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RED HOT **TESLA**
COULD PUT **HUGE**
STOCK OFFERING
ON THE TABLE

BIDEN BECOMING
US PRESIDENT
COULD BE **BAD**
FOR **STOCKS**

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Investments



Biden becoming US president could be bad for stocks

It could lead to higher taxes, fewer share buybacks and lower corporate profits

Investors' ferocious appetite for tech stocks is helping to drive up the US stock market. The second quarter earnings season is now underway and could easily knock this rally off course if the tech companies disappoint with their earnings growth, profit margins or outlook, due to heightened expectations.

Whether that happens or not, there is a potentially much stronger force just around the corner which could truly derail markets and that's a Biden presidential election victory.

Markets may not be worried about such an event now, but this situation could change as we draw closer to the November vote. What happens to US markets typically sets the tone for investors in other parts of the world.

Donald Trump's tax cuts for individuals and businesses have been good for the US stock market as well as for companies doing business in the US and listed on foreign exchanges such as London.

Democratic presidential candidate Joe Biden currently has a lead in the election polls, according to Real Clear Politics, and he wants to reverse some of Trump's tax policies.

Corporate tax rates would go up, higher earners would pay more tax, many companies would see margins squeezed as the minimum wage is lifted, and a sharper focus on environmental issues would likely be negative for fossil fuel companies.

Biden has also shown a desire to make large companies pay more tax, including big tech firms. In a recent speech, he said: 'It's way past time we put an end to the era of shareholder capitalism. The idea the only responsibility a corporation has is with shareholders, that's simply not true, it's an absolute farce. They have responsibility to their workers, their community, to their country.'

Many US companies have used tax savings to buy



back shares which has in turn boosted returns for shareholders. A less favourable tax regime could therefore remove a major catalyst for stocks.

A report from investment bank Goldman Sachs suggests Biden's tax plans would cut earnings per share of S&P 500 companies by 12% in 2021, presenting another headwind for markets.

Trump's hard line on US trade talks with China may have contributed to a lot of stock market volatility before the pandemic and so a Biden victory could lift hopes of a better relationship between the two countries, although that is far from certain.

As it currently stands, Biden becoming the next US president has the potential to cause shockwaves in global markets. It might make investors reduce their US exposure and shift more attention to other geographic regions, thereby triggering a rotation away from a market that has delivered superior returns for the past decade and potentially looking at ones that have underperformed.

Given the UK still has considerable risks around Brexit trade deals investors may instead prefer to look at somewhere like Continental Europe. Germany's DAX index is down nearly 4% this year compared to an 18% gain from the Nasdaq in the US. That certainly looks like a good place to do some homework for investment opportunities before the money starts to travel from the US across the North Atlantic Ocean.



By **Daniel Coatsworth** Editor

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If you're a regular reader, you'll know that we often talk about dividends. That's because they can make a big difference to your long-term investments. Indeed, with more uncertainty in the area now, we invite you to revisit their role.

Making dividends work for you

If you're a shareholder in a company, you may receive a dividend from that company's profits – as a reward for entrusting it with your capital. As with all investment trusts, The Scottish's main source of income used to pay dividends to its investors are the dividends received from its portfolio of holdings. You may not be aware that we deliver one of the highest dividend yields in the AIC Global peer group. This is important because, in conjunction with share price movements, dividend income forms a substantial part of an investor's total return.

Compounding occurs as dividends are used to buy more shares which, in turn, earn dividends on their own. These reinvested dividends would then gain or lose in line with the movement of the share price. For example, over 25 years to 31 May 2020, the share price of The Scottish increased by 225%. The share price plus dividends taken as cash would raise this to 357% over the same period and, if those dividends had been reinvested, the total return would have been 497% (all before any dealing expenses). It's important to remember, of course, that markets can be volatile and shares (and the income from them) can go down as well as up.

Why a contrarian approach can pay dividends

As we've demonstrated, dividends can play an integral part in the return on your investments over the long-term. We're pleased to say that we've increased our regular dividend for the last 36 consecutive years which makes us a 'dividend hero' according to the AIC. Even in these unprecedented times, we stand firm in our intention to maintain our long track record of regular dividend growth, having recently announced that we will increase this year's dividend. However, as we have seen from many companies in the past few months, dividends are not guaranteed and they can fall as well as rise.

In this context, how does our contrarian style come into play? It guides us to look for what we call 'ugly ducklings' – unfashionable and unpopular investments. The share price of such investments typically reflects their 'unloved' status, often written off by other investors. By contrast, we research these companies to ascertain if they are ripe for improvement. Has there been a change in their business model, or to senior management? Are there nascent opportunities in the markets in which they operate? If we believe we can see a change, and the company

presents a credible plan for recovery, we'll consider investing. However, we also take a 'belt and braces' approach to our investment – which brings us back to dividends.

One of the things we may consider before investing in an 'unloved' company is if it has sufficient cash to pay dividends throughout its turnaround. As our approach is based on long-termism and patience, a sustainable dividend may make it easier for us to hold the stock while the business is recovering. A good example of this is our investment in US telecoms group AT&T. Deemed unexciting by many, we view the steadiness of this business as a virtue. It fits our 'unloved' criteria, because investors' expectations are low. The company has a credible plan to improve its fortunes. As we wait for positive development, we can enjoy the dividend – the belt to the braces.

“dividends can play an integral part in the return on your investments over the long-term”

What if a company doesn't pay a dividend?

If dividends are so useful, does that mean we'll shun companies that don't pay one? Not necessarily. When a company is putting its house in order, it might choose to stop paying a dividend, conserving its cash to allow it to improve the business (investing in new technology or changing its business model, for example). Indeed, this was the case with Tesco, which suspended its dividend before we invested. Tesco addressed areas of concern, made improvements to its business – then restarted its dividend. We see the reinstatement of a dividend as an important signal that a company's rehabilitation is underway.

As you can see, dividends can tell us a lot about a company's health – and its future prospects. We always pay close attention to a company's dividends when we're considering investing – both its ability to pay them and its track record of doing so, because dividends can make a tangible difference to long-term investors. ■

14 July 2020



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Red hot Tesla could put huge stock offering on the table

Debt could be wiped out leaving it stronger financially

Shares in Tesla have been on a tear this year, rallying right through the Covid-19 pandemic to close at record highs of \$1,544.65 on 10 July, posing the question of whether the company should take the opportunity to raise more cash.

At that price the stock had already jumped almost 43% in July alone, and is 269% higher so far in 2020. The Elon Musk-run firm is now the most valuable car company in the world.

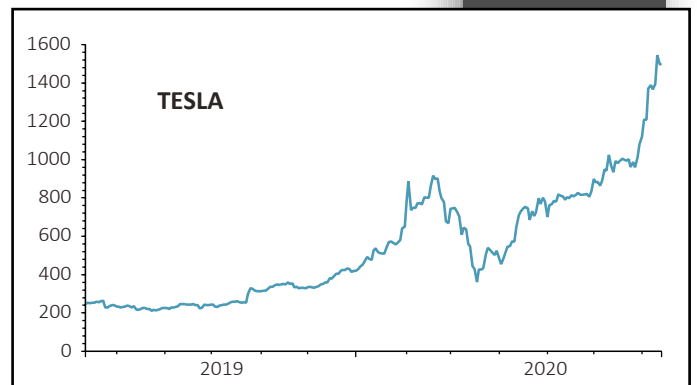
At \$277.5 billion it is worth as much as Toyota, Ford, General Motors and Fiat Chrysler put together.

This valuation puts stock on an astonishing next 12 months price-to-earnings multiple of 180.5, according to Refinitiv data.

Investors will continue to argue over the relative merits of the electric car and energy technology company, whether discounted future cash flows are the right way to value it, and if not, how else to do so.

But most investors would agree that companies should raise fresh funding when they can, not when they need to, and that could put a big stock offering on the agenda for Tesla.

A share placing could completely wipe all the debt off Tesla's books as well as leaving a giant pile of cash to fund operations and expansion years into the future. This would undermine some of the key



bear arguments against the stock.

About 7.5% of Tesla's shares are currently in the hands of short-sellers, aiming to profit from falls in the share price, a painful position to be in so far this year.

By offering up to 5% of the current 184 million shares in circulation, about 9 million new shares, at \$1,400 (a rough 6.7% discount) Tesla would raise approximately \$12.5 billion. This would limit dilution of existing shareholders at a time when there is evidently immense appetite for the stock, and provide huge financial firepower to support its growth plans.

Net debt is forecast at around \$4.14 billion by the end of this year, taking account of a \$2.3 billion stock offering carried out in February, although it is possible Covid-19 will impact this estimate. Tesla had \$7.15 billion of net debt at the end of 2019.



TESLA'S FREE CASH AND NET DEBT



	2017	2018	2019	2020*	2021*	2022*
Net debt (\$m)	\$6,947	\$8,286	\$7,151	\$4,135	\$2,260	\$2,186
Free cash flow (\$m)	-\$3,475	-\$2,922	\$968	-\$87	\$2,434	\$4,091

Source: Refinitiv to 31 December *Forecast

Fevertree shares fall on margin concerns

Post-Covid, investors seem more concerned with short-term profits than long-term growth

Shares in upmarket mixer supplier **Fevertree Drinks (FEVR:AIM)** fell flat on 14 July as investors focused on cautious comments regarding the firm's gross margin instead of its sales growth in its latest trading update.

Despite positive momentum in spirits and mixers in UK and US supermarket and convenience shop sales post lockdown, and the gradual reopening of the pub, hotel and restaurant trade across most regions since June, the firm advised that changes in its channel and geographic sales mix would create gross margin headwinds over the course of this year.

That was enough to send the shares down 5% to £22.95, reversing two days of strong gains.

After a solid start in January and February, the closure of the hospitality and leisure sector to Covid-19 meant that sales from March to June were almost entirely dependent on customers buying its products to consume at home, known as the off-trade.

Consultancy Nielsen estimates that the firm's UK off-trade sales grew 34% in the 12 weeks to 14 June, which Fevertree puts down to 'the popularity of long mixed drinks as an everyday affordable treat' during lockdown.

In the US, Nielsen data, which covers just under half of Fevertree's US off-trade business, said the company's sales rose by 89% in the 12 weeks to 13 June thanks to increased in-home consumption, revised pricing and format, and improved distribution.

Sales in Continental Europe were more problematic given the huge skew towards bar culture in countries such as Italy and Spain and the dominance of the on-trade (pubs, restaurants and hotels) as a result.

Also, uncertainty over how soon hospitality and leisure outlets would be able to reopen led some of its importers to destock, which amplified the negative impact on sales.



Despite these headwinds, the firm remains committed to its investment plan, including its sizeable marketing spend, and is looking for new ways to add value.

Along with the trading update, it announced the acquisition of Global Drinks Partnership, its sales agent in Germany.

Fevertree has worked with Global Drinks Partnership for seven years to build its presence in the German market, which it calls a 'notable opportunity' given its sheer size and the fact that the premiumisation trend in spirits and mixers – which has been such a key driver of its sales success in the UK and the US – is just beginning. Stockbroker Numis estimates premium mixers only accounted for 18% of the overall German mixer market at the end of 2019.

Buying Global Drinks Partnership with its established relationships is an important strategic move as it allows Fevertree to accelerate the strength and depth of its presence in Germany much faster than could have been achieved by building the same capabilities from scratch.

DISCLAIMER: The author Ian Conway owns shares in Fevertree.

US earnings season unlikely to add clarity to full year outlook

Stock and sector-specific factors will have a big impact on results

After US stocks racked up their best quarterly performance for 20 years in the three months to June, with the S&P 500 index gaining 20%, this month sees the start of the US reporting season.

According to Factset, the consensus forecast is for a 44.6% fall in second quarter earnings for the S&P 500, which if accurate would be the worst quarterly decline since the end of 2008 when earnings dropped nearly 70%.

