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The companies we invest in include family-controlled holding companies, property companies, closed-end funds and, most recently, cash-rich Japanese companies. The approach is benchmark-agnostic, with no preference for a particular geography or sector.

AVI has a well-defined, robust investment philosophy in place to guide investment decisions. An emphasis is placed on three key factors: (1) companies with attractive assets, where there is potential for growth in value over time; (2) a sum-of-the-parts discount to a fair net asset value; and (3) an identifiable catalyst for value realisation. A concentrated portfolio of c. 37* investments allows for detailed, in-depth research which forms the cornerstone of our active approach.

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Turning point for markets: sectors to explore or ditch

What worked in the first half of the year may not do as well in the second half

Society is at a turning point and so is the stock market as the focus shifts from Covid recovery opportunities to the threat of rising inflation and changes to monetary policy. Fundamentally, what's worked this year in terms of stock selection may not continue to do so.

Companies will need to show they can pass on higher costs to customers or have substantial gross margins to be able to stomach inflationary pressures. Others will have to deliver on earnings expectations as even the slightest miss could be punished by a big share price decline, given how parts of the market are trading on elevated valuations.

At the start of 2021, earnings forecasts were quite bullish, based on the premise that companies would come out of the pandemic in decent shape and a strong economic recovery would drive corporate earnings.

First quarter results were good for a wide range of industries. Reality is now sinking in and we could see a divide in terms of positive and negative reporting at the second quarter results, which should get underway in late July.

The global stock market, as measured by the MSCI All Countries World index, was up by nearly 13% in the first half of 2021, according to FE Fundinfo, and has just hit another all-time high. The FTSE 100 index of UK stocks is up 8% year to date. These are good performance figures.

There are new factors for investors to digest, such as the US Federal Reserve signaling it will raise interest rates sooner than expected. US President Joe Biden in late June declared 'a deal' on a $1.2 trillion infrastructure spending plan, which has fired up markets again. However, the infrastructure boom is not 'new' news, so may not be a long-lasting share price catalyst.

In terms of UK stocks, Morgan Stanley says pharmaceuticals has been the best performing sector, outperforming the market by 9% in the past three months. This is despite deteriorating earnings per share trends. It says valuations are now back towards their long-run averages.

Travel and Leisure has been the worst performing sector in the past quarter, underperforming by 10%. It has the weakest relative earnings per share revisions in the UK and valuations look increasingly stretched, meaning anyone who has been playing this sector as a reopening trade may want to lock in any profits.

Oil and gas has been the second worst performing sector relative to UK market, lagging by 7% during the past three months despite strength in the oil price. The sector continues to see positive revisions to earnings per share and dividend estimates, suggesting this could be a good place for investors to explore despite ongoing concerns about the industry having to transition to a renewable energy-led world.

Consumer staples is the most oversold UK sector, according to Morgan Stanley. Performance trends have started to turn in recent weeks and the sector is seeing an improvement in relative earnings revisions. The bank says that relative valuations are close to a historical low and the sector may offer some good value defensive exposure.

Other sectors to watch closely include retail, where share prices appear to be losing momentum, while on a global basis technology stocks seem to be regaining favour with investors again.

By **Daniel Coatsworth** Editor

Housing market could lose steam as stamp duty holiday is tapered

Estate agents could be the first to see signs of flagging interest

The Government's holiday on stamp duty payable on house purchases is starting to be wound down, which could have a major impact on shares related to housebuilding, estate agency, DIY retail and conveyancing.

From 1 July, the rate above which the tax becomes payable in England and Northern Ireland dropped from £500,000 to £250,000, and from the start of October rates return to normal.

This will likely put a dent in housing transactions given the average house price in the UK is nearly £262,000, according to the latest data from the Halifax.

The bank claims the average house price for home *movers* in England and Wales in the six months to June 2020 was £373,537 but following the increase of the stamp duty limit to £500,000 prices increased by an astonishing £57,790 or 15.5% to an average of £431,327 in the six months to December 2020.

