rates lift consumer confidence.

Despite a tough macroeconomic backdrop in the year to September 2023, Victorian Plumbing demonstrated resilience by growing sales, market share and profits and 2024 should be a transformational year for the taps and toilets retailer founded by CEO Mark Radcliffe. The key catalyst for the currently capacity-constrained firm will be the opening of its new automated distribution centre in Lancashire in mid-2024 which should accelerate growth and boost margins.

This state-of-the-art warehouse will provide capacity to double sales to around £600 million, take on more stock within the core bathroom category and allow Victorian Plumbing to scale in the growth categories of lighting, flooring, tiles and trade, which could more than double its UK total addressable market to over £3.5 billion and provide scope for profitable cross-selling opportunities.

A fortress balance sheet business flush with £46.4 million in the coffers at last count, Victorian Plumbing should benefit from the fall in shipping rates, which remain below pandemic

peaks, as well as its recently launched app for trade and retail customers which should drive marketing efficiencies.

Canaccord Genuity's Karl Burns says: 'We believe Victorian Plumbing could see a re-rating as revenue growth and margins rise.'

'While cash generation will also build, resulting in a higher dividend payout and yield, further supporting the share price.' [JC]

Tap into an exciting growth and income stream

Year to September	Sales (£m)	Adjusted pre-tax profit (£m)	EPS (p)	DPS (p)	PE	Yield
2023	285.1	20.3	5.1	1.4	17.2	1.6%
2024 (F)	297.4	22.9	5.4	1.5	16.3	1.7%
2025 (F)	328.9	25.2	5.9	1.7	14.9	1.9%
2026 (F)	357.3	29.2	6.9	3.0	12.7	3.4%

PE & yield calculations based on 87.9p share price. EPS = earnings per share DPS = dividend per share PE = price to earnings

Table: Shares magazine • Source: Canaccord Genuity

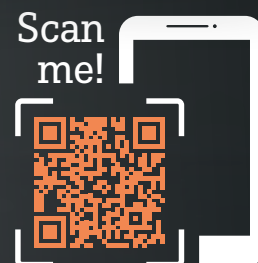
Xtrackers
by **DWS**

Let's go for gold – literally.

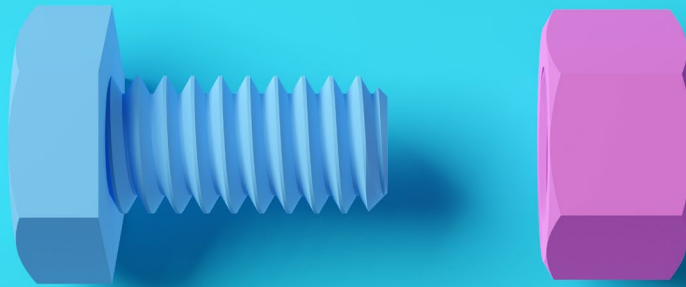
Diversify your portfolio with an asset class that can offer both rarity value and diversification benefits. Xtrackers Gold ETCs provide you with exposure to gold without requiring you to obtain ownership in gold in the physical form. Discover how to invest in gold the easy way.

Together we grow.

[Xtrackers.com](https://www.xtrackers.com)



Investments involve risks.



Do mergers and acquisitions actually add value for shareholders?

Why bolt-on acquisitions are preferable to ‘transformational’ deals

In an environment marked by intense global competition and industry disruption, successful mergers and acquisitions (M&A) are increasingly important to the growth and profitability of many companies.

Yet research shows most mergers disappoint. Over the decades, multiple studies have shown that mergers and acquisitions fail to generate the anticipated synergies, and many actually destroy value instead of creating it. In other words, a significant percentage of M&A causes two plus two to equal three instead of five.

Those are the views of Nuno Fernandes, professor of finance at Barcelona’s IESE Business School and the author of *The Value Killers: How Mergers and Acquisitions Cost Companies Billions – And How To Prevent It*.

So why do companies continue to chase M&A deals and how can they improve the odds of adding rather than destroying value?

BIGGER DOESN’T MEAN BETTER

As professor Fernandes explains, the fact most M&A deals fail to create value is not random or down to bad luck but due to a series of failures starting at the pre-acquisition phase.

In an article for the Harvard Law School Forum on Corporate Governance, he sets out the golden rules which companies need to stick to if they

aren’t going to destroy value.

First, companies should never rely on investment bankers for valuation because ‘bankers are always on the side of the deal, not the company’. In other words, the bigger the deal the bigger the fees.

Having an in-house valuation expert or business development group is a good start, but there still needs to be a vast amount of planning and attention to detail before a deal even comes to the table, looking at how it stacks up in terms of cash-flows, both before and after, and what is the right multiple.

While there may be good commercial reasons to do a deal – improving manufacturing or distribution and reducing unit costs, for instance – there are just as many bad reasons.

‘Strategic deals’ in particular are dangerous as they usually amount to little more than empire-building or egomania on the part of the acquiring chief executive.

The most obvious reason why deals don’t tend to add value is price – too many companies overpay for the target company’s assets even if the projected synergies do eventually materialise.

‘This seems both simple and obvious, but the reality is that most companies overpay. In fact, one could make an argument that, directly or indirectly, overpayment is *the* cause of the high M&A failure rate,’ says Fernandes.

HOW TO MAKE M&A A SUCCESS

Instead of overpaying, companies need to think like financial investors and set a price limit meaning chief executives must be prepared to say no and walk away rather than do a deal at a poor price.

‘Successful acquirers develop models to identify the pros and cons of a deal, they avoid bidding wars, they exercise the discipline to walk away from bad deals, and they establish processes to keep CEO emotions in check. Overconfidence is a notorious value killer, and the board of directors has a strong role to play here,’ advises Fernandes.

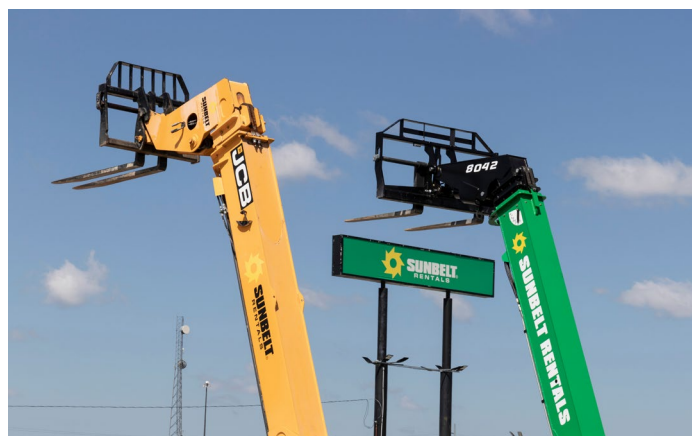
Companies should have a continuous process linking the pre-deal phase with the transaction and post-deal phase, assigning clear responsibilities and accountability to the executives or teams in charge of planning, negotiating and implementing the acquisition.

‘Too often, the people making promises about merger synergies are not the same ones in charge of putting those synergies into place. Ideally, companies should assign the same team members to every phase of the transaction, including the post-merger integration,’ suggests Fernandes.

Linked to this, companies need to move fast and communicate effectively as the news that a company is in talks to be acquired can have a negative effect on employee morale and customer relationships.

‘Companies that communicate quickly, constantly and openly during a deal are better able to retain their focus and reduce uncertainty among customers and employees, especially the best employees of the target company. Because talent exodus is a big risk during most M&As, senior managers must be ready to answer the “What happens to me?” question before employees even ask it,’ is the advice.

Finally, all successful acquirers have the management capability not to get distracted or pulled away from their day-to-day operations so deals which result in chief executives and finance officers taking their eye off the ball are likely to end badly.



WHAT ABOUT ‘BOLT-ON’ DEALS?

Some of the most successful, highest-return businesses in the UK market are also serial acquirers, but their dealmaking doesn’t make the headlines.

Instead of ‘strategic’, or worse still ‘transformational’ acquisitions, they seek out attractive smaller businesses which they can comfortably absorb to increase their geographical footprint or their commercial offering to clients, complementing their organic growth and making them more of a ‘one-stop shop’.