It would also be the biggest fall in second quarter earnings since 1968, according to the *Wall Street Journal*.

First quarter earnings were expected to fall 7%, but they ended up falling 15% so analysts have slashed their second quarter estimates.

The problem is that with so many companies withdrawing guidance, the analysts are still flying blind. Just 22 companies in the S&P 500 issued positive second quarter guidance, while 27 companies issued negative guidance: normally more than twice as many companies issue quarterly forecasts.

This week saw reports from snack and fizzy drink maker PepsiCo on Monday, followed by banking giants JPMorgan and Wells Fargo on Tuesday.

PepsiCo was a clear beneficiary of lockdown, posting forecast-beating revenues due to a surge in sales of snack foods, while beverage sales slipped due to lower sales to restaurants and the food-service industry.

JPMorgan was the first of the banks to report and blew away forecasts thanks to strong trading revenues, which allowed it to provision \$1 billion more for bad loans than the market was expecting yet still beat estimates.

On the other hand, Wells Fargo – a major holding for legendary investor Warren Buffett – swung to its first quarterly loss in a decade as it provisioned

S&P 500 EARNINGS GROWTH: END OF QUARTER ESTIMATE VS ACTUAL GROWTH

Date	Estimate	Actual
3Q 2017	3.2%	6.5%
4Q 2017	11.0%	15.2%
1Q 2018	16.9%	24.7%
2Q 2018	19.7%	25.1%
3Q 2018	19.2%	26.1%
4Q 2018	12.1%	13.2%
1Q 2019	-4.1%	-0.3%
2Q 2019	-2.7%	-0.2%
3Q 2019	-4.1%	-2.2%
4Q 2019	-1.7%	0.8%
1Q 2020	-6.9%	-15.0%
2Q 2020	-44.6%	

Source: Factset, Shares

nearly \$10 billion for bad corporate loans. 'Our view of the length and severity of the downturn has deteriorated considerably since last quarter,' said chief executive Charles Scharf.

Like the UK, the US economy is dominated by service industries and consumption, with many companies and sectors dependent on government aid in the form of handouts for the time being.

Also, businesses which had to close during lockdown face extra costs to restart, so while the outlook for revenues might suggest a V-shaped recovery, earnings could take a lot longer to bounce back.

With luck the bar is so low this time that most companies will at least be able to meet forecasts, but it still seems unlikely they will be able to offer any more clarity on the full year.

Global company debt could jump by \$1 trillion in 2020

Already stretched company balance sheets face record levels of fresh borrowing

Global corporate net debt could jump by as much as \$1 trillion this year as companies grapple with the massive impact of the Covid-19 pandemic.

The stark warning comes from the Janus Henderson Corporate Debt Index, which studies the long-term borrowing trends of companies from around the world.

The report estimates that net borrowings (all debt less cash) globally could rise to \$9.3 trillion.

'Borrowing needs will be very large this year, even though

companies in our index are set to cut their dividends by \$140 billion to \$300 billion this year, are slashing share buybacks, putting acquisitions on hold and reducing capital expenditure,' the study states.

Even before the pandemic began company debts were on an upwards trajectory. Net borrowings around the world surged to a record \$8.3 trillion in 2019, according to Janus Henderson data, an increase of 8.1% year-on-year, 'easily the largest increase of any of the last five years'.



The UK's corporate borrowings rose by more than 9.5% in 2019, faster than the global average, reaching a record \$539 billion.

Vodafone's (VOD) acquisition of Liberty Global assets accounted for half of that increase, while **Royal Dutch Shell (RDSB)** borrowed heavily to help fund its \$15 billion dividend, a payout that was cut in April for the first time since the Second World War.

Halma's record profit streak set to end

But an impressive dividend growth track record is preserved for now

HEALTH, SAFETY AND environmental electronics equipment designer **Halma (HLMA)** says a 17-year track record of consecutive annual revenue and profit growth won't extend into next year.

The downgrade – with management suggesting pre-tax profit will drop between 5% and 10% in the financial year to 31 March 2021 – disappointed the market and sent

Halma
10-year total
return = 697%

Source: SharePad

the shares down more than 5% to £21.75 on 14 July.

This fall is worth keeping in perspective with Halma still within sight of the record high of £23.77 set in June and, assuming a 10% fall in earnings, trading on a forward price-to-earnings ratio of 49.7-times.

Over the last 10 years it has delivered a total return of nearly 700% according to SharePad,

covering share price gains and dividends. These gains have been underpinned by a successful strategy built on modest acquisitions and exposure to trends around health and safety regulation and demand for healthcare and life-critical resources.

Halma's order book continues to grow and revenue in the three months to 30 June was down just 4%. The dividend was lifted for the 41st consecutive year, up 5% to 15.7p.

B&M shares hit new record high as analysts upgrade forecasts

Will the variety goods retailer continue to outperform now lockdown is easing?

Shares in **B&M European Value Retail (BME)** have just hit a new record high of 439.9p following a materially better than expected first quarter that included a welcome uptick in June trading. The update led analysts to upgrade their earnings forecasts for the year, acting as a share price catalyst.

Price-conscious shoppers have warmed to the essential goods retailer's core B&M UK chain, which sells a variety of goods from mostly out of town locations where it is easier to shop safely.

But with non-essential rivals having reopened, and given the structural shift to online and the impact of social distancing, will B&M be able to keep hold of its recently secured market share gains?

For the first quarter to 27 June, like-for-like sales in the B&M UK business grew 26.9% amid broad-based growth across grocery and non-food products, while group revenue grew 27.7% to north of £1.15 billion.

With people stuck at home, cut-price general merchandise purveyor B&M has benefited from bumper sales of everything from groceries and fast-moving consumer goods to DIY and gardening and home products.

Quilter Cheviot analyst Amisha Chohan believes B&M is winning market share, has attracted a new middle-class client base and as a business will continue to outperform peers especially in a

recessionary environment.

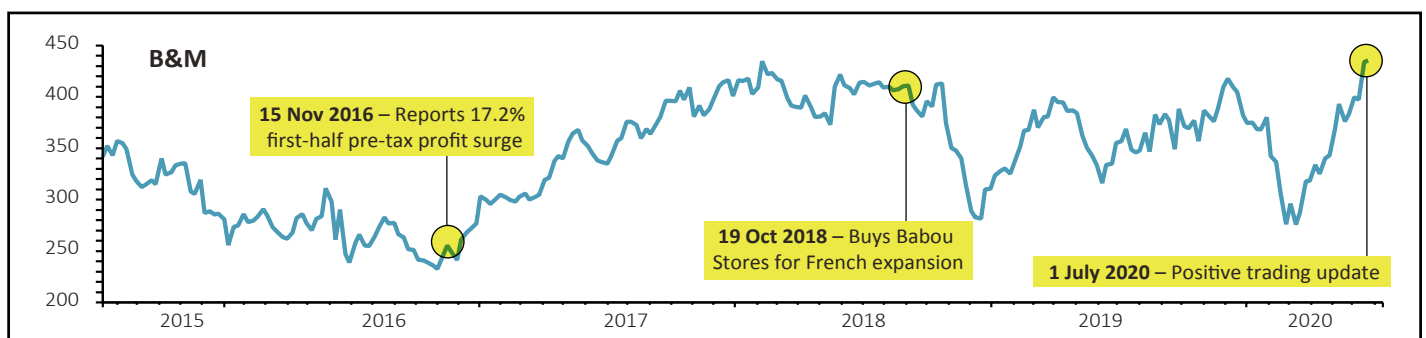
Being a discounter, B&M's appeal is strengthened when large sections of the population are worried about their personal finances or are having to live within straitened household budgets.

B&M UK stores are increasingly in high quality locations and are not dependent on shopping malls or anchor department stores to generate footfall.

An additional strength is the breadth of B&M's product range, which delivers a balance to the retailer's financial performance from year to year and allows the company to absorb downturns in any one product category.

In the first quarter update, chief executive Simon Arora stuck with his cautious outlook, pointing to 'a great deal of uncertainties ahead'. While the high street has reopened, footfall remains muted with many consumers cautious about Covid-19 and/or continuing to work from home and ordering their goods online.

While the backdrop is testing, Shore Capital believes B&M is firmly in the retail survivor camp and remains a well-managed company with good cash generation and tight stock and cost controls. However, the broker noted the continued cautious outlook with uncertainties from the pandemic. It said: 'It remains to be seen how long the social distancing rules will remain in place and what impact this will have on (B&M's) peak trading this Autumn.'



Hidden in full view



FIDELITY JAPAN TRUST PLC

This investment trust uses local know-how to spot Japan's untapped potential.

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Nicholas Price and our team of analysts hone in on stocks often not picked out by others.

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To find out more, go to [fidelity.co.uk/japan](https://www.fidelity.co.uk/japan) or speak to your adviser.

PAST PERFORMANCE

	May 15 – May 16	May 16 – May 17	May 17 – May 18	May 18 – May 19	May 19 – May 20
Net Asset Value	9.9%	26.7%	31.4%	-12.0%	20.1%
Share Price	2.9%	30.1%	40.6%	-13.7%	24.8%
TSE Topix Total Return Index	2.4%	29.0%	13.8%	-6.4%	9.1%

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 31.05.2020, bid-bid, net income reinvested.

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Play the healthcare boom via 'best in class' UDG

The outsourcing expert is fighting fit to grab market share while rivals struggle

The global healthcare pandemic has increased awareness of diseases and the threat they pose to public health as well as economic activity. This has spurred the pace of drug discovery with an increasing number of new drugs in trials and provides a supportive backdrop for **UDG Healthcare (UDG)** to capture growth.

UDG provides outsourced services to over 300 healthcare companies and smaller biotech firms. It is active across the whole spectrum of health services such as helping firms bring new products to market and supporting patients to access medications.

It has two divisions: Ashfield provides advisory, communications and commercialisation services and generates just over two thirds of group operating profit, while Sharp is a leader in contract clinical trials, manufacturing and packaging.

Investment bank Berenberg estimates that roughly 20% of the company's profits are affected by the pandemic, relating to sales reps' work restrictions and face-to-face meetings. Sales reps have since come off the government support schemes in Belgium while Germany is showing signs of improvement and the same is expected in the UK later in the summer.

The 80% of the business not

**UDG
HEALTHCARE**

BUY
(UDG) 694p

Market cap: **£1.7 billion**

affected is showing good demand although lower expected levels of activity led the group to withdraw its earnings guidance for the rest of the year.

Low leverage will allow the company to continue deploying \$100 million to \$200 million on two or three acquisitions a year. Net debt-to-earnings before interest, tax, depreciation and amortisation (EBITDA) is 0.3-times.

UDG is classified by Berenberg as a 'best in class' company. It says such businesses can trade on higher than average valuations, but they can scale and compound high returns over many years, thus deserving a premium rating. UDG trades on 20 times forecasts earnings for 2021.

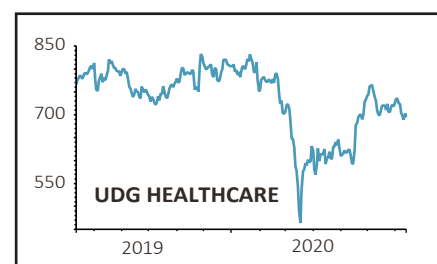
Operating profit has grown at a compound annual growth rate of 14% over the last five years. Before the pandemic management targeted underlying operating profit growth of between 5% and 10% a year with supplemental acquisitions on top.

The total addressable market across all segments is estimated

to be around \$30 billion a year and with UDG's 2019 revenues of \$1.3 billion implying a market share under 5%, there is plenty of runway to maintain good growth and deliver shareholder value.