As a result, the proportion of homeowners paying stamp duty on transactions dropped from 93% in the six months to last June, to just 26% in the six months from June and December last year.

That means the Chancellor will have taken a lot less than the typical £12 billion a year which the duty generates.

The majority of people taking advantage of the stamp duty holiday were not first-time buyers but people moving home for a second, third or fourth time, including those downsizing to properties just under the £500,000 threshold.

If anything, first-time buyers were penalised by the need to find even bigger deposits due to the acceleration in house prices caused by the tax holiday. Once the duty is reintroduced, however, there is no guarantee house prices will fall back to the same level.

Evidence from Scotland, where the stamp duty holiday on the first £250,000 of the purchase price ended in March, suggests house prices will continue to rise, albeit at a slower rate and buyer interest is likely to fall. In March, Scotland had the weakest figures for new buyer enquiries of any UK region, according to the Royal Institute of Chartered Surveyors.

If that trend is replicated across the rest of the UK, estate agents will be the first to feel the air being sucked out of the market while lack of supply of quality properties is likely to underpin demand for new houses.

For now, the housebuilders are still on a roll – stamp duty didn't even get a mention in **Berkeley Group's (BKG)** latest results – as are the building materials stocks, but without Government stimulus sales will eventually revert to more normal levels. [IC]

Was JD Sports' Nike-driven jump justified?

Nike's direct to consumer drive poses a major threat to retail partners

Shares in trainers-to-tracksuits seller **JD Sports Fashion (JD.)** rallied on a positive read-across following forecast-beating fourth quarter results from US sportswear giant Nike on 24 June.

JD Sports has built its success on close ties with Nike and other powerhouse sportswear brands, so voracious consumer appetite for the Nike brand should be positive for the company short-to-medium term.

However, one must consider if the market is underappreciating a major risk to JD Sports, namely Nike's highly successful focus on direct-to-consumer sales. Even as physical retail reopened, Nike's digital sales grew by 41% versus the prior year and 147% compared to the pre-pandemic fourth quarter of 2019.

The increase in trainer manufacturers including Nike and Adidas selling direct to customers rather than only via retailers could have negative longer-term implications for JD Sports.

Hard-nosed Nike is investing in its direct-to-consumer network while it is already reducing the number of weaker retail partners carrying out its product. Cutting out distributors and going direct gives the Oregon-based giant greater control over the brand message and crucially, allows it to generate much higher margins, meaning JD Sports will need to stay on its toes.

Nike shares hit an all-time high following its fourth quarter results. Revenues for the period grew by 96% year-on-year to $12.3 billion. Its gross margin increased by 850 basis points to 45.8%. [JC]

Are UK companies being taken over on the cheap?

Big shareholders are pushing for higher offers from private equity bidders

ON 29 JUNE private equity firm Clayton, Dubilier & Rice increased its offer for pharmaceutical firm **UDG Healthcare (UDG)** by 5.5% to £10.80, valuing the company at £2.93 billion, including debts.

The new higher price represents a premium of 28.3% to the pre-bid closing price on 11 May 2021 which is below the average 36% premia offered across almost 50 takeovers since last October according to data collected by Russ Mould, investment director at AJ Bell.

The private equity firm had already obtained approval from UDG's board at a lower price, but its largest shareholder Allianz Global Investors, together with other top shareholders, criticised the board for accepting a price they considered to undervalue the company.

Institutional shareholders are increasingly pushing back against private equity takeovers, asking for more in the belief that private equity buyers are picking up UK companies on the cheap.

In all-cash offers the selling shareholders are forgoing the upside of future value creation and therefore need to be compensated appropriately.

Institutional shareholders have a responsibility to their customers to ensure they receive a price as close to fair value as possible.

It's hard to believe that UDG's leading shareholders had such a stingy 5.5% increase in mind when they were in discussions with the private equity group, but unless a rival bid materialises the latest deal looks like it will be enough to secure the prize. [MG]

Shares magazine is owned by AJ Bell. Daniel Coatsworth who edited this article owns shares in AJ Bell.