Take equipment hire firm **Ashtead (AHT)**, which in the year to April 2022 posted 22% growth in rental revenue helped by \$2.4 billion of investments in its business and \$1.3 billion spent on 25 small acquisitions.

In the year to April 2023, the firm reported another 22% increase in rental revenue, helped this time by \$3.8 billion of capital invested in the business and \$1.1 billion spent on 50 small bolt-on acquisitions.

All these investments are funded from operating cash flow, and they allow the company to open hundreds of new sites in North America to, in the words of chief executive Brendan Horgan, ‘take advantage of the substantial structural growth opportunities that we see for the business’.

Alternatively, look at ‘global specialist’ acquirer **Halma (HLMA)**, which in the year to March 2022 posted a 16% increase in revenue and a record profit for the 19th consecutive year thanks to strong organic growth, spending on R&D (research and development) and 13 small acquisitions for a total of £164 million.

In the year to March 2023, [Halma reported](#) a 21% increase in revenue and its 20th consecutive

year of record profit due once again to double-digit organic growth, another hike in R&D spending and seven medium-sized acquisitions worth just under £400 million to complement its existing businesses.

Or take the example of video games service company **Keywords Studios (KWS:AIM)**, which saw revenue rise by 37% in the year to December 2022 driven by 22% underlying growth together with five 'high-quality' acquisitions, delivering against its strategy of extending its reach and capabilities while scaling its technology offering.

For the year just ended, Keywords reported revenue growth may have slowed to 17% on a constant currency basis due to the Hollywood strikes but the firm still enjoyed nearly 10% underlying growth and made five more 'high-quality' bolt-on acquisitions.

ACQUISITION-DRIVEN COMPOUNDERS

The appeal of these high-quality 'acquisition-driven compounders' hasn't gone unnoticed by professional investors.

Scandinavian wealth management

firm REQ specialises in running ultra-long-term, concentrated equity funds focused on just such companies, including the three mentioned above.

The managers look for companies which:

- Are excellent at sourcing and closing frequent, small acquisitions in the private market at highly attractive multiples;
- Have strong cash flow generation, which in turn is reinvested at high returns on capital;
- Have management teams who are excellent capital allocators and often own a significant part of these companies;
- Have decentralised business models and offer exposure to a diverse array of small private companies spanning multiple end-markets;
- Have dual engines of profitable growth (organic and through acquisitions).

A selection of specialist and generalist 'acquisition-driven compounders'

Specialist Acquirers	Generalist Acquirers
Ashtead	Constellation Software
AutoNation	Danaher
CDW Corp	DCC
Dassault Systemes	Diploma
Eurofins Scientific	Fastenal
Ferguson	Halma
Keywords Studios	IMCD
LVMH	Interpump
Nemetschek	Judges Scientific
Rollins	Nordson
Thermo Fisher	Roper Technologies
Watsco	Software Circle
Waste Management	TransDigm

Table: Shares magazine • Source: REQ Capital

Acquisition-driven compounders, also known as ‘programmatic acquirers’, specialise in buying small, private niche businesses, frequently family-owned which enjoy a solid financial record and organic growth but typically lack the organic reinvestment opportunities to absorb the significant cash flow they produce.

Once these small, niche businesses have been acquired, the strong cash flows they generate can be reinvested to generate a higher return on capital than their cost of capital for an extended period.

At first glance, acquisition-driven compounders may seem confusing: ‘From a 30,000-foot view, what you see might look like a mess. The logical conclusion may be to embark on integration efforts as these businesses seem ripe for serious cost and sales synergies.’

However, a closer look at the highest-performing companies in the universe reveals a collection of decentralised and autonomous business units, each protecting its entrepreneurial independence.

‘Many of these businesses have distinct cultures, but they all thrive on ownership and autonomy enabled by decentralisation. Therefore, finding the right balance between decentralisation and integration represents an ongoing battle with temptations and difficult trade-offs,’ argue the managers.

DISCLAIMER: The author of this article owns shares in Halma.



THE WORST M&A DEALS IN HISTORY

The golden era of mega-takeovers was the late 1990s, when technology and telecom firms saw their valuations soar giving them the financial firepower to make all-share offers for their rivals.

The biggest and most ill-timed deal of all time has to be AOL-Time Warner, a \$165 billion transaction announced in January 2000 just before the tech bubble burst.

The merged firm racked up almost \$100 billion of losses in less than two years and the firms ultimately went their separate ways a decade later.

Companies Involved	Value
AOL-Time Warner, 2000	\$165 billion
Citicorp-Travelers, 1998	\$83 billion
Daimler-Chrysler, 1998	\$37 billion
Sprint-Nextel, 2005	\$35 billion
CBS-Viacom, 1999	\$35 billion
Alcatel-Lucent, 2006	\$13 billion
HP-Autonomy, 2011	\$12 billion
Kmart-Sears, 2004	\$11 billion

Table: Shares magazine



By Ian Conway Deputy Editor



WE MAKE INVESTING A BLAST

Launch your ISA in minutes from
our low-cost investment platform.

Take off today



AJBell

Feel good, investing.



Capital at risk. ISA rules apply.

The bond funds to buy as the rate hiking cycle draws to a close

US markets have priced in several rate cuts for 2024



By Martin
Gamble
Education
Editor

There are hopes for an improved picture for bonds in 2024 as the rate hiking cycle turns. In this article we look at the case for bonds, consider whether the 60/40 portfolio could make a comeback and look at our best ideas to play the bond market through funds.

ARE BONDS POISED FOR A RECOVERY?

As central banks signal an end to the interest rate hiking cycle investors might be thinking the prospects for their fixed income investments look quite promising.

Markets have repriced inflation expectations following sharp central bank interest rate hikes and bonds have experienced a scary drop in prices, especially those with longer maturities.

In fact, the last two years have been one of the worst on record with cumulative falls in price for longer duration bonds exceeding the brutal drawdown (peak-to-trough fall) seen in the financial crisis.

WHAT IS DURATION?

Duration, based in part on the length of time until a bond matures, can help predict the likely change in the price of a bond given a change in interest rates.

For every 1% increase or decrease in interest rates, a bond's price will change approximately 1% in the opposite direction for every year of duration.

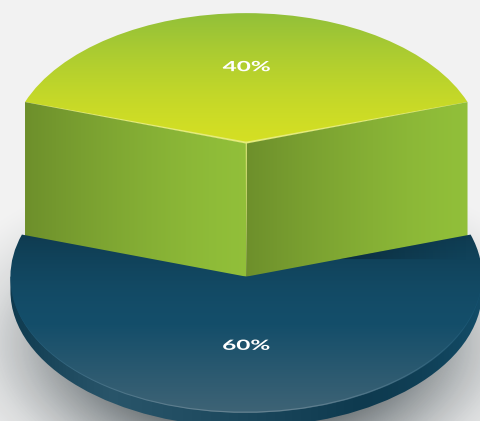
For example, if a bond has a duration of five years, and interest rates increase by 1%, the bond's price will decline by approximately 5%. Conversely, if a bond has a duration of five years and interest rates fall by 1%, the bond's price will increase by approximately 5%.

The lower a bond's coupon (interest paid as a percentage of the face value) and the longer the time to its maturity (when capital is returned) the more sensitive a bond's price is to a change in interest rates.

Higher duration bonds expose investors to the risk of inflation for longer which explains why long duration US treasuries have performed so poorly in the last two years.

WHY PLAY BONDS THROUGH FUNDS?

Because most corporate bonds have to be purchased in large denominations, they principally remain the preserve of institutional investors. For both this reason and in the interests of diversification, there is logic in using funds to gain exposure to the bond market. There are a large number of products available which target all different parts of the fixed income market.



IS THE 60/40 PORTFOLIO STRATEGY STILL VALID?

For the last 40 years, bonds have provided ballast against falling stock markets, a relationship statisticians describe as a negative correlation. It essentially means they move in opposite directions.

Asset prices can also move together perfectly in lockstep, (positive correlation) or there might not be any strong relationship at all (zero correlation).

The success of the popular 60-40 portfolio (60% equities, 40% bonds) has largely been

due to equity and bond prices moving in opposite directions.