'Healthcare spending will increase as awareness in defeating diseases and combating health crises rises,' says Berenberg. 'Pharmaceutical companies will increasingly rely on outsourcing partners to manage complexities and improve flexibility.'

'UDG's strong balance sheet will leave management with sufficient power to further consolidate the market. Smaller, more inefficient and more levered competitors will likely struggle over the coming months, providing UDG with opportunities to deploy capital for the right acquisitions.'



Buy care home investor Target Healthcare for a 6% yield

A focus on quality assets with single occupancy rooms and en-suite facilities should serve it well

The care home sector has clearly suffered a devastating impact from coronavirus but the need for quality accommodation for older, vulnerable people has arguably never been greater.

We think investors should buy **Target Healthcare REIT (THRL)** which is growing its portfolio of purpose-built assets and offers a highly attractive yield of 6.2%.

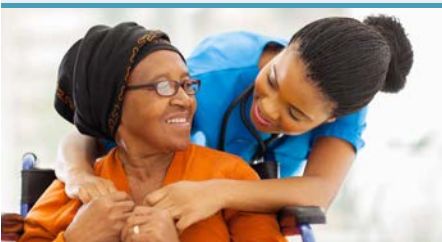
While not quite as secure as the income on offer from the GP surgery and primary healthcare facility space, occupied by the likes of **Assura (AGR)** and **Primary Health Properties (PHP)**, this situation is reflected in dividend yields from the investment-related care home sector being slightly higher to compensate for the extra risks.

For way of comparison, the effectively government-backed income stream from Assura and Primary Health is available at a significantly lower yield of around 3.5%.

Unlike sector peer **Impact Healthcare (IHR)**, which trades at an 8.6% discount to net asset value (NAV), Target trades a smidge above its NAV of 106.3p. However, we think this premium is justified by its longer track record and bias towards assets which are particularly well-

**TARGET HEALTHCARE
REIT** **BUY**
(THRL) 106.8p

Market cap: **£488.6 million**



positioned in a post-coronavirus future when there is likely to be significant emphasis on infection control.

Its facilities are focused on single occupancy units with full en-suite wet rooms. Stockbroker Numis says by design these promote enhanced infection control and allow for effective isolation.

Care home demand is driven by long-term demographic changes as the UK's population gets older and this helps underpin long leases with upwards-only, inflation-linked rental growth.

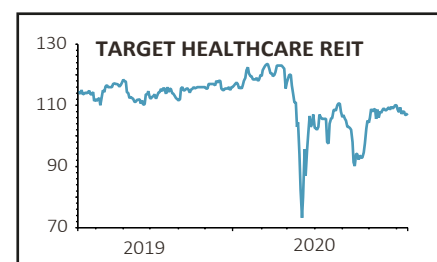
A recent rent collection update from Target suggests its income stream remains relatively secure. On 6 July it reaffirmed its dividend having collected 96% of rent due. The 4% outstanding is subject to what are described

as 'active asset management initiatives' which in effect is likely to mean bringing in new tenants.

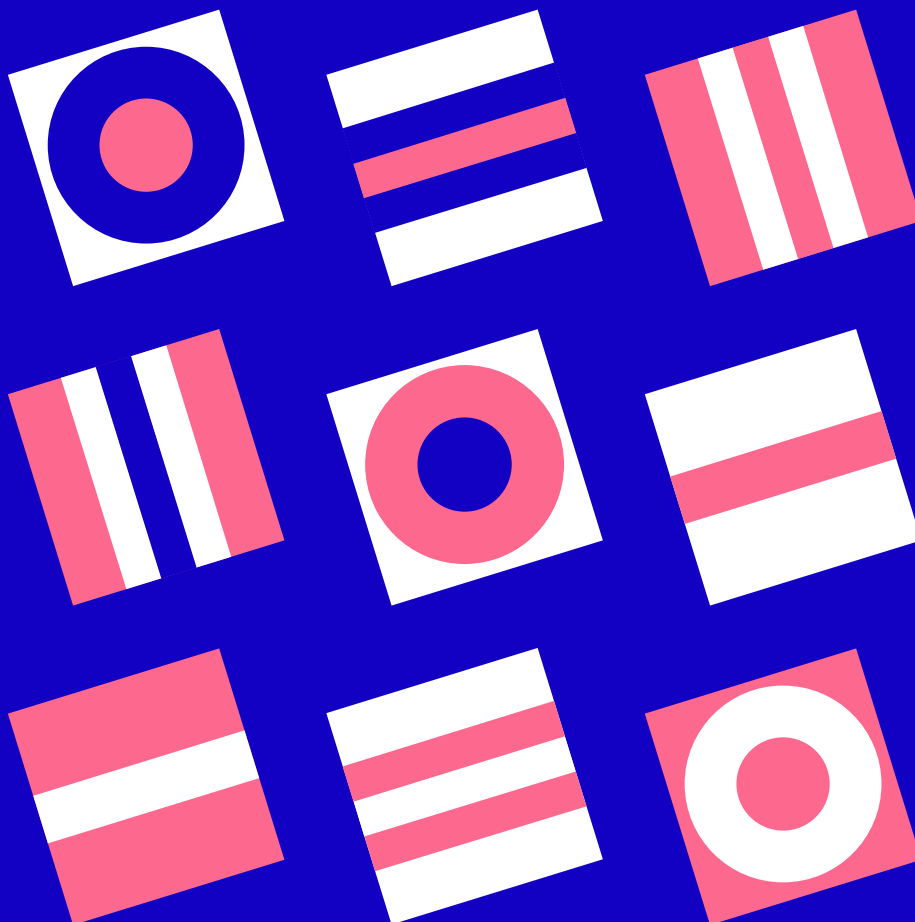
Tenants running into financial problems is clearly a risk, particularly in the short term as they are forced to adjust to increased costs and disruption associated with Covid-19. However, Target has a good track record of dealing with issues when they arise.

For example, in September 2019 Orchard Care Homes announced its intention to exit six homes leased to the group and Target managed to re-tenant the properties with no interruption to residents, limited impact on rental income and a modest increase in property value.

The trust recently demonstrated its confidence in the outlook by resuming acquisitions, agreeing the purchase of a new-build 66 bed care home in Oxfordshire for £15 million. This will be let to its largest existing tenant, Ideal Care Homes.



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HIPGNOSIS SONGS FUND

(SONG) 121.5p

Gain to date: 5.2%

Original entry point:

Buy at 115.5p, 18 June 2020



BETTER THAN EXPECTED demand for investment trust **Hipgnosis Songs Fund's (SONG)** equity placing has seen it raise £236.4 million by issuing new stock at 100p per share. Of that amount, £3 million came from retail investors.

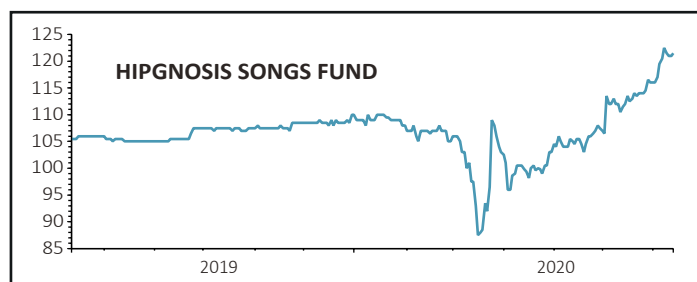
Hipgnosis originally set out to raise £200 million to buy more song catalogues. It makes money from royalty payments and has a £1 billion pipeline of potential acquisitions.

The new shares will trade separately to the existing ones until one month after a minimum 80% of the new money is deployed or the close of business on 15 July 2021, whichever is earliest.

Investors in these 'C' class shares will qualify for dividends from any income generated from investments using the new cash.

The C shares will eventually be converted into ordinary shares and so anyone owning the C shares will then benefit from having exposure to a much broader catalogue of royalty-generating songs.

Hipgnosis wants shareholders to vote at the September AGM on changing the conversion date so that it is linked to the semi-annual net asset value calculation. Under the proposed changes, the latest calculation date would be 30 September 2021 and the latest conversion date would be 28 February 2022.



SHARES SAYS: ↗

Hipgnosis now has a large chunk of cash to buy songs and increase their value through film, advert and TV placements. Buy the ordinary shares, not the C ones.

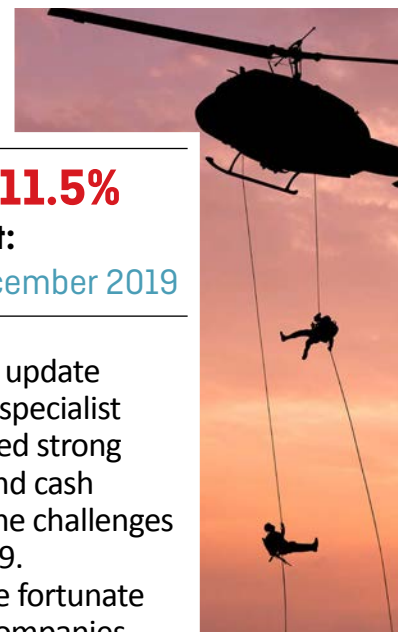
QINETIQ

(QQ.) 301.7p

Loss to date: 11.5%

Original entry point:

Buy at 341p, 12 December 2019



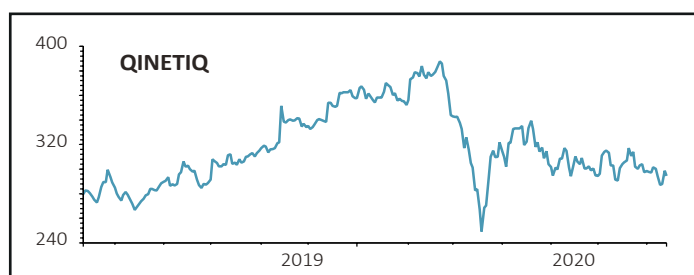
IN A RECENT trading update defence and security specialist **QinetiQ (QQ.)** reported strong first-quarter orders and cash generation, despite the challenges presented by Covid-19.

QinetiQ is in a more fortunate position than some companies because it provides mission critical services to governments on long-term contracts, which are deemed essential and which helped keep the work flowing despite widespread global restrictions aimed at tackling the pandemic.

In addition 2019's acquisition of US-based advanced sensor solutions provider MTEQ ensured revenues pushed ahead despite some delays in customer deliveries.

The strategy to internationalise the business and focus on mission-led innovation made good progress over the last few months with new contracts won in the US and Australia.

With data intelligence and analytics becoming more crucial in modern warfare, the £25 million acquisition of data and cloud specialist Naimuri, announced with the trading update, looks like a good fit. The company provides services to the UK intelligence and law enforcement communities and has worked alongside QinetiQ on several programmes.



SHARES SAYS: ↗

QinetiQ continues to deliver on its growth strategy and remains a buy.

OCADO

(OCDO) £20.20

Gain to date: 70.2%

Original entry point:

Buy at £11.87, 25 July 2019

ONLINE GROCERY DELIVERY

and fulfilment systems firm

Ocado (OCDO) is looking at

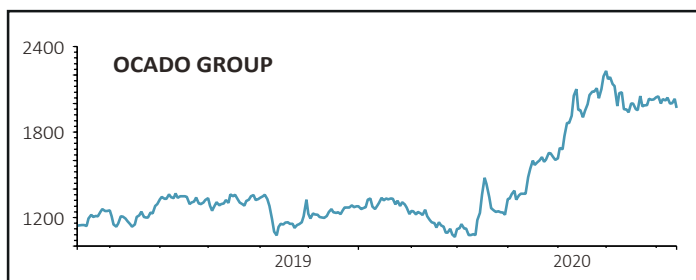
'a scale of opportunity that we have never seen before' according to chief executive Tim Steiner.

With Covid-19 having accelerated the take-up of online shopping by years, Steiner believes there has been 'a permanent redrawing of the landscape of the grocery industry worldwide'.