Activist manager Crystal Amber targeted by another activist

The future looks uncertain for the AIM-quoted investor

It's not often you see an activist investor target another activist for poor performance but that's what happening at **Crystal Amber Fund (CRS:AIM).**

On 25 June Crystal Amber revealed that Saba Capital Management, its largest shareholder holding over 25% of its shares, intended to vote against the company at November's continuation vote.

A resolution passed in 2013 requires 75% of shareholder approval to continue trading. Failure to hit this number would mean the directors have to propose alternative arrangements which could end up with winding down the business.

There had been some speculation that Crystal Amber founder Richard Bernstein was in the process of selling off some of the company's assets, but Saba's surprising move is likely to speed up events in that direction.

Although the shares are higher than the 77p level they were trading at when Saba purchased its stake last October, they still trade a deep 17% discount to net asset value of 129p.

Shares in Crystal Amber gained 2% on 28 June as investors took the view that the discount would likely narrow as some of its assets attracted strategic buyers.

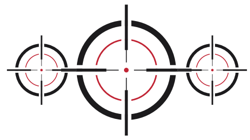
One holding which is likely to attract interest is banknotes maker **De La Rue (DLAR)** which represented 45% of Crystal Amber's assets as of 31 May.

Crystal Amber is the company's largest shareholder with an interest of 14%. French giant Oberthur Fiduciaire and German company Giesecke & Devrient are thought to be frontrunners in any negotiations to buy the De La Rue shares.

De La Rue rejected a 935p offer from Oberthur Fiducaire in 2010 which subsequently walked

Crystal Amber: Largest holdings and net asset value

	Per Share (p)	% of investee equity
De La Rue	59.3	14.0
Equals Group	19.6	22.4
GI Dynamics	17.7	not disclosed
Allied Minds	13.5	20.9
Board Intelligence	4.2	not disclosed
Other Holdings	14.5	
Net Cash	0.2	
Total	129	



Source: Crystal Amber, as at 31 May 2021

away after saying its board failed to engage in meaningful discussions.

In 2018 De La Rue was left reeling when it lost a contract to make the new post-Brexit blue passports to Dutch-French competitor Gemalto.

Crystal Amber also owns a 22% stake in foreign exchange provider **Equals Group (EQLS:AIM)** and a 20.9% stake in intellectual property commercialisation company **Allied Minds (ALM:AIM)**.

It also owns 14% of **Hurricane Energy (HUR:AIM)**. On 28 June the high court ruled against a controversial debt restructuring plan for the oil company which would have wiped out shareholders, giving Hurricane a temporary respite.

One twist to the story emerging at Crystal Amber is that Sabre Capital has built up short positions in some of the fund's largest holdings. Data from shottracker.co.uk show that it holds a 2.2% short interest in De La Rue and 1.2% in Allied Minds.

While shorting is usually done to make money from a falling share price, it can also be used to hedge exposure to long positions. [MG]

Private equity may have a mixed reputation but returns have been good

Bridgepoint is the latest private equity firm to consider listing its shares on a stock market

Private equity firms aren't always viewed in the best light by investors. They are often considered to be tight when it comes to paying a fair price for a business, and then they load these companies with debt and deprive them of investment.

However, it would be wrong to say all private equity firms behave in this manner. Some are very supportive of businesses and invest to make them stronger.

London-based private equity firm Bridgepoint is considering a listing on the UK stock market, with a goal to raise up to £300 million from new investors to help fund its growth plans and pay down debt.

It will have to work hard to convince potential investors that it falls into the 'good guy' camp and is not all about buying a business and cutting as many jobs as possible.