Take a typical bear market. Let's say equities fall 30% and bond prices move up 10% as yields drop. A £100 portfolio with 100% in equities will fall to £70.

A 60/40 portfolio will see its equity portion fall from £60 to £42 (60×0.7) while the bond portion will rise to £44, (40×1.1) giving an overall value of £86.

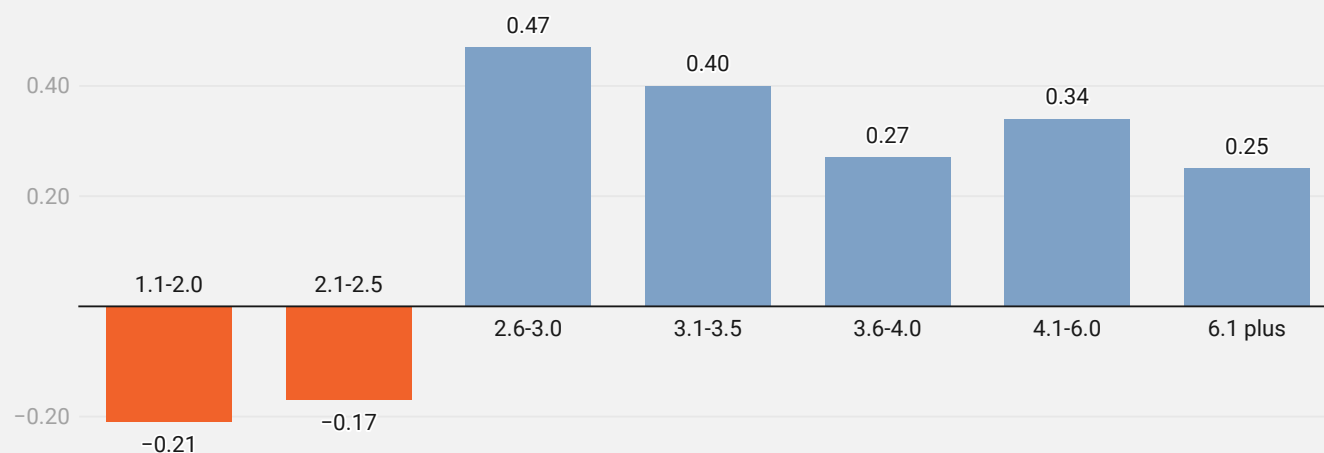
The strength and relative stability of bonds reduces the overall loss to 14%. The all-equity portfolio needs to gain 43% to get back to £100 ($100/70$) while the 60/40 only needs a 16% gain ($100/86$).

The negative correlation relationship between stocks and bonds is strongest in government bond markets. Corporate bonds act more like stocks because of the credit risk associated with investing in company debt.

One aspect to be aware of is that corporate bonds of lower quality are more susceptible to losses during a recession as weaker companies struggle to generate enough cash to service debts.

In conclusion, there is a good chance bonds and stocks re-establish their negative correlation as interest rates fall but there is an outside chance that markets have moved into a new paradigm.

Equity/bond correlation in different inflation environments



Rolling 36-month correlation between one month S&P 500 total return and one month 10-yr Treasury return versus 3-yr average core inflation

Chart: Shares magazine • Source: Bloomberg-Barclays, Shiller, Ruffer, GFD, BLS, Minack Advisors



THE BULLISH CASE FOR INVESTING IN BONDS

If interest rates are close to their peak in the current economic cycle a case can be made for locking in 4% plus yields on 10-year UK and US government bonds.

Markets are anticipating as many as six interest rate cuts from the Fed this year which looks too aggressive relative to Fed forecasts of three cuts.

There are two justifications why the central bank might cut rates. First, if inflation continues to fall towards target, not cutting rates increases the real rate of interest (nominal rate minus inflation) which tightens financial conditions.

Given all the good work done so far to create the conditions for a soft landing, it would appear self-destructive for the Fed to inadvertently push the economy into recession.

Second, if the economy slows faster than anticipated it makes sense for the central banks to begin cutting interest rates. In any case Fed chair Jerome Powell has indicated the bank will not wait for inflation to return all the way back to 2% before cutting rates.

In both scenarios bonds should do well if inflation remains well behaved. Investors can lock-in a decent yield and potentially see capital gains as rates fall and prices rise. Another factor to consider is money flow.

There is an estimated \$6 trillion of cash sitting in US money market funds according to Bob Michele, head of global fixed income at JP Morgan.

These investors are happy clipping 5.5% coupons in the current environment argues Michele but will quickly move into bonds when interest rates come down.



THE BEAR CASE

There is no guarantee inflation will return to pre-Covid levels. Sticky, volatile inflation is the enemy of bonds as it eats away at the purchasing power of fixed income.

Economist Mohamed El-Erian argues the combined effects of deglobalisation (more expensive supply chains) and the transition to a green economy imply higher levels of inflation than the past.

The investment team at capital preservation fund **Ruffer Investment Company (RICA)** are in the same camp. They argue markets are too complacent on inflation risk. This matters for bond investors because history shows that during periods of higher inflation bonds do not provide protection against equity market turmoil.

Under the scenario where inflation remains elevated and more volatile than in recent years bonds may struggle to perform. Longer duration bonds will be more vulnerable to the effects of inflation than shorter duration bonds.



PASSIVE EXPOSURE

Investors interested in getting broad exposure to global bond markets might consider the **iShares Core Global Aggregate Bond ETF (AGGU)**.

This £2.4 billion fund invests in more 13,000 issuers and tracks the Bloomberg Global Aggregate Bond index for an annual charge of 0.1% a year.

BOND FUNDS TO BUY

ARTEMIS STRATEGIC BOND FUND INC (BJTOKT2)

The £1 billion fund has a flexible mandate to invest across fixed income markets as the economic cycle turns and market conditions change. It invests in government bonds, investment grade bonds, and high yield bonds.

The managers aim to preserve capital in difficult times and to profit when conditions improve. The fund has outperformed the Bloomberg Global Aggregate Bond Index over three, five and 10 years.

The Artemis team have a positive view across the whole spectrum of bonds. In a recent update they said bonds of almost any variety are a buy and high yield bonds are attractive under almost any scenario.

The fund typically holds between 100 and 130 positions and is well diversified across different sectors.

The portfolio has around 73% exposure to corporate credit and the rest to government bonds. The fund has a 30% weighting to credit of the highest quality companies, 41% to companies on the lowest rung of investment grade and around 5% in the lowest quality.

The underlying yield is 4.3% and the ongoing charge is 0.59% a year.

INVESCO BOND INCOME PLUS (BIPS)

This £300 million fund is managed by Rhys Davies who is supported by Edward Craven of Invesco's fixed income team which, combined, oversee assets worth £28 billion.

The strategy is to maximise income without taking undue credit risk based on company specific research, taking a two-to-three-year view.

Performance has been good with net asset value outperforming Morningstar's Flexible Bond category over one, three and five and 10 years. The portfolio tends to be diversified across more than 160 issuers with the top 10 currently representing 37.5% of net asset value.

The biggest sector exposures are financials (around 27% of net asset value) and insurance (8%) followed by automotives (7%), food and beverage (5%) and telecoms (5%).

At the end of December 2023, the fund had a trailing yield of 7.5% and a yield to maturity of 8.6% which is higher than the ICE BofA European Currency High Yield index.

Yield to maturity is the expected yield including capital gains (the portfolio's average price was 92) and income. The fund has a duration of around four years.

The ongoing charge is 0.86% a year and the shares trade at a 1.27% premium to net asset value.

Artemis Strategic Quarterly Bond



Chart: Shares magazine • Source: LSEG

Invesco Bond Income Plus



Chart: Shares magazine • Source: LSEG

Fidelity Special Values PLC

An AJ Bell Select List Investment Trust



The recent strong relative performance of the UK equity market has gone largely unnoticed by investors, reinforcing its unloved status. Alex Wright, portfolio manager of Fidelity Special Values PLC, believes the value-oriented areas of the UK market represent a strong investment opportunity.