The firm's UK delivery business saw sales increase by 23% to £1.02 billion in the six months to May, while earnings before interest, taxation, depreciation and amortisation (EBITDA) rose by 87% to £46m, which analysts at Peel Hunt say demonstrates 'very strong operational leverage' and shows potential customers the gains they could enjoy if they bought Ocado's technology.

The overseas business helps third parties set up and run online fulfilment centres using Ocado's technology platform. This part of Ocado billed its partners for fees of £74 million, a 58% increase as the first two overseas customer fulfilment centres (CFCs) opened in Paris and Toronto. But continued investment in CFCs and its own technology led to group pre-tax losses of £40.6 million against a loss of £147.4 million last year.

The UK joint venture with **Marks & Spencer (MKS)** is due to go live in less than three months.



SHARES SAYS: ↗

Ocado has a winning formula and first-mover advantage, and the opportunity in front of it is monumental. Keep buying.

MOTORPOINT

(MOTR) 241p

Gain to date: 26.8%

Original entry point:

Buy at 190p, 14 May 2020



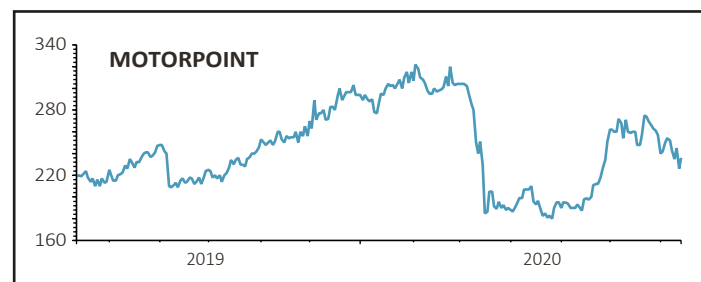
OUR POSITIVE stance on second hand car specialist **Motorpoint (MOTR)**, based partly on a return to work tailwind, is a bumper 26.8% in the money.

And we are staying positive on the nearly new vehicle seller given its strong balance sheet and scope for further market share gains.

Full year results (14 Jul) reflected the impact of the Covid-19 crisis and the subsequent lockdown on the key March trading period, with site closures behind a 15.3% drop in pre-tax profit to £18.8 million. Motorpoint understandably decided to pull the final dividend.

However, the positive news was Motorpoint's encouraging restart post lockdown, with current trading stronger than anticipated and ahead of the same period last year, margins said to be robust and cash levels significantly ahead of the year-end balance and trending positively.

At this stage, it is too early in the unlocking process to decipher whether recent weeks reflect pent up demand or a return to more normal trading conditions, but Motorpoint is seeing strong web traffic and has also invested for the post-coronavirus future via a move towards automation with fully contactless sales routes.



SHARES SAYS: ↗

Keep buying.

LUCECO

(LUCE) 128p

Gain to date: 10.3%**Original entry point:****Buy at 116p, 19 December 2019**

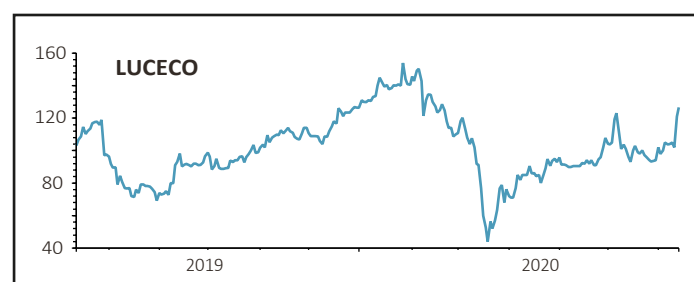
BROKER NUMIS has upwardly revised its forecasts for **Luceco (LUCE)** for the second time in barely a month after the LED lighting and portable power products maker said that trading was materially ahead of current analyst expectations.

Luceco said adjusted operating profit would at least equal its 2019 performance of £18 million, sending shares in the business soaring more than 25%. It also expects to restart dividends for the first half of the current financial year, having axed the second half 2019 payout.

Numis analyst Kevin Fogerty has recalculated his full year to December 2020 estimates to reflect the strength of current trading momentum, having done similarly in early June.

His adjusted operating profit estimate has been lifted by 16.5% from £16.9 million to £19.7 million. That's just £0.8 million shy of his £20.5 million 2020 forecast pencilled in before the Covid-19 outbreak, illustrating how Luceco has quickly bounced back from coronavirus-related business disruption.

'Our current year adjusted earnings per share (EPS) forecast increases by 23% to 9p,' the analyst confirmed. His pre-Covid EPS estimate stood at 8.9p. Forecasts for 2021 were also raised around 13%.

**SHARES SAYS: ↗**

Management has done an exceptional job during the pandemic and we are confident in the shares' scope for further gains.

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What a looming UK jobs crisis means for stocks



By Tom Sieber
Deputy Editor



Significant redundancies are being announced by employers in the wake of coronavirus

The UK is on the cusp of a serious unemployment crisis. In recent weeks thousands more job cuts have been announced by major employers and the real pain is probably still to come with the conclusion of the furlough scheme in October.

Widespread unemployment, expected to hit levels not seen since at least the 1990s, will impact the stock market in several ways.

First there is the question of what major redundancies will mean for individual companies and second, for the UK jobs lost, there is the read-across to shares which are exposed to the consumer economy.

In June think-tank The Institute of Employment Studies observed that the number of claims for work benefits had risen by 1.6 million since March. By its reckoning this is a faster rate than was seen during the Great Depression in 1929.

Recent updates from recruitment agencies aren't that encouraging either. **PageGroup (PAGE)** saw UK gross profit fall 62% year-on-year between April and June. Both PageGroup and its peer **Robert Walters (RWA)** have announced job cuts of their own – 531 and 200 respectively in the second quarter.

VICIOUS CIRCLE

If people are out of work, they will not have the disposable income to spend on non-essential items, or to go out for food, drink

Some of the big job cuts announced so far

HSBC - resumption of plan to cut 35,000 jobs worldwide – 'meaningful number' in UK

BP - 10,000 global job cuts, reported to be 2,000 in the UK

Rolls-Royce - 9,000, including 3,000 in the UK

SSP - 5,000

Centrica - 5,000

Boots - 4,000

Travis Perkins - 2,500

Johnson Matthey - 2,500

Royal Mail - 2,000 management roles

John Lewis - 1,200



or entertainment, hampering the recovery of hospitality, leisure and retail businesses already reeling from lockdown.

The danger is that we see a vicious circle with a drop in demand for these sectors leading to more job losses for the firms which operate in them, thereby feeding into further reductions in demand.

Makers of consumer staples such as **Unilever (ULVR)** and **Reckitt Benckiser (RB.)** and supermarkets should be better positioned as they sell essential items. However, investors will need to watch carefully for any signs that shoppers are trading down to non-branded goods or switching from their usual supermarket option to a cheaper alternative.

The measures announced in Chancellor Rishi Sunak's mini-Budget (8 Jul), including a £1,000 bonus for companies who retain currently furloughed staff and a discount for going to a restaurant in August, seem unlikely to do much to change the general trajectory of the jobs market.

The unemployment picture could even outweigh the benefit to the housing market from an increase in the stamp duty threshold to £500,000.

You also need to consider the potential disruption from Brexit at the end of the transition period on 31 December 2020.

'REAL CHALLENGE' WHEN FURLOUGH ENDS

In response to measures introduced by Sunak, Andreas Billmeier, sovereign research analyst at fixed income investment manager Western Asset, said: 'The overall envelope (announced by Sunak) is not particularly large by international comparison and effective spending will be markedly below the headline number.

'We think that the real challenge will come when the furlough scheme runs out, and structural change in the economy due to this pandemic but also the fallout from Brexit could cause a marked increase in the unemployment rate. We don't think the announced retention bonus will have any impact on those structural forces.'

The impact on share prices when job cuts are announced

In ordinary times firms might expect job cuts to be received positively by the market because it signals cost savings which are beneficial to profits. However, there are reasons why we have seen a different response as businesses react to the coronavirus crisis.

First, it's worth noting that recent news on jobs will have probably been accompanied by disappointing updates on trading which will have in turn influenced the share price reaction.

That speaks to the reality that these are not proactive cuts being made to a bloated workforce by new management intent on creating a more efficient business. These are companies being forced to react to a major and sharp drop in demand.

There are tangible upfront costs to redundancy programmes as departing staff get the financial packages owed under their contracts and less immediately perceptible long-term costs. These include a potential dilution of the quality of a group's product or service as they lose skilled employees.

When *Shares* spoke to **Reach (RCH)** chief financial officer Simon Fuller in the wake of an update revealing the loss of 550 roles at the newspaper publisher, he was adamant the cuts wouldn't impact the distinctiveness and quality of its regional and national titles. However, a double-digit decline in the share price on the news suggests investors weren't necessarily convinced.

Other issues to consider with companies cutting jobs is that there are future costs to hiring and training new staff to replace those lost at a time of acute financial pressure if and/or when demand returns.

HOW STOCKS HAVE REACTED TO JOB CUT ANNOUNCEMENTS

Company and date job cuts announced	Share price performance on day cuts were announced
Restaurant Group (3 June)	13%
EasyJet (28 May)	4%
Rolls-Royce (20 May)	2%
BP (8 June)	1%
Travis Perkins (15 June)	-1%
SSP (1 July)	-2%
Aston Martin (4 June)	-3%
Centrica (11 June)	-4%
Johnson Matthey (11 June)	-7%
Royal Mail (25 June)	-12%
Reach (7 July)	-14%