Turning insight into opportunity

Despite the UK being a value market, many of those who invest in the market don't invest with a value bias. However, Alex looks to construct portfolios focused on unloved UK companies entering a period of positive change. The market is often slow to recognise change in out-of-favour stocks which creates opportunities to add value by identifying companies whose improving growth prospects are not yet recognised by other investors.

Our broad analyst coverage means that we are able to find ideas across the market cap spectrum, giving us many shots on goal. Our network of over 400 investment professionals around the world place significant emphasis on questioning management teams to fully understand their corporate strategy. They also take time to speak to clients and suppliers of companies in order to build

conviction in a stock. Our approach translates into a clear bias towards small and mid-cap value stocks, compared to most of our competitors who are often less differentiated.

It's a consistent and disciplined approach that has worked well; the trust has significantly outperformed the FTSE All Share Index over the long term both since Alex took over in September 2012 and from launch over 29 years ago.

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



Past performance

	Jan 2019 - Jan 2020	Jan 2020 - Jan 2021	Jan 2021 - Jan 2022	Jan 2022 - Jan 2023	Jan 2023 - Jan 2024
Net Asset Value	11.4%	-8.3%	30.1%	5.4%	1.4%
Share Price	9.2%	-6.7%	29.8%	-4.5%	2.5%
FTSE All Share Index	10.7%	-7.5%	18.9%	5.2%	1.9%

Past performance is not a reliable indicator of future returns

Morningstar as at 31.01.2024, bid-bid, net income reinvested. ©2024 Morningstar Inc.

All rights reserved. The FTSE All Share Index is a comparative index of the investment trust

Important information

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



Investment professionals include both analysts and associates. Source: Fidelity International, 31 January 2024. Data is unaudited. The latest annual reports, key information documents (KID) and factsheets can be obtained from our website at www.fidelity.co.uk/its or by calling 0800 41 41 10. The full prospectus may also be obtained from Fidelity. The Alternative Investment Fund Manager (AIFM) of Fidelity Investment Trusts is FIL Investment Services (UK) Limited. Issued by FIL Investment Services (UK) Ltd, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. UKM0224/385993/SSO/0524



How to play gold through exchange-traded products

Geopolitical tensions, a weaker dollar and potential interest rate cuts in the US have helped to push the precious metal to record highs

In December 2023 gold reached new all-time highs above \$2,100 an ounce and it has been above \$2,000 for all of 2024 to date.

So far in the 21st century gold has even outperformed the total return from the S&P 500 – one of the best performing equity markets globally.

According to the World Gold Council in 2023 the precious metal beat the performance of emerging market stocks, US bonds, the US dollar, global treasuries, and commodities in general. One of the most cost effective and straightforward ways to gain exposure to gold is exchange-traded products and we will explain why later in this article.

WHY INVEST IN GOLD?

The precious metal is often viewed by investors as a 'safe haven' during periods of geopolitical

Gold vs S&P 500

Rebased to 100

— Gold bullion — S&P 500 (total return)

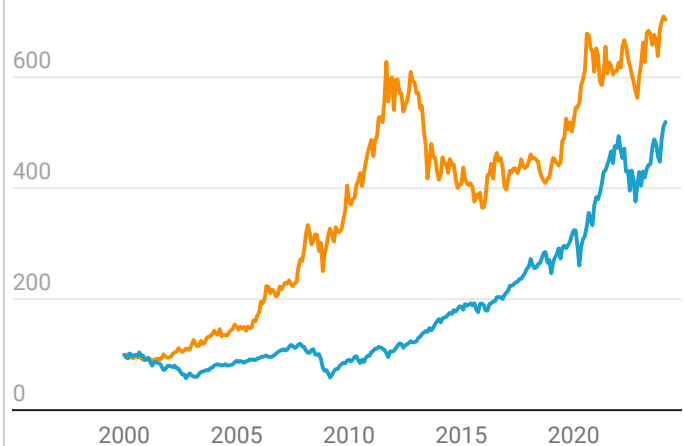


Chart: Shares magazine • Source: LSEG

tension and economic uncertainty.

ETF provider WisdomTree's head of commodities and macroeconomic research Nitesh Shah says gold can function as a 'hedge against inflation' for investors as well as having 'defensive' and 'cyclical'

qualities as part of a diversified portfolio.

He adds: 'Although geopolitical risk seems to have calmed down a little since October 2023, when the Israel-Hamas war broke out, this source of risk remains elevated.

'In December 2023, Houthi attacks on ships in the Red Sea highlighted that tensions in the Middle East are not simply confined to Israel-Gaza. Chinese president Xi Jinping used his annual new year address to the nation to sound a warning to Taiwan's voters, days ahead of the island's presidential election. He said, reunification of Taiwan and China was a historical inevitability.

'Many analysts had thought the prolonged war in Ukraine would be a deterrent to Xi in pursuing annexation of Taiwan, but recent rhetoric from Xi indicates that risk is still on the cards.'

A peak in the current interest rate cycle is also potentially supportive for gold prices. Because the precious metal offers no income, it tends to have an inverse relationship with 'real' or inflation adjusted interest rates.

Another big driver for gold in recent times is demand from central banks as they seek to diversify their reserves. Gold's inverse relationship with the US dollar, another major reserve asset, is an element of its appeal for central banks. When the dollar drops in value, gold typically rises, enabling central banks to protect their reserves when



“

When the dollar drops in value, gold typically rises, enabling central banks to protect their reserves when markets are volatile”

Gold price forecast

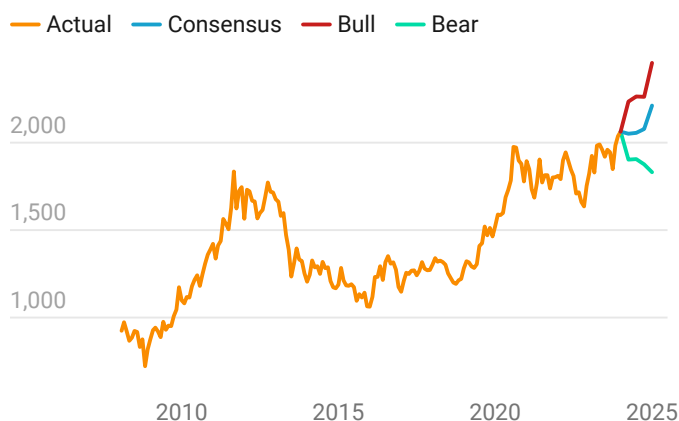


Chart: Shares magazine • Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close December 2023.

markets are volatile.

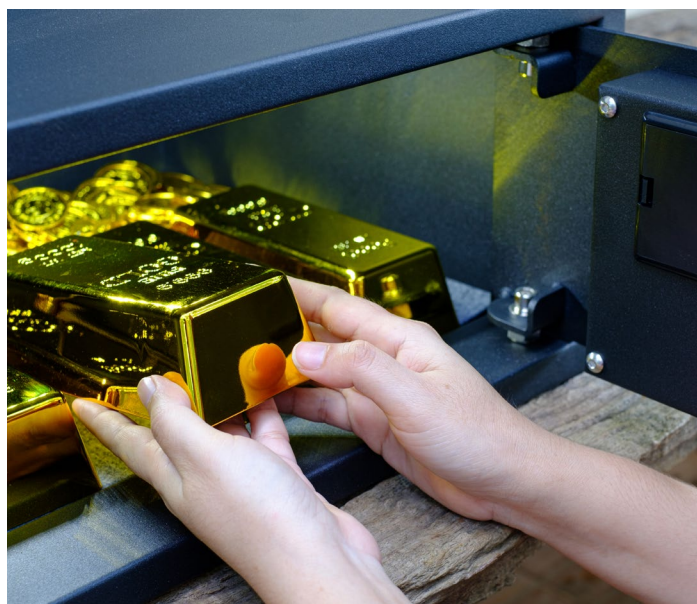
Analysts at JP Morgan are positive about both gold and silver. Gregory Shearer, head of base and precious metals said: 'Across all metals, we have the highest conviction on a bullish medium-term forecast for both gold and silver over the course of 2024 and into the first half of 2025, though timing an entry will continue to be critical.

'At the moment, gold still appears quite rich relative to underlying rates and foreign exchange fundamentals, and still looks vulnerable to another modest retreat in the near-term, as Fed rate cut expectations are now running earlier than our forecasts.' JP Morgan forecasts gold prices will peak at \$2,300 per ounce in 2025.

HOW TO INVEST IN GOLD

Whatever the short-term trajectory for gold there are decent arguments for having exposure to the precious metal as part of a diversified portfolio. There are several ways to invest in gold. You can in theory buy the physical product – a kilo, coins, or a 400-ounce bar. The latter would set you back around \$798,435 in today's money and be pretty heavy to carry.

There would also be the cost of storing physical gold (which adds up). It is not surprising then, that people invest in gold instead through



Gold ETCs compared

ETC	EPIC	Ongoing charges	Three-year performance (%)
Xtrackers IE Physical Gold ETC Securities	XGDU	0.11%	18.57%
Amundi Physical Gold ETC (C)	GLDA	0.12%	18.55%
Invesco Physical Gold A	SGLP	0.12%	18.80%
iShares Physical Gold ETC	SGLN	0.12%	18.39%
WisdomTree Core Physical Gold	GLDW	0.12%	18.68%
WisdomTree Physical Swiss Gold	SGBX	0.15%	18.77%
HANetf The Royal Mint Responsibly Sourced Physical Gold ETC	RMAP	0.22%	18.57%
iShares Physical Gold GBP Hedged ETC	IGLG	0.25%	n/a
WisdomTree Physical Gold - GBP Daily Hedged	GBSP	0.25%	5.69%
Xtrackers Physical Gold ETC	XGLD	0.25%	18.39%
Xtrackers Physical Gold ETC (EUR)	OXA5	0.25%	18.08%
Xtrackers IE Physical Gold GBP Hedged ETC Securities	XGDG	0.28%	5.26%
Invesco Physical Gold GBP Hedged ETC	SGLS	0.34%	5.17%
WisdomTree Physical Gold	PHGP	0.39%	17.91%
Gold Bullion Securities	GBSS	0.40%	17.84%

Table: Shares magazine • Source: JustETF, 2 February 2024

funds, investment trusts and gold mining shares.

Among the lowest-cost options can be found in the exchange-traded product universe. These gold vehicles are not ETFs (exchange-traded funds) because their single-asset focus means they don't meet diversification criteria. Instead, they are known as ETCs (exchange-traded commodities). They are easy to buy and sell and can be held in a SIPP or ISA.

THE RANGE OF GOLD ETCs

Many providers offer gold-related ETCs including Xtrackers, WisdomTree, Invesco, BlackRock and Amundi. Most are backed by securely stored physical gold bullion. Providing all the benefits and security of owning physical gold at a significantly reduced cost compared to those you would face as

“
**Easy to buy and
sell and can be
held in a SIPP
or ISA**”

an individual.

There is even a gold ETC backed by the Royal Mint and created in partnership with HANetf. This product is backed by LBMA (London Bullion Market Association) good delivery bars that are sourced on a best endeavour basis from the LBMA's Responsible Sourcing

programme to assure investors that the gold is from conflict-free, legal sources. However, soothing any ethical concerns does come at a higher cost than the more plain-vanilla gold ETCs.

The table compares the main products by both cost and three-year performance.



By **Sabuhi Gard** Investment Writer



How the WPP tortoise beat the S4 Capital hare



Sorrell aimed to leave his former charge for dust but it continues to plug away while his new vehicle stalls

When Martin Sorrell completed his acrimonious exit in 2018 from the business he had built up over decades he had a point to prove.

His **S4 Capital (SFOR)** vehicle was supposed to leave his former charge in the shade by adopting a similar buy-and-build model to that employed at **WPP (WPP)**.

The latter started life as wire shopping-basket manufacturer Wire and Plastic Products before Sorrell and co-founder Preston Rabl acquired it in the mid-1980s as a listed entity through which to build a global advertising giant.

The idea was S4 would be a clean digital-led marketing business without the legacy analogue bits which remained in the WPP group.

Sorrell's name, and some swiftly-executed acquisitions, initially created a real buzz and at its peak in 2021 S4 had a market valuation almost two thirds that of WPP.

A big retrenchment in advertising spend has subsequently taken the air out of its balloon and the shares are down 95% from their highs.

Revenue has reversed sharply; the company is scrambling to cut costs and Peel Hunt says it expects 'little clarity on the outlook' for 2025 'as visibility on client budgets will likely be low'.

On the face of it, the story is only marginally happier at WPP. Under Sorrell's successor, Mark Read, the shares have continued to slide against a difficult backdrop. However, it is a more established, more diversified business which has seen its way through several economic cycles, and the unshowy Read provided some evidence at the company's latest capital markets day (31 January) that the business might have some life to it.

While S4 was making a splash with a series of acquisitions, WPP has made significant progress in simplifying an operation which had a lot of individual moving parts.

While the growth targets outlined at the investor event are steady rather than stratospheric – with 3%-plus organic revenue growth being projected – if they can be delivered alongside stronger margin performance and improved cash flow they could help lift a valuation which, at a little more than eight times forecast earnings, feels pretty bombed out.

Read was clear-eyed on the impact of AI (artificial intelligence). This author would be minded to agree with him that machines aren't suddenly going to replace the creative elements of advertising. Instead, they can help increase efficiency in areas like buying media space for ads.

What is striking is that AI is not a new thing for WPP. It has played a role for almost 10 years, with its adoption accelerated by the acquisition Satalia in 2021. This business builds and applies AI technology to solve efficiency problems for clients such as supermarket giant **Tesco (TSCO)** and Big Four accounting firm PwC.

Shore Capital says the company's use of AI is 'the next chapter in its digital and technology adoption story, rather than a radical reboot – providing comfort around the likelihood of successful execution'.

'We also regard the group's ongoing commitment to self-help initiatives, investing in technology and building partnerships with key industry players, as key to cementing its position as a leading global player and its ability to add value to a diversified blue-chip client base,' add the analysts.



WATCH RECENT PRESENTATIONS

SHARES
INVESTOR EVENINGS

César Sánchez
CFO
Atalaya Mining (ATYM)

Webinar 23 January 2024

Atalaya Mining (ATYM) César Sánchez, CFO

Atalaya Mining is a sustainable and reliable producer of copper and other critical metals that are essential for economic growth and the energy transition. The company maintains open engagement and strong relationships with its key stakeholders, including the local communities in the regions surrounding its operations.

SHARES
INVESTOR EVENINGS

Ian Simm
Founder & Chief Executive
Impax Asset Management Group (IPX)

Webinar 23 January 2024

Impax Asset Management Group (IPX) Ian Simm, Founder & Chief Executive

Impax Asset Management Group (IPX) offers a range of listed equity, fixed income and private markets strategies. All strategies utilise the firm's specialist expertise in understanding investment opportunities arising from the transition to a more sustainable economy.

SHARES
INVESTOR EVENINGS

Sapan Ghai
Chief Commercial Officer
Sovereign Metals (SVML)

Webinar 23 January 2024

Sovereign Metals (SVML)

Sapan Ghai, Chief Commercial Officer

Sovereign Metals is a mineral exploration company. It is engaged in the mineral exploration, identification, and appraisal of resource projects.

Visit the Shares website for the latest company presentations, market commentary, fund manager interviews and explore our extensive video archive.

CLICK
TO PLAY
EACH
VIDEO

SHARES SPOTLIGHT

www.sharesmagazine.co.uk/videos

Mortgage rates have fallen, what does it mean for homeowners?

Home loans are becoming more affordable but you still need to be alert

The Bank of England has held interest rates for a fourth time, but despite that mortgage rates are dropping, giving some hope for homeowners who are refinancing. The base rate was kept at its 15-year high of 5.25% at the Monetary Policy Committee's first meeting of 2024. However, the year has started with a significant drop in mortgage rates, despite there being no shift in base rate. We'll look at the outlook for rates, what the fall means for those who are coming to remortgage this year and what action homeowners can take.

WHAT'S THE OUTLOOK FOR INTEREST RATES?

Market expectations are that base rate will be held at current levels until May or June this year, when the Bank will make its first cut to rates. It is then expected that it will keep cutting for the remainder of the year, with rates ending up at around 4.25% by December this year – a significant drop from where we are now.