Source: Shares, SharePad

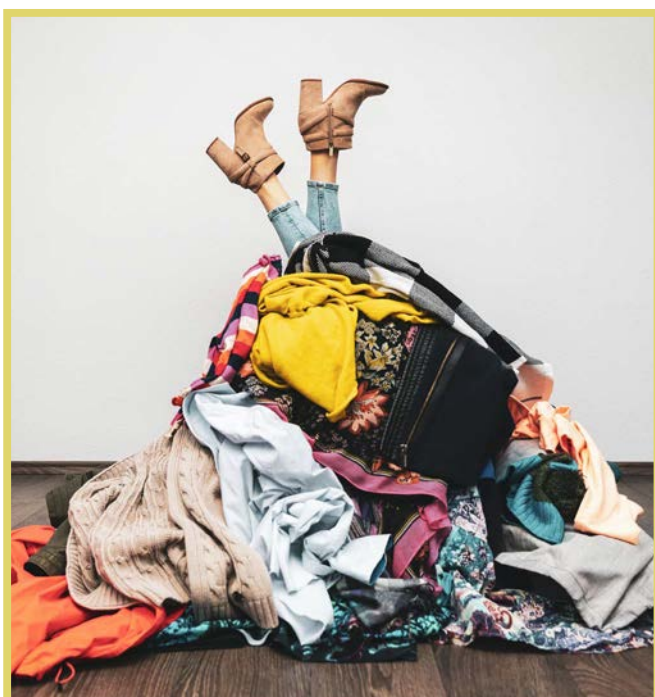
ETHICAL INVESTING 1

BOOHOO 0

Why investors are no longer standing for **poor behaviour**



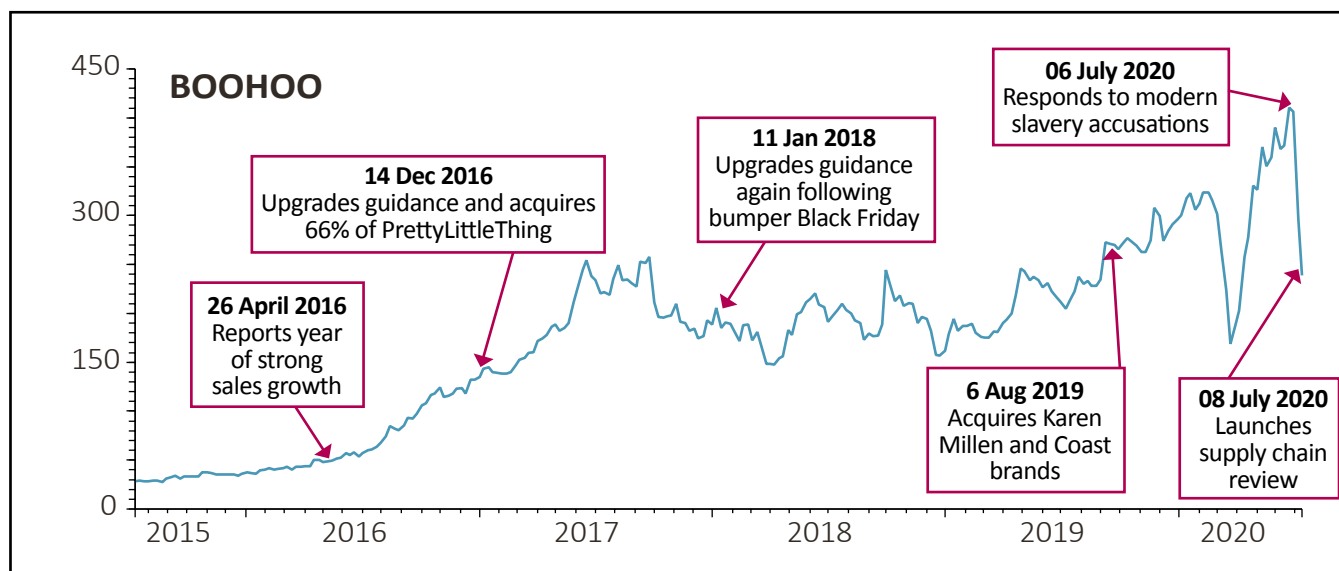
By James Crux
Funds and Investment Trusts Editor



Shares in once high-flying **Boohoo (BOO:AIM)** have fallen by 44% so far in July with professional fund managers and retail investors losing patience with the online fashion group's poor ESG (environmental, social and governance) practices.

Shares believes the Boohoo blow-up sets a precedent for how investors will react to the next company that messes up in terms of ESG factors.

The increasingly ESG-principled investment community simply isn't going to stand for poor practices in terms of governance, sustainability and the treatment of employees. It will turn bearish on a stock that breaches ESG guidelines in a heartbeat, ejecting the name from portfolios, institutionally and retail managed alike.





HOW BOOHOO MESSED UP

The ESG theme is heavily in demand with investors, particularly among the millennial cohort, who are concerned about the fate of the planet and wish to invest their money with companies that are trying to make the world a better place.

The key catalyst for the Boohoo share price collapse was allegations that workers at factories supplying its clothes are paid less than the minimum wage and weren't adequately protected from coronavirus; a charge of complicity with modern slavery in effect.

These claims only compounded concerns over Boohoo's actions in buying companies from connected parties and the egregiously large incentive plans put in place for directors.

Selling cut-price clothing, while at the same time making a decent margin, is a volume business. It necessitates a hard-nosed approach to costs. We're in no position to point fingers, but the fast fashion industry is an area of the market ESG-focused investors need to keep an eye on.

FASHION INDUSTRY DISASTER

Owned by **Associated British Foods (ABF)**, Primark has been one of the fashion retail industry's major success stories, but its reputation was sullied by the 2013 collapse of an eight-story commercial building, Rana Plaza, in Bangladesh.

Primark sourced from New Waves Bottoms, a supplier operating in Rana Plaza which contained five clothing factories. Most of the people in the building at the time of the collapse were garment workers and more than 1,100 people died, with many more left with life-long debilitating injuries.

Reports suggested the lowly-paid workers had

been ordered into the building on the day of the disaster despite cracks in the building having been reported just the previous day.

Post-Rana Plaza, the clothing industry's deadliest accident, ESG-cognisant consumers probably asked themselves how a T-shirt costing as little as £2 could ever be responsibly made.

Primark deserves credit for the numerous steps it has taken to become more responsible and more vocal concerning its commitments to producing responsible fashion in the wake of Rana Plaza.

Among the first retailers to sign the Accord on Fire and Building Safety in Bangladesh, the discounter was also one of the first to ensure the factory victims and families affected by the collapse received financial support and food aid immediately following the disaster.

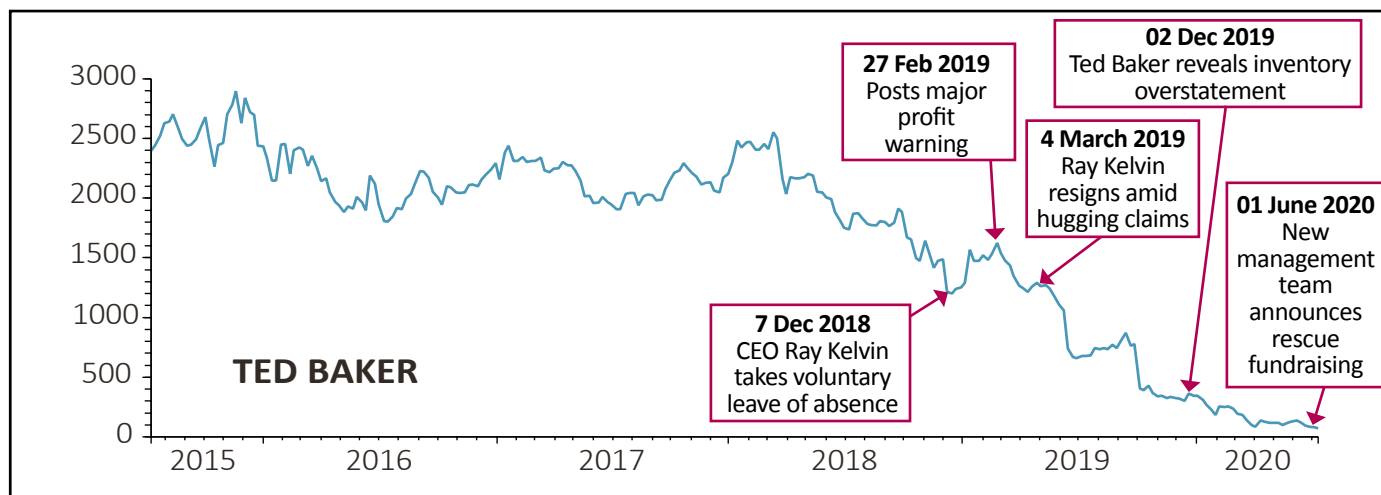


Poor ESG practices aren't restricted to the fast fashion sector. At the luxury end of the spectrum, **Burberry (BRBY)** has previously drawn the ire of the ESG crowd for burning millions of pounds worth of unsold clothes to protect its upmarket brand, although the trench coats-to-cashmere scarves purveyor has garnered plaudits for obtaining energy from renewable sources and its coronavirus relief efforts are commendable.

Burberry retooled its Yorkshire factory to make gowns and sourced surgical masks through its global supply chain, life-saving initiatives that ESG-principled investors shouldn't forget once the pandemic has passed.

WHY INVESTORS TURNED TED(DY) BEARISH

Before Boohoo, quirky British fashion label **Ted Baker (TED)** offered an exemplar of how a strong brand built over decades can be swiftly impaired when ESG principles are breached.



Shares in Ted Baker approached the £30 mark in 2015, yet a sharp downswing in fortunes leaves them swapping hands at a shredded 69p today. This demonstrates just how brutal shareholder value destruction can be when a business unravels.



Ted Baker's stock market value was unstitched over time by a string of profit warnings around margin pressures, competition, weak consumer spending and an unhelpful exposure to the structurally challenged department store sector.

These external factors were masking deep-rooted internal problems that had set the demise of the business in motion.

More recently, the market was spooked by the departure of dominant founder and CEO Ray Kelvin in 2019; though denied by Kelvin, 'hugging' claims made by some employees didn't sit well with shoppers, especially in the #MeToo era.

Also weighing on sentiment were the internal controls and governance issues that led to a material inventory miscalculation that proved the previous management didn't have a firm grip on the numbers.

Once regarded as one of retail's high-quality

names, bombed-out Ted Baker is now very much a contrarian trade from an investment perspective.

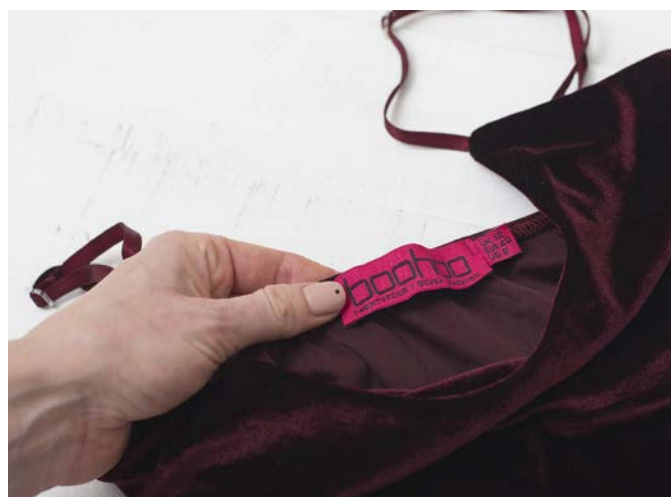
A new management team, led by chief executive Rachel Osborne, has outlined a bold turnaround strategy dubbed 'Ted's Formula for Growth', which includes ambitious sales and profit targets and demonstrates faith in the future of the brand.

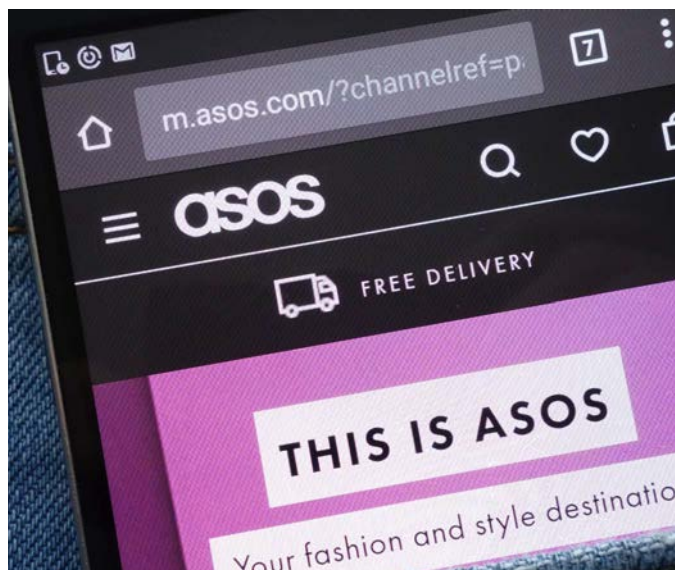
Analysts at Liberum Capital say the near-term focus for management will be on fixing the internal ways of working, reorienting the supply chain and taking cost out of the business.

BOOHOO BACKLASH BEGINS

A few short weeks ago, digital fast-fashion purveyor Boohoo was being applauded for continuing to grow during the pandemic.

It had (seemingly) wrong-footed short-seller ShadowFall too, by bringing forward the acquisition of the remaining 34% minority stake in PrettyLittleThing from Umar Kamani, the son of Boohoo co-founder and executive chairman Mahmud Kamani, and Paul Papworth.





Despite poor corporate governance manoeuvres including this connected party transaction, and criticism over an incentive scheme that would see directors share £150 million based only on share price performance and with no shareholder vote, investors bid the shares up to new record highs.

The tide turned following a weekend expose in *The Sunday Times*, which reported that workers at one of Boohoo's Leicester suppliers were being paid as little as £3.50 per hour.

There were further allegations that workers were forced to work throughout the COVID-19 lockdown without social distancing measures being implemented or protective equipment available.

ASOS (ASC:AIM), Next (NXT) and Zalando then dropped Boohoo's brands from their websites, although Boohoo bulls pointed out that 95% of its sales are made through the online fashion firm's own websites.

Boohoo said it would launch an immediate independent review of its UK supply chain, £10m would be invested into the supply chain to improve ESG credentials and it would further boost its internal audit structures led by ethical specialist Verisio and bureau Veritas. It also committed to appointing two new non-executive directors to beef up the board. Ironically, it said it would pay close consideration to any candidates who had proven skills in dealing with ESG issues – a little too late, perhaps.

All these steps could start to help rebuild confidence that Boohoo intends to do the right thing. Chief executive John Lyttle said the board was 'deeply shocked by the recent allegations about the Leicester garment

industry' and reiterated how 'seriously we are taking these matters'.

Boohoo stressed it would not hesitate to terminate any relationships where non-compliance with its code of conduct is found, adding: 'Our commitment to an incremental £10 million of investment demonstrates our resolve to enforce the highest standards of ethics, compliance and transparency for the benefit of all garment workers.'

BOYCOTTING BOOHOO – THE POWER OF INFLUENCERS

Despite this statement, long-run fan Shore Capital said it was time to sell the shares, pointing out that Boohoo's sales will be impacted by not being on the ASOS, Next and Zalando websites in the short term.

The broker also drew attention to a surge in social media hashtags including '#BoycottBoohoo' and highlighted that millennial consumers are interested in sustainability as well as business ethics.

Social media can help build a brand very quickly as influencers show off a company's products. However, the reverse is also true.

A social media backlash is now building against Boohoo, with Instagram influencers and former brand collaborators Jayde Pierce and Vas Morgan having turned their backs on the company.



Negative headlines could also heighten awareness over the very nature of the fast fashion model and low-ticket price tags, which mean customers can buy clothes, wear them once and then chuck them in the bin, which is hardly ethical.

Shore Capital also questioned the impact on the cost base, wondering whether Boohoo had been experiencing input prices for goods that might be no longer sustainable. 'This may put pressure on gross margins and prices could rise, which would negatively impact their competitiveness,' it said.

The broker also warned that Boohoo had to deliver the outcome of its own investigations and it faces the potential of external enquiries

such as a possible police investigation. 'Until the outcomes are better understood, the stock feels less than appetising for many investors and may be totally off limits for many ESG funds for now,' added the broker.

We share this conclusion. Do not be tempted by the shares trading on a much lower rating than historically. We believe the reaction to Boohoo's situation is proof that ESG principles are front and centre for investors and the retailer's name is now mud.

Investors' attitudes are changing and any company who messes up on any of the E, S or G factors will be punished in the form of a plunging share price.



ESG CHECKLIST – BOOHOO & TED BAKER



BOOHOO	Verdict - Very poor
Environmental	✗ Sells disposable fashion wares
Social	✗ Alleged links to modern slavery
Governance	✗ Related party transactions and egregiously generous incentive schemes



TED BAKER	Verdict - Must do better
Environmental	✗ E-commerce business creates waste
Social	✗ Hugging allegations suggest cultural problems
Governance	✗ Accounting error points to lax internal controls



Russ will return next week.

Russ Mould's column will return on 23 July

Fundraisings underline investor preference for long-term growth

Firms with strong franchises have been the most successful in raising capital

So far this year UK companies have tapped investors for a record £15.7 billion of cash through 217 share placings, according to AJ Bell investment director Russ Mould.

‘The question for investors is whether this rash of fundraisings is a threat, an opportunity or somewhere in between,’ he says.

The answer to that question depends on who’s asking for the money. Firms with a strong proposition, and which are perceived to be ‘winners’, have used the crisis as an opportunity to steal a march on their rivals by bullet-proofing their balance sheets or building their war chests.

Those with a weaker franchise have had to go cap in hand to their shareholders often just to keep from breaching their banking covenants and remain a ‘going concern’.

BACK UP THE TRUCK

The biggest cash raise by far was global food service firm **Compass (CPG)**, which snaffled up £2 billion at a slim 3% discount to its-then market price. It did so to strengthen its balance sheet and liquidity position, ‘reducing leverage to deal with the challenging environment and ensure the



EXAMPLES OF COMPANIES RAISING NEW CASH

Company	Amount	Discount	Purpose
Anexo	£7.5m	9.1%	VE emissions cases
Aston Martin Lagonda	£688m	25.0%*	Surviving lockdown
Carnival	\$500m	9.1%	Surviving lockdown
Compass	£2 billion	3.3%	Consolidation post pandemic
EasyJet	£419m	5.0%	Surviving lockdown
Whitbread	£1 billion	47.2%	Growth post-pandemic

Source: Shares. *Best estimate given two placings at different times

company remains resilient in the event of further negative developments in the pandemic’.

This was despite Compass scrapping its full year earnings and margin guidance, and already having £2.8 billion of committed credit facilities. Investors clearly bought into the story that the cash would be used to enhance its competitive advantages and consolidate its position, likely through acquisitions.

Also, as Mould observes, Compass is ‘at the top of the food chain and its smaller rivals don’t have the luxury of tapping the capital markets for billions in

fresh liquidity’.

Another big cash raise was also in the hospitality sector, with hotel and restaurant firm **Whitbread (WTB)** gathering £1 billion of cash ‘to ensure that the company emerges from the pandemic in the strongest possible position to take advantage of its long-term structural growth opportunities and win market share in both the UK and Germany’.

Like Compass, Whitbread wasn’t exactly short of cash in the first place with £500 million in the bank and £950 million of loan facilities, but it grasped the

opportunity to copper-bottom its balance sheet.

CARPE DIEM

Other firms have raised funds for specific growth opportunities, such as credit hire and legal services provider **Anexo (ANX:AIM)** which collected £7.5 million to buy up work in progress books from other firms and specifically to expand its litigation team to take on more VW emissions cases.

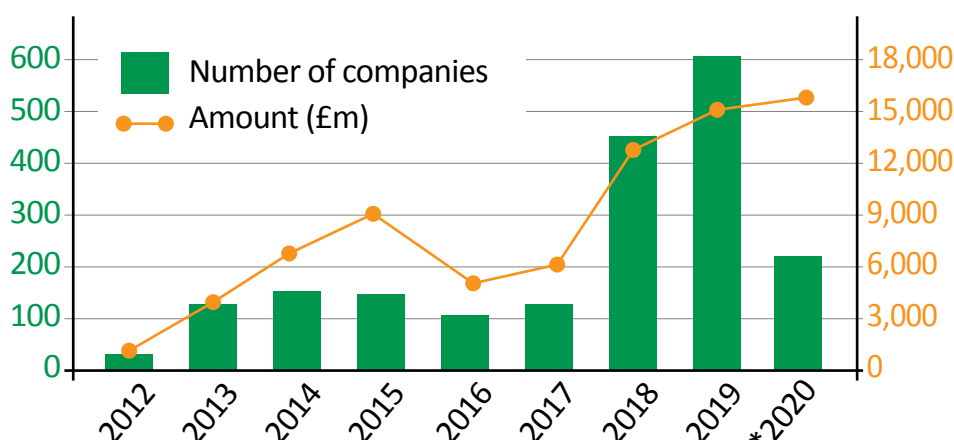
The firm's Bond Turner legal business is already engaged in 8,000 cases, some of which were existing customers of the group and some of which are new. Chairman Alan Sellers believes the percentage of damages and costs accruing to Anexo could have 'a significant positive impact on expectations for profits and cash flow'.

The VW case includes cars made by Audi, SEAT and Skoda, and the firm is now mulling backing customer claims against Mercedes which is also accused of cheating air pollution tests.

KEEPING THE LIGHTS ON

Many of the fundraisings have

COMPANIES HAVE RAISED MORE MONEY THIS YEAR THROUGH PLACINGS, OPEN OFFERS AND RIGHTS ISSUES THAN THE WHOLE OF 2019



Source: London Stock Exchange apart from 2020 data which refers to 1 Jan to 10 July and source AJ Bell, Shares, company announcements

been for growth initiatives, but some have been out of necessity as firms have found their working capital requirements shoot through the roof, causing big cash outflows which aren't being offset by inflows from revenues.

Sports car maker **Aston Martin Lagonda (AML)** raised nearly £700 million in fresh capital so that it could 'successfully emerge from the extended lockdown and the dealers' inventory de-stocking period'. This was after it warned it would lay off up to 500 staff to save a mere £10 million of costs. The shares are now trading well

below the level at which it raised this new money in June.

Low-cost airline **EasyJet (EZJ)** tapped shareholders for over £400 million last month in order to help it withstand up to nine months of its fleet being fully grounded. EasyJet reckons it will burn through £1 billion of cash every three months so the £400m is just over a month's outgoings. Again, its shares are trading well below the June issue price.

Anglo-American cruise operator **Carnival (CCL)** raised \$500 million at the end of March at a massively discounted share price, alongside \$4 billion of secured borrowing at an eye-watering 11.5% coupon and a further \$1.75 billion of convertible bonds with a coupon of 5.75%, all for 'general corporate purposes' as its ships sit idle at quaysides around the world.

FTSE 100 COMPANIES RAISING NEW MONEY VIA PLACINGS AND RIGHTS ISSUES THIS YEAR

Company	Price discount (%)	Cash raised (£m)
Compass	3.3%	2000
Informa	4.0%	1001
Whitbread	47.2%	1000
Flutter Entertainment	5.5%	813
Segro	4.5%	680
Taylor Wimpey	4.0%	515
Carnival	9.1%	402
Auto Trader	8.9%	186

Source: AJ Bell, Shares, company announcements



By Ian Conway
Senior Reporter

The great misconception about investment trust revenue reserves

They are not ringfenced pots of cash, contrary to popular belief

Revenue reserves are often touted as a major advantage of owning investment trusts over traditional funds (also called open-ended funds). However, there can be some misunderstanding over how this feature works, which we will now explain.

Investment trusts (also called closed-ended funds) are allowed put aside up to 15% of their income to support dividend payments during harder times, which is called the revenue reserve. This is one of the factors why many investment trusts have a long track record of rewarding shareholders with consistent dividend growth.

Today's Covid-19 scorched economic landscape is just the time when this unique feature of investment trusts should come into its own.

After all, income investors have been battered and bruised this year as the forecast dividend payout for the FTSE 100 has shrunk by a third to £62 billion, lowering the forecast yield to 3.6% from 4.7%.

The knock-on effect to open-ended investment funds has been evident too, leaving income investors with large holes in their portfolios, in turn reducing investment income by an average of 27%.



RESERVES AREN'T RING-FENCED

Investment trusts are required to pay out at least 85% of their income in order to retain their tax status (or 90% for real estate investment trusts), while open-ended funds must pay out all the investment income they receive.

The effect of retaining 15% of earned but undistributed income over many years has resulted in many investment trusts boasting enough reserves to cover many years of future dividends. For example, the **Monks Investment Trust (MNKS)** managed by Baillie Gifford has enough reserves to pay out almost 10 years of dividends, although it is worth pointing out its tiny yield of 0.2%.

It is important for investors to be aware that revenue reserves are effectively bookkeeping entries and are in no way ring-fenced in separate legal

structures or held in protected cash accounts as some may believe.

HOW DOES IT WORK?

The undistributed cash is invested in the trust's assets and therefore the reserves benefit from the growth of the assets.

A spokesperson for the Association of Investment Companies says: 'If the revenue reserves are invested in assets and they increase in value, the gain adds to the revenue reserves.'

In order to release revenue reserves, investment trust managers need to sell down assets in order to raise cash and pay dividends to shareholders. Depending on the liquidity of the trust's portfolio, turning capital into income is relatively straightforward.