However, this is just what the market expects and the Bank of England has continually said it's potentially too soon to be talking about rate cuts. We have also learnt from recent experience that a few bits of economic data can make a big difference to rate expectations. If inflation proves stubborn, for example, the path to rate cuts could change.

WHY HAVE MORTGAGE RATES DROPPED WHEN BASE RATE HASN'T?

Mortgages are priced based on market expectations of interest rates but also on competition. At the start of 2024 we saw a number



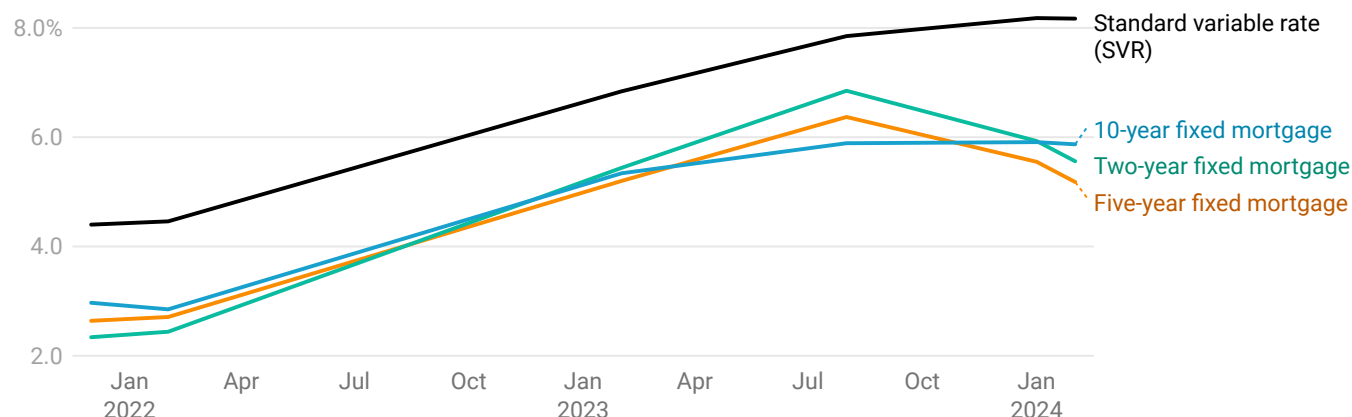
of big lenders come out and cut their rates, which prompted others into rate cutting action. This will partly be based on the expectation that rates are going to fall, with mortgages being priced based on interest rates across the two or five years of the fix, not just what rates are today. It will also partly be based on a lacklustre housing market meaning that not as many people have been taking out mortgages – so banks and building societies need to price more attractively to sell more.

WHAT ARE RATES NOW?

The latest Bank of England data shows a drop in the interest rate paid on new mortgages by six basis points in December – which was the first fall in average mortgage rates for three years. Based on Moneyfacts data since the start of August 2023, the average two-year fixed rate mortgage has fallen from 6.85% to 5.56% and the average five-year fixed rate has fallen from 6.37% to 5.18%. But what's perhaps more dramatic is the drop we've seen this year, with the average two-year deal falling from 5.93% to 5.56%, and the five-year deal falling from 5.55% to 5.18%. Also bear in mind that these are average figures, so those with good credit ratings and a healthy loan-to-value ratio will be able to lock in much lower rates.

However, there are some words of caution that these rates may not last. Rachel Springall, finance expert at [Moneyfactscompare.co.uk](https://moneyfactscompare.co.uk), says: 'Lenders

How rates have changed in the mortgage market



Average rates shown are as at the first available day of the month, unless stated otherwise.

Chart: Shares magazine • Source: Moneyfactscompare.co.uk

can pull deals if they have an influx of applications, and a volatile swap rate market can put pressure on pricing where margins are already tight. It would be inevitable to see a mix of both fixed rate rises and cuts when lenders endeavour to manage consumer demand, any targets and future rate expectations.'



MY FIX IS UP THIS YEAR, WHAT SHOULD I DO?

Around 1.5 million homeowners have a fixed rate mortgage deal coming to an end this year, according to the FCA (Financial Conduct Authority), which means they need to face the realities of higher mortgage rates for the first time. The best thing to do is be prepared. Make a note of when your fixed rate deal is up and put a note in your diary for six months ahead. At this point you can lock in a new mortgage deal – if rates fall in the six months between then and when your fixed rate deal expires you can move to the lower rate – but by getting a deal in place six months ahead you have a fallback plan. You can use a broker to help

navigate this (there are fee-free brokers out there) or do it with your current lender.

The worst thing you can do is let your fixed rate deal elapse and fall onto the lender's [standard variable rate](#) or reversion rate. It's the default rate that you go onto when your fixed-rate deal expires and you haven't lined up a new one, but it is the most expensive rate a mortgage lender will charge and currently some are charging 8% or even 9%. Even a few months on this rate could be financially crippling for some – so avoid it at all costs.

While mortgage rates have dropped, they are still almost guaranteed to be higher than your current deal. So, it's good to work out ahead of time whether your new repayments will be affordable or not. If you need to reduce your monthly repayments you could extend the term of your mortgage – although this will cost you more in the long-run – or you could switch to an interest-only deal for a while (but this should be a short-term move rather than a long-term plan).

If you think you're going to struggle to make your payments ahead of your fixed rate deal ending (or if you're on a variable rate deal) contact your lender as soon as possible to work out your options. You can also get help from organisations like Citizens Advice.



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

SHARES

INVESTOR EVENINGS

27 FEBRUARY 2024
EDINBURGH

Registration and
coffee: 17.15

Presentations: 17.55

During the event and
afterwards over drinks,
investors will have the
chance to:

- Discover new investment opportunities
- Get to know the companies better
- Talk with the company directors and other investors

Sponsored by



IN-PERSON EVENT

RADISSON BLU HOTEL
THE HISTORIC ROYAL MILE

Reserve your place now!

COMPANIES PRESENTING



ANEXO GROUP (ANX)

A specialist integrated credit hire and legal services group focused on providing replacement vehicles and associated legal services to impecunious customers who have been involved in a non-fault accident.



REABOLD RESOURCES (LSE- RBD)

The principal activity of the company is an investment in pre-cash flow upstream oil and gas projects, primarily as significant minority interests in unlisted oil and gas companies or majority interests in unlisted oil and gas companies with non-operating positions on licenses.



TEAM INTERNET (TIG)

Since 1996, (formerly CentralNic) has been transforming the way organisations, brands, publishers and consumers connect and thrive online.



TIME TO ACT PLC

A development business focusing on Advancing Clean Technologies. We own, operate, improve and scale up cleantech and renewable supply chain businesses with promising profiles but embedded challenges that we can help to overcome.

Register for free now

www.sharesmagazine.co.uk/events



What could the next general election mean for UK equities?

Examining how markets have performed under Labour and Conservative governments with a poll looming on the horizon

Given the rate at which prime ministers (and chancellors of the exchequer) seem to come and go, investors may be inclined to avoid second-guessing the result of the next general election, even as the Conservatives' Rishi Sunak drops hints of an autumn ballot, and the opposition Labour Party starts to finalise its manifesto.

The lack of available cash in the Government's kitty, the Conservatives' occasionally frayed relationship with 'business' and the likelihood that Labour took on board Trussonomics' lesson that unfunded promises could prompt chaos may all mean that investors could be in the mood to take Sir Keir Starmer's big lead in the polls, and any eventual victory, in their stride.

The current Conservative Government, whose tenure dates back to 2010 and covers a flurry of five prime ministers, could be seen as having taken an increasingly interventionist approach to the economy, given such initiatives as sugar taxes, Help to Buy, energy price caps, windfall taxes on North Sea oil producers, 2021's National Security and Investment Act and additional levies on housebuilders' profits.

Increasingly vocal and forceful regulators, such as the Financial Conduct Authority, Ofcom, Ofgem, Ofwat and the Competition and Markets Authority,



also appear to be responding to public pressure for greater action, and perhaps the hardest part for investors going forward will be spotting which industry or sectors will come under scrutiny next, in the wake of such recent examples as betting, funeral services and veterinary services.