One other thing to bear in mind is that the decision to



TRUSTS WITH HIGHEST DIVIDEND COVER

Trust	Dividend Yield (%)	Dividend Cover (years)
Monks	0.23	9.93
Majedie	5.64	4.40
Scottish Investment Trust	3.12	3.04
AVI Global	2.38	2.44
Alliance Trust	1.76	2.38
Average	2.63	4.44

TRUSTS WITH HIGH YIELDS

Trust	Dividend Yield (%)	Dividend Cover (years)
Chelverton UK Dividend	7.97	2.00
Aberdeen Standard Equity Income	7.63	1.16
Value and Income	7.42	0.72
Merchants	7.19	0.99
Temple Bar	6.67	1.08
Average	7.38	1.19

Source: AIC/Morningstar, data as at 07/07/20

make up any income shortfalls by dipping into undistributed income sits entirely with the board of directors. Just because they exist doesn't mean they will be paid out.

The board needs to consider the interests of shareholders looking for income with those focused on long-term capital growth. Paying out today reduces future growth potential.

CHANGING THE RULES

In 2012 the tax rules were changed which allowed investment trusts to pay dividends from the accumulated profits built up, providing a potentially much bigger capital pool from which to distribute future income and plug any holes

caused by falling dividends.

One investment trust that distributes dividends from capital is the **International Biotechnology Trust (IBT)** managed by SV Health Managers, which pays out the equivalent of 4% of net asset value.

Investors wouldn't normally buy a biotech trust for income, but the board reasoned that it would help reduce the shares' discount to net asset value, in addition to buying back shares. Over the last years the shares have traded at an average discount of 2.5%.

WATCH OUT FOR HIGH YIELD TRAPS

While paying dividends from

capital is more secure than relying on investment income, it would be dangerous to lump all trusts together and assume the ones with the highest dividend yields are the best.

Focusing on the UK Income and Global Income sectors, the tables show trusts with the highest dividend cover, expressed in number of years and compares them with the highest yielding trusts.

The cover calculation takes the revenue reserves as reported in the latest set of accounts and compares it with the current dividend to see how many years it could be paid purely from those reserves.

The highest yielding trusts have very poor cover with the **Value and Income Trust (VIN)** and **Merchants Trust (MRCH)** having less than a year's cover. A top 10 holding for Merchants includes **Royal Dutch Shell (RDSB)** which was one of the UK market's highest yielding stocks until recently when it slashed its dividend by two thirds.

In contrast, **Majedie Investments (MAJE)** is yielding more than the market average and has more than four years of dividend cover.

CORRECTION

The original version of this article incorrectly stated that gains from investing the revenue reserve are added back to the revenue reserve amount. This is not the case. We apologise for any confusion.



By **Martin Gamble**
Senior Reporter

How would moving overseas impact my pension?

Our resident pensions expert explains how the QROPS scheme works

I'm thinking of retiring in Portugal or some other tax advantageous location. I've heard about QROPS but I'm unsure how this would work with my SIPP and defined benefit pension. Can you please explain the mechanics?

Robert



Tom Selby
AJ Bell
Senior Analyst says:

A Qualifying Recognised Overseas Pension Scheme or 'QROPS' is a type of pension plan designed for UK residents who want to retire abroad.

You do not have to set up a QROPS if you want to retire overseas – private or workplace pensions can be paid to you wherever in the world you decide to retire.

Anyone thinking about retiring abroad should speak to their pension scheme or provider first to check how they will pay your income. Some will only pay into a UK bank account, for example, while others might pay into an overseas account if you ask.

Some schemes may also charge you extra to pay your pension into an overseas account and your income will be paid in pounds sterling, exposing you to currency fluctuations.



Anyone thinking about retiring abroad should speak to their pension scheme

BENEFITS OF QROPS

Because a QROPS is established in the country you reside in, you'll get your pension in local currency and so avoid the uncertainty of exchange rate rises and falls. It may also be easier to keep track of the tax changes in the country you reside, rather than having to constantly monitor the UK's rules and regulations.

THE 25% TAX CHARGE

Since March 2017, transfers to QROPS have been subject to a 25% HMRC charge unless any one of the following conditions are met:

- you are resident in the country where the QROPS receiving your transfer is based;
- you are resident in a country in the European Economic Area (EEA) and the QROPS you are transferring to is based in another EEA country;

- the QROPS you are transferring to is an occupational pension scheme and you are an employee of a sponsoring employer under the scheme;
- the QROPS you are transferring to is an overseas public service scheme and you are employed by an employer that participates in that scheme;
- the QROPS you are transferring to is a pension scheme of an international organisation and you are employed by that international organisation.

ADVICE AND THE LIFETIME ALLOWANCE

You will likely need to go through a regulated adviser if you want to open a QROPS. If you do so, make sure you know exactly what you'll be paying in costs and charges – both for the advice and investing through the new scheme.

If you want to transfer out of a defined benefit (DB) scheme worth £30,000 or more – which would be necessary if you wanted the money to go into a QROPS – UK rules also require you to speak to an adviser first.

It's worth noting that if you are under age 75 and transfer to a QROPS your fund will be tested against the UK lifetime allowance. This is set at £1,073,100 for 2020/21 and rises each year in line with Consumer Prices Index (CPI) inflation. Any pension savings above this level will be hit with a charge of 25%.

You can read more about how the lifetime allowance tests work [here](#).



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

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

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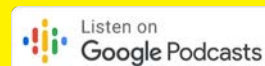
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Doing the maths on the temporary stamp duty relief

The maximum saving under the new scheme is £15,000 for someone buying a property worth £500,000 or more

Homebuyers will face far lower stamp duty bills for the next nine months after the Government vastly reduced the cost of the tax.

The mini-Budget from Chancellor Rishi Sunak revealed that a temporary stamp duty relief would be implemented immediately, running to 31 March 2021. Currently no-one pays stamp duty on the first £125,000 of any home purchase in England and Northern Ireland, but this will now be increased to £500,000.

The move means that anyone buying a main home worth

£500,000 or less will now pay no stamp duty. It is intended to kick-start the housing market after a summer of lockdown and uncertainty about house prices. The maximum saving under the new scheme is £15,000, for someone buying a property worth £500,000 or more.

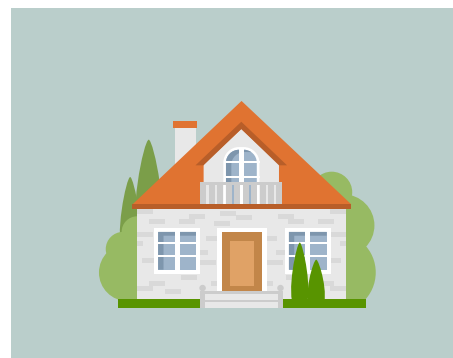
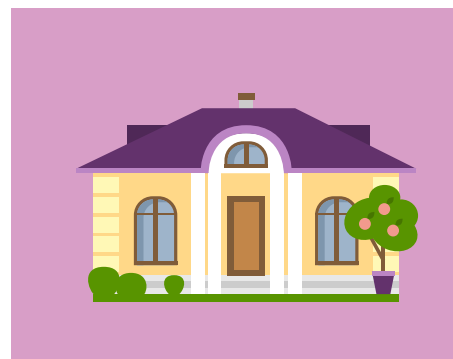
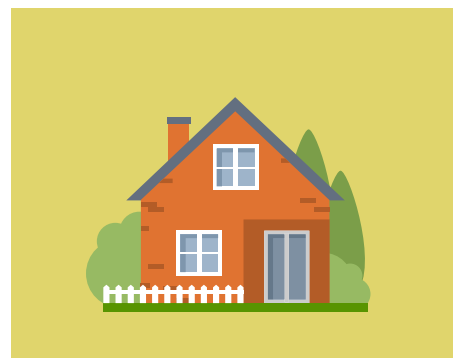
WHO IS AFFECTED?

The change in the tax-free limit applies to anyone who buys a property in England or Northern Ireland, including those buying a second home or landlords who own multiple properties.



HOW THE STAMP DUTY BANDS HAVE CHANGED

Property value band	Old stamp duty	New stamp duty
£0 - £125,000	0%	0%
£125,001 - £250,000	2%	0%
£250,001 - £500,000	5%	0%
£500,001 to £925,000	5%	5%
£925,001 - £1,500,000	10%	10%
Over £1.5 million	12%	12%





CHANGES TO STAMP DUTY

First-time buyers

Property value	Old stamp duty	New stamp duty	Stamp duty saving
£150,000	£0	£0	£0
£250,000	£0	£0	£0
£300,000	£0	£0	£0
£400,000	£5,000	£0	£5,000
£500,000	£10,000	£0	£10,000

Standard house purchase

Property value	Old stamp duty	New stamp duty	Stamp duty saving
£150,000	£500	£0	£500
£250,000	£2,500	£0	£2,500
£300,000	£5,000	£0	£5,000
£400,000	£10,000	£0	£10,000
£500,000	£15,000	£0	£15,000

Second home purchase

Property value	Old stamp duty	New stamp duty	Stamp duty saving
£150,000	£5,000	£4,500	£500
£250,000	£10,000	£7,500	£2,500
£300,000	£14,000	£9,000	£5,000
£400,000	£22,000	£12,000	£10,000
£500,000	£30,000	£15,000	£15,000

Source: AJ Bell. Assumes first-time buyer only purchases a property up to the value of £500,000 and so makes full use of first-time buyer relief.

An additional 3% surcharge was introduced in 2016 for anyone buying a second or additional home – this surcharge will remain, but these buyers will still benefit from the new reduced rate (see table).

First-time buyers already benefited from first-time buyer relief, where they paid no stamp duty on the first £300,000 of their home purchase, so long as the property they were buying was worth less than £500,000.

However, the change in the rules means that they will pay no stamp duty up to £500,000 and that those buying a property worth more than £500,000 will be eligible for the tax break – where they weren't under the first-time buyer relief.

REGIONAL DIFFERENCES

Those in areas where property is worth more will undoubtedly

enjoy a greater benefit. The average house price in the north east is £126,945, according to the latest Land Registry house price data, meaning it is only a shade above the current £125,000 tax-free limit. The average buyer in this region will save just £38 under the new stamp duty system – the cost of a new toaster for their new house.

Compare that to the average house price of just under £485,800 in London, which means from today the average buyer will save £14,289 in stamp duty – the cost of new Ford Fiesta car.

Those in the south east will save an average of £6,167 under the new system, compared to just £684 saved by the average homebuyer in Yorkshire and the Humber.

First-time buyers fare worse and only those buying in London and the south east will see any additional savings on top of the existing first-time buyers' relief, on average.

Only London and the south east have average house prices above the £300,000 mark (the existing relief). In the south east on the average house price a first-time buyer will now save £1,167 in stamp duty, while in London at the average price they will save £9,289.

WHY MAKE THE CHANGES?

The Government is hoping the tax cut will encourage more people to move home, and to get the housing market moving again. While some estate agents and online estate agent portals have reported a pick up in



AVERAGE SAVING BY REGION

Region	Average property price	Stamp duty saving
London	£485,794	£14,289
South East	£323,353	£6,167
East of England	£291,254	£4,562
South West	£263,360	£3,168
West Midlands	£195,971	£1,419
East Midlands	£194,664	£1,393
North West	£166,202	£824
Yorkshire and the Humber	£159,208	£684
North East	£126,945	£38

Source: Land Registry/Money Advice Service/AJ Bell. Average house prices based on Land Registry data for regions. Stamp duty calculations assume the person is not a first-time buyer and not buying an additional property.

interest, there are worries that this is a short-term blip or that it won't transfer into an actual boom in sales.

In his Summer Statement speech, Sunak himself referred to the fact that property transactions fell by 50% in May and that house prices had fallen for the first time in eight years.

If people don't move home, not only does an entire industry face lower revenues and potential job losses but the Government generates less in tax. While the stamp duty cut is expected to cost almost £4 billion, the Government will be hoping that its tax cut will help to encourage more people to

move home and so generate tax revenue in stamp duty.

GLOOMY OUTLOOK

Unfortunately, the outlook for the property market doesn't look too rosy. The Bank of England's mortgage approval figures, which are a good indication of the pipeline of new home purchases, have fallen dramatically and are a third lower than their worst point in the financial crisis – showing just how dire the outlook is for the market for the rest of this year.

Getting a mortgage is a big hurdle at the moment for homebuyers who want to make use of the Government's tax break, as many mortgage companies have tightened their lending criteria or increased the amount of deposit you need in order to be approved.



By **Laura Suter**
AJ Bell Personal
Finance Analyst

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Great places to find investment ideas and do research

We offer some pointers as to where you should look for information to support investment decisions

One of the first questions asked by beginner investors is where to find investment ideas. The choice is vast with more than 2,000 companies listed on the London Stock Exchange and hundreds of funds.

Run an internet search for 'investment ideas' and you'll be deluged with options. 'Expert investment tips from £50 to £50,000' and 'Investment ideas for 2020' are just a couple of the top entries we found when running the search for this article. There are many others. That can make it confusing trying to work out where to begin.

EXPERT COMMENT

Most of the national newspapers write about investments and you can also find ideas in specialist investment websites and magazines. They are either presenting their own ideas or ones suggested by expert investors such as fund managers.

Since you are reading this, you have already discovered some of the vast universe of help *Shares* provides to investors, from beginners right through to semi-professionals.

Without wanting to blow our own trumpet too much, *Shares* has been providing investors



of all stripes with investment intelligence, data and education for more than 20 years. We've seen the best of financial markets, and the worst, and continue to act as a trusted source of investment help for thousands of people thinking about their finances and futures.

It is very important to understand that any investment idea you read online or in print, or find via a video, should be treated as a starting point for your own research. You should never buy something simply because someone else says to do so. Many investment ideas won't be suitable for everyone and some will be suitable for no-one.

SHARING INFORMATION

Investment ideas can come from anywhere, and the explosion of social media over the past decade has massively increased the amount of content you

can access. Twitter can be particularly useful for finding out what's going out with certain companies and help with investment strategy, education, and which parts of the market are looking interesting.

Many contributors are seasoned investors willing to share their experience. For example, @rhomboid1MF and @wheelidealer are among the people worth following on Twitter, part of a community of investors offering great insight into the markets.

Sadly, there are also plenty of charlatans on social media networks and internet bulletin boards, often promising that you can make many times your investment back in months. We encourage you to switch on your own 'quality control' filter. Remember, if it sounds too good to be true, it probably is. These are usually ways to get you to

FIRST-TIME INVESTOR

sign up to paid-for 'tips' services that fail to deliver nine times out of 10.

HELP FROM YOUR ISA AND SIPP PROVIDER

Any decent DIY investment platform will provide you with investment food for thought, such as list of preferred funds and investment trusts. There will also likely be market commentary, thematic features and educational content. This should help to improve your knowledge and your investment research capabilities.

There are lots of online

services designed for a range of different users and should appeal to everyone from occasional investors to the more active. Things like key company data, news, alerts, stock watch lists and portfolio tools are typically available for free from your ISA or SIPP provider or financial data providers such as Morningstar.

PAYING FOR INVESTMENT TOOLS

You may not be ready just yet, but in time you'll need more analytical data, like screening tools and stock reports. For this extra analysis you'll likely need

to sign up to one or more of the online subscription services available, such as SharePad or Stockopedia for example, although there are others.

SharePad is an online service that works best on tablets, PC or laptop, although you can also access it on your smartphone. The software provides access to in-depth results and financial ratios for stocks listed on the UK and US markets.

Stockopedia is also an online service with a wealth of fundamental data on UK, US and European stocks. There are detailed reports on each of the companies and users can quickly screen specific parts of the market for shares that meet their required criteria.

Both offer a basic monthly or annual subscription, typically starting at around the £25 to £30 a month mark, with extra tools available if you spend more.

A LITTLE BIT OF RESEARCH GOES A LONG WAY

Starting to invest can seem daunting for beginners. It can seem as if there are a million things to learn, and the risk of losing money.

All investors lose out from time to time; it is a normal part of investing regardless of how clever or knowledgeable you may be, even the professionals.

But investing successfully is possible for everyone. You just need to invest some time as well as money in weighing up opportunities.

USEFUL PLACES TO FIND INFORMATION ON INVESTMENTS

- | | |
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By **Steven Frazer**
News Editor



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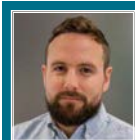
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Why are AIM stocks so volatile and what role do market makers play?

We explain how the professionals set prices at which they will buy and sell shares

The fluctuation in share prices for AIM stocks can be extreme; can you explain how the market works and the role of the market makers in setting prices?

David



Deputy Editor **Tom Sieber** replies

Investors in smaller companies are often frustrated about their inability to buy and sell as many shares as they want and at the price they want, particularly when a big announcement comes out.

Market makers are the banks or stockbrokers which commit to trading shares so you can always buy and sell on an exchange during normal market hours. They attract criticism for the role they play in creating frustration for investors.

Their job is more important with AIM and small cap stocks as, unlike their larger counterparts in the FTSE 350, there aren't always investors lining up to buy or sell shares. In other words, there is less liquidity.

Nick Conyerd, head of market making at Shore Capital, says there are several different factors behind setting a price. 'The concept of supply and demand is fundamental to the pricing of all securities,' he comments.

Significant news events often generate considerable interest from investors and as such a market maker will respond to the demand that such statements may encourage

'Significant news events often generate considerable interest from investors and as such a market maker will respond to the demand that such statements may encourage. Equally, the supply of stock into that demand also dictates how market makers will price the stock.

He adds: 'The obligation of a market maker to provide liquidity upon request, dictates that regardless of client orders being worked a market maker will at some stage have to make prices on risk. The management of risk, therefore, is also crucial in determining how a market maker responds to a news statement.'

The price you pay to buy a stock is nearly always higher than the price you get quoted to sell a stock. As Conyerd suggests, the

spread between the two is the compensation a market maker gets for the risk of holding shares.

After all they may see a decline in the value of a stock after it has been purchased from a seller and before it is sold to a buyer. This is even before you consider that market making is a commercial activity and the spread is where the money is made.

Another factor to weigh is that market makers, which usually only hold a modest number of shares, will set their price at a level which they know they will be able to both buy and sell stock.

You may find it difficult to buy shares which are rising sharply, but this is likely because the market makers themselves are struggling to find sellers from whom to buy stock.

Regulation has improved the situation for retail investors, effectively pushing brokers and market makers to deliver the best outcome for clients, however the nature of the small cap market and the more limited liquidity in small cap shares means both the volatility and spreads will be higher.

This can be particularly true when there are only one or two market makers in a stock, with the limited competition reducing the incentive to keep spreads lower.

What can you learn from the correlation matrix in a portfolio X-ray report?

It provides a quick overview of which investments are increasing or decreasing portfolio diversification

Could you explain the correlation matrix on a portfolio X-ray analysis tool? It has no meaning for me, so I am unaware if it provides any useful information.

Charles Gibbs



Senior reporter
Martin Gamble replies

Imagine the shares and funds in your portfolio as magnets, attracting and repelling other magnets.

Correlation is simply the strength of the attraction, with positively correlated shares moving in lockstep and negatively correlated ones

moving in opposite directions.

The numbers in the boxes are a mathematical measure of the strength of the attraction or correlation between pairs of assets in your portfolio.

A +1.0 reading indicates they move in the same direction with perfect synchronisation and -1.0 means they have perfect synchronisation in opposite directions. A value of zero shows there is no relationship between the two assets.

Pairs of assets with values less than 0.5 are considered uncorrelated, like magnets which



CORRELATION MATRIX

	1	2	3	4	5	6	7	8	9	10
1	1.00									
2	0.83	1.00								
3	-	-	-							
4	-	-	-	-						
5	0.77	0.92	-	-	1.00					
6	0.82	0.88	-	-	0.77	1.00				
7	0.36	0.52	-	-	0.50	0.53	1.00			
8	0.77	0.89	-	-	0.84	0.82	0.51	1.00		
9	0.46	0.63	-	-	0.63	0.49	0.29	0.63	1.00	
10	0.41	0.57	-	-	0.57	0.55	0.34	0.66	0.78	1.00

1.00 To 0.60
0.60 To 0.20
0.20 To -0.20
-0.20 To -0.60
-0.60 To -1.00

There is no data for holding #4 (Stock A) because it does not have the required 3 years' performance to feature on the matrix.

Source: Morningstar, Shares

TOP 10 HOLDINGS FROM A HYPOTHETICAL PORTFOLIO

	Name
1	Fund A
2	Fund B
3	Cash GBP
4	Stock A
5	Fund C
6	Fund D
7	Stock B
8	Stock C
9	Stock D
10	Stock E



neither attract nor repel.

The matrix is based on three years' performance. An important point to remember is that correlation isn't equivalent to causation. If a different three-year window was used the results wouldn't necessarily be the same.

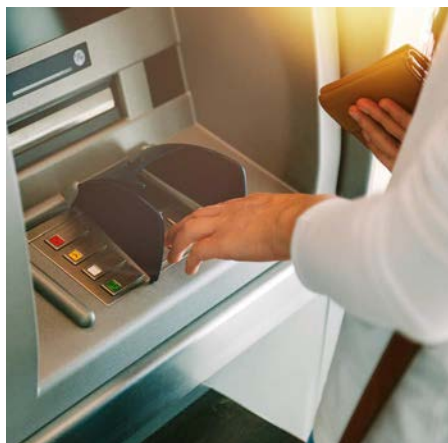
It's also worth noting that the number doesn't have anything to do with relative performance between the two assets, it just tells you how much they 'bob and weave' together or don't.

The role of diversification is very important in the context of risk management because the more you have of it the less the portfolio will move around. It's also worth remembering that if the value of your portfolio falls, it needs to rise more in percentage terms to get back to where it was due to the base effect.

For example, a loss of 10% requires the portfolio to go up by 11.1% to fully recover the loss. A more extreme example is where a 50% gain is required to recapture a 33% loss.

If you can reduce the ups and downs of the portfolio, it will likely perform better as well as giving you a better night's sleep.

In a perfect world it would be great to have some assets which



**Greater
diversification
can be
achieved by
spreading
your holdings
across sectors
with different
sensitivities to
the economy**



are negatively correlated to each other because the portfolio would then be relatively stable. In practice you won't often see two shares which are negatively correlated, because all shares tend to move together.

However, greater diversification can be achieved by spreading your holdings across sectors with different sensitivities to the economy, for example utilities and supermarkets will behave differently to the very cyclical sectors like banks and construction firms.

Lastly, holding different types of assets like bonds or bond funds will increase diversification and provide stability to the portfolio. Bonds can provide safety when share prices fall.

DO YOU HAVE ANY QUESTIONS ABOUT MARKETS AND INVESTING?

Let us know if we can help explain how something works or any other question relating to markets and investing. We'll do our best to answer your question in a future edition of *Shares*.

Email editorial@sharesmagazine.co.uk with 'Reader question' in the subject line.

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

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The value of your investments can go down as well as up and you may get back less than you originally invested.



KEY

- **Main Market**
- **AIM**
- **Investment Trust**
- **Overseas**

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

21 July: Begbies Traynor. **22 July:** Stagecoach. **23 July:** Cohort.

Half year results

21 July: Audioboom. **23 July:** Croda, RELX, Unilever. **24 July:** Centrica.

Trading statements

20 July: BP Marsh & Partners. **21 July:** Euromoney, RPS. **22 July:** Close Brothers, Eve Sleep, Tristel.

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