Investors may nevertheless be tempted to look at the FTSE All-Share's history since its launch in 1962 to see if the 16 general elections and 13 prime ministers over that timespan offer any clues as to what may happen this time around.

The FTSE All-Share has often reacted positively to a change in government

	1 year before	1 year after	Term * - NOMINAL	Term * - REAL **
Change in Government	6.0%	12.8%	47.9%	1.3%
Incumbent wins	11.8%	0.9%	30.0%	11.5%

LSEG Datastream data

Table: Shares magazine • Source: * 1964/66 to 1970 Wilson Governments and 1974/74 to 1979 Wilson/Callaghan Governments counted as one term. 2019 Conservative Government to 16 Jan 2024. **Adjusted for retail price index (RPI).



The FTSE All-Share has, on average, done better under Conservative governments

	1 year before	1 year after	Term * - NOMINAL	Term * - REAL **
Labour	0.4%	4.1%	26.8%	-9.0%
Conservatives	14.9%	5.7%	41.8%	17.2%

*1964/66 to 1970 Wilson Governments and 1974/74 to 1979 Wilson/Callaghan Governments counted as one term. 2019 Conservative Government to 16 Jan 2024. **Adjusted for retail price index (RPI)

Table: Shares magazine • Source: LSEG

UNLUCKY FOR SOME

A study of all 16 polls and 13 national leaders suggests the following:

- A change of government, and defeat for the incumbent is not necessarily a bad thing for UK equities.
- The UK stock market has, on average, done better under Conservative governments in nominal and particularly in real, post-inflation terms.
- Size of majority is of little concern to the stock

market (even if it is hugely important to the PM) and a much greater factor for investors is inflation.

Ultimately the economic backdrop is ultimately the real key, rather than the identity of the PM or their political persuasion. The 1974-79 Labour administration that began under Harold Wilson and ended under James Callaghan started off with a tiny majority but on paper generated healthy returns for the FTSE All-Share, which rocketed.

Inflation is a key factor when it comes to assessing UK equity returns by prime minister

Nominal percentage change in FTSE All Share

Margaret Thatcher, Conservative (1979-90)	270.6%
John Major, Conservative (1990-97)	107.1%
James Callaghan, Labour (1976-79)	66.7%
David Cameron, Conservative (2010-16)	43.2%
Edward Heath, Conservative (1970-74)	21.9%
Tony Blair, Labour (1997-2007)	19.9%
Theresa May, Conservative (2016-19)	0.4%
Harold Wilson, Labour (1964-70)	9.0%
Rishi Sunak, Conservative (2022-)	8.9%
Harold Wilson, Labour (1974-76)	8.6%
Boris Johnson, Conservative (2019-22)	-0.1%
Liz Truss, Conservative (2022)	-4.2%
Gordon Brown, Labour (2007-10)	-19.2%
Average under Conservatives	56.0%
Average under Labour	17.0%

Table: Shares magazine • Source: LSEG Datastream data 2019 Conservative Government to 16 Jan 2024

Real terms percentage change in FTSE All Share

Adjusted for retail price index (RPI)

Margaret Thatcher, Conservative (1979-90)	132.9%
John Major, Conservative (1990-97)	87.6%
James Callaghan, Labour (1976-79)	26.1%
David Cameron, Conservative (2010-2016)	25.4%
Rishi Sunak, Conservative (2022-)	-1.2%
Liz Truss, Conservative (2022)	-7.6%
Theresa May, Conservative (2016-19)	-9.5%
Tony Blair, Labour (1997-2007)	-10.9%
Edward Heath, Conservative (1970-74)	-24.1%
Boris Johnson, Conservative (2019-2022)	-17.5%
Harold Wilson, Labour (1964-1970)	-20.0%
Gordon Brown, Labour (2007-2010)	-27.3%
Harold Wilson, Labour (1974-76)	-36.5%
Average under Conservatives	23.2%
Average under Labour	-13.7%

Table: Shares magazine • Source: LSEG Datastream data 2019 Conservative Government to 16 Jan 2024



The 1970s' galloping inflation hurt Labour's reputation for almost two decades

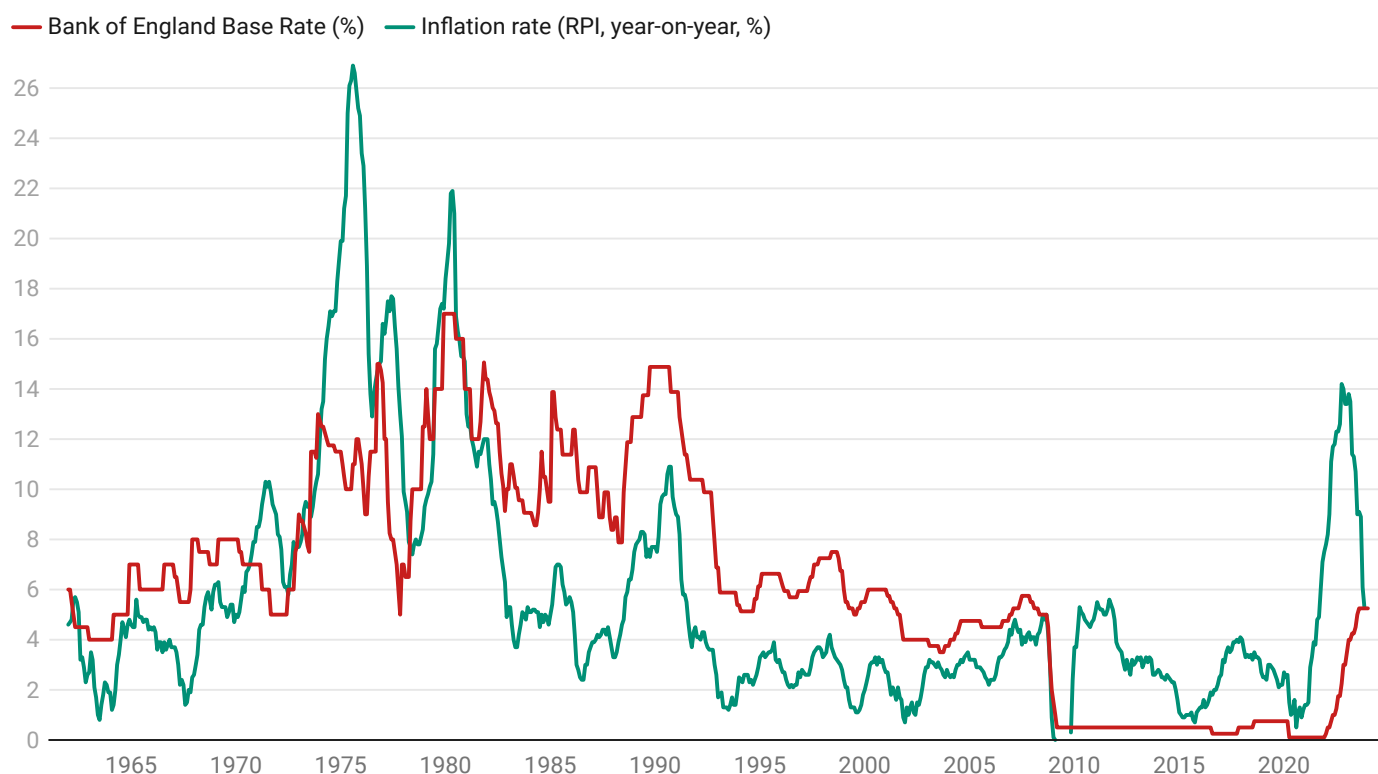


Chart: Shares magazine • Source: LSEG

However, once those returns take a spiral in the RPI measure of inflation into account (and RPI is used as it offers a longer history than CPI), then investors actually lost out in real terms, in what was a difficult decade for shareholders, owing to the ravages of inflation.

THE ECONOMY, STUPID

This is to make an economic point, rather than a political one. As former US President Bill Clinton's strategist, James Carville, argued ahead of the then Arkansas Governor's 1992 election win. 'It's the economy, stupid.' If the voters feel flush, they are more likely to vote for the incumbent government and less so if not and inflation is a key part of that.

The galloping inflation of the 1970s, and subsequent labour unrest, did for both the Tories' Ted Heath in 1974 and Labour's James Callaghan in 1979. In the latter case, public appetite for a change of tack was particularly strong and ushered into power the nation's first female prime minister.

Gordon Brown had little or no chance, having had the bad luck to preside over the Great Financial

Crisis of 2007-09 and Tony Blair's second term coincided with the bursting of the technology, media and telecoms bubble, the blame for which could not be laid at Downing Street's door under any circumstances.

What will be interesting this time around is the degree to which inflation and the economy shape public thinking once more. The Brexit vote dealt Theresa May a difficult hand and the pandemic gave Boris Johnson a dud one, but the public will remember inflation and the cost-of-living crisis. Regardless of whether they blame that on the Bank of England's monetary experimentation, supply chain dislocations caused by the pandemic, the oil price spike that followed Russia's invasion of Ukraine, or just stick it on the Government may be a crucial factor in how the next general election plays out and how stock, bond and currency markets subsequently respond.

By **Russ Mould**
Investment Director at AJ Bell



I want to pay a lump sum into my pension but could I breach my annual allowance?

Answering a question about the different limits on contributions to your retirement pot

I am paying into both my SIPP and a workplace pension scheme. I earn about £50,000 a year and pay about £500 a month into my SIPP. My workplace pension scheme contributions are paid completely by my employer, whom I have a salary sacrifice arrangement with.

I have just had a windfall of a cash lump sum and want to pay in more money into my pension. Hopefully up to the maximum allowed this year.

I understand that there are limits on the maximum amount you can make to a pension, called the annual allowance. But is there also a limit which is related to how much I earn?

Could you help me make sense of it?

Donna



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

Figuring out how much people can pay into a pension shouldn't be a tough question, but unfortunately it often is. There are four different controls on how much they can pay in, so navigating through the rules can be difficult.

The amount people can pay into any pension and benefit from tax relief is based on their earnings and how much tax they pay. The general rule is they can personally pay in up to 100% of their taxable UK earnings, including any tax relief.

OTHER LIMITS TO BE AWARE OF

But there are other limits to be aware of. These are the three annual allowances. The standard annual allowance is £60,000 and includes someone's personal contributions, their employer contributions



and tax relief on their contributions to the SIPP. (It went up to £60,000 this tax year, before that it was £40,000.)

There are two other annual allowances. One is called the tapered annual allowance. This applies to very high earners – those who earn over £260,000 could get caught. It reduces their annual allowance on a sliding scale depending on how much they earn. If they earn £360,000 or over then their annual allowance falls all the way down to £10,000.

The third and final annual allowance is the money purchase annual allowance. If someone has 'flexibly accessed' their pension – usually by taking money from an income drawdown plan – then they trigger this allowance. It reduces their annual allowance to £10,000. And there it will stick. Even if they don't withdraw any more money from their pension. (If they only take their tax-free cash from their pension or buy a standard annuity, they avoid triggering this allowance.)

If their total pension contributions are below the standard annual allowance of £60,000 they can make it up to that level by contributing to their pension. If they pay into a SIPP, they will have to remember to include their 20% tax relief which gets added to their pension pot.

But watch out – they can't personally contribute more than they earn, including tax relief.

Anything they put in that takes them over their



100% earnings figure will be returned to them, and the tax relief they received on it returned to the government.

WHAT HAPPENS IF YOU EXCEED THE ALLOWANCE

However, if an individual's total contributions go over the annual allowance then it's a different story. There's a tax charge on the excess. This is called an annual allowance charge and it effectively cancels out the tax relief they receive above the allowance. But it's not as neat a solution as having their contributions just returned to them, as it involves more interaction with HMRC. So, as you can see, sometimes it's your earnings that is the limiting factor, sometimes it's the annual allowance.

Finally, if someone hasn't reached their maximum annual allowance in the last three tax years, they can carry forward any unused annual allowance to the current tax year. (Remember, over the last three years the annual allowance was £40,000, not £60,000.)

They must use up the current annual allowance for this tax year before they start on any unused allowance on previous years. But even if they have enough unused annual allowance to justify a really big payment into their pension, they have to remember to stick to that first limit of not being able to put in more than 100% of what they earn. It's no wonder people struggle with this.

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.

AJOT
AVI Japan Opportunity Trust

AVI
Asset Value Investors

Finding Compelling Opportunities in Japan

Driving positive change
through **active engagement**



Discover AJOT at
www.ajot.co.uk

Past performance should not be seen as an indication of future performance. The value of your investment may go down as well as up and you may not get back the full amount invested. Issued by Asset Value Investors Ltd who are authorised and regulated by the Financial Conduct Authority.

Main Market



AG Barr	17
Ashtead	26
Balfour Beatty	21



Britvic	17
Burberry	14
Centrica	10
Elementis	9
Halma	26
Hargreaves Services	21
Kingfisher	23
S4 Capital	38



Saga	17
Shell	22
Superdry	17



Wickes	23
WPP	38

AIM

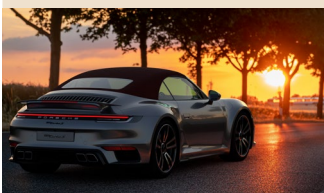
Celadon Pharmaceuticals	19
EnSilica	20
Keywords Studios	27
Kistos Energy	22
Serica Energy	22
Victoria Plumbing	23

Overseas shares

Alphabet	7
Amazon	7
Apple	7, 16
Aston Martin Lagonda	8
BYD	9
Coca-Cola	11



Ferrari	8
Hermes	14
Hertz Global Holdings	8
Innospec	9
LVMH	14
Mercedes	8
Meta Platforms	7, 16
Microsoft	7, 16, 18
Nvidia	7
Pfizer	7



Porsche	8
SAP	8
Tesla	7, 8, 9
Texas Instruments	21



Funds

Artermis Strategic Bond Fund Inc	33
Invesco Bond Income Plus	33

ETFs

iShares Core Global Aggregate Bond ETF	32
--	----

WHO WE ARE

EDITOR:
Tom Sieber
@SharesMagTom

DEPUTY EDITOR:
Ian Conway
@SharesMagIan

NEWS EDITOR:
Steven Frazer
@SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR:
James Crux
@SharesMagJames

EDUCATION EDITOR:
Martin Gamble
@Chilligg

INVESTMENT WRITER:
Sabuhi Gard
@Sharesmagsabuhi

CONTRIBUTORS:
Daniel Coatsworth
Danni Hewson
Laith Khalaf
Laura Suter
Rachel Vahey
Russ Mould

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

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

All Shares material is copyright. Reproduction in whole or part is not permitted without written permission from the editor.

DISCLAIMER

Shares publishes information and ideas which are of interest to investors. It does not provide advice in relation to investments or any other financial matters. Comments published in Shares must not be relied upon by readers when they make their investment decisions. Investors who require advice should consult a properly qualified independent adviser. Shares, its staff and AJ Bell Media Limited do not, under any circumstances, accept liability for losses suffered by readers as a result of their investment decisions.

Members of staff of Shares may hold shares in companies mentioned in the magazine. This could create a conflict of interests. Where such a conflict exists it will be disclosed. Shares adheres to a strict code of conduct for reporters, as set out below.

1. In keeping with the existing practice, reporters who intend to write about any securities, derivatives or positions with spread betting organisations that they have an interest in should first clear their writing with the editor. If the editor agrees that the

reporter can write about the interest, it should be disclosed to readers at the end of the story. Holdings by third parties including families, trusts, self-select pension funds, self select ISAs and PEPs and nominee accounts are included in such interests.

2. Reporters will inform the editor on any occasion that they transact shares, derivatives or spread betting positions. This will overcome situations when the interests they are considering might conflict with reports by other writers in the magazine. This notification should be confirmed by e-mail.

3. Reporters are required to hold a full personal interest register. The whereabouts of this register should be revealed to the editor.

4. A reporter should not have made a transaction of shares, derivatives or spread betting positions for 30 days before the publication of an article that mentions such interest. Reporters who have an interest in a company they have written about should not transact the shares within 30 days after the on-sale date of the magazine.