Performance record of various private equity firms listed on a stock market

	Five-year share price return
KKR	390%
Apollo Global	310%
Blackstone	305%
Partners Group	233%
Carlyle	189%
3i	110%
Melrose Industries*	90%
Eurazeo	56%

Source: Refinitiv, Shares.
*Melrose Industries isn't strictly a private equity firm, but it has a lot of similarities

In recent years Bridgepoint has backed Pret a Manger, Itsu and **Deliveroo (ROO)**, among others, in what has been a bumper time for deals in the private equity space.

Such deals have intensified in the UK this year, prompting investors both professional and retail to ponder whether buyout firms are taking advantage of Covid-19 and Brexit to snap up companies on the cheap.

Supermarket chain **Morrisons (MRW)** is the latest big name to be targeted by private equity buyers when Clayton, Dubilier & Rice launched a £5.5 billion offer in late June, which was turned down on valuation grounds.

Bridgepoint looks to buy businesses that it believes are being undervalued by public markets, concentrating on mid-sized deals of up to about £1.5 billion. It has around £23 billion of assets under management across Europe, Asia and the US, including investments in cycle retailer Wiggle, and Burger King's France and UK outlets.

Floating shares on a public stock market presents an opportunity for interested investors to get a foothold in a sector that is normally shrouded in secrecy and is typically run via a partnership structure.

Bridgepoint is expected to be tweak its ownership structure when it lists, with shareholders receiving fees from the funds it manages along with a share of profits made by realising investments.

Private equity firms typically prefer to do business behind closed doors, but the select few listed on a stock exchange have generated decent returns for investors in general.

For example, US listed private equity firm Blackstone has returned 305% over five years versus the S&P 500's 104%. UK-listed private equity firm **3i (III)** has rallied 109% over the same timeframe. [SF]

Ideal time to add inflation protection with this cheap trust

JPMorgan Global Core Real Assets' shares have moved from a premium to a discount to the value of its assets

Considering the amount of discussion about investors' need for some inflation protection for their portfolios, it's somewhat surprising to see a real assets investment trust trading at a sizeable discount to net asset value.

As well as sitting at an 8% discount to NAV, compared with a premium of 15% at the start of the year, shares in **JP Morgan Core Real Assets (JARA)** are trading at a 12-month low, whereas other 'flexible' trusts such as **Capital Gearing (CGT)** and **Personal Assets (PNL)** are trading close to 12-month highs.

Don't be put off by the 26% share price decline over the past year. The trust has the right qualities to shine in the current environment, and the market will hopefully cotton on to its potential soon.

Manager Phil Waller puts the trust's share price performance down to headwinds from the strength of sterling but given currency moves are transitory this seems like a big anomaly.

JPMorgan Global Core Real Assets invests in high quality real assets in high quality locations, with a focus on developed economies, what it describes as 'moderate' leverage and minimal development risk.

JP MORGAN CORE REAL ASSETS
BUY
(JARA) 81.2p

Total assets: **£184 million**

Just over half of the portfolio is invested in real estate, while a quarter is in infrastructure and a fifth is invested in transportation assets, which all generate returns that are uncorrelated with equities and bonds.

In each field, the trust looks for assets with a stable, regulated income stream and some inflation linkage. It has the support of JPMorgan's existing expertise in real assets where it manages $75 billion.

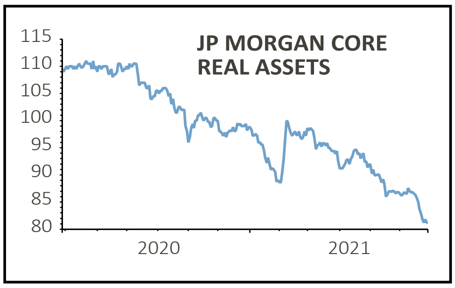
The trust's 700 investments are spread globally, with half in the US, just under a third in the Asia-Pacific region and a fifth in Europe and the UK, which adds another level of diversification.

In the real estate market, as well as prime residential and commercial property the trust invests in public companies operating in sectors like warehousing and logistics.

In infrastructure, the trust owns long-term power generation assets as well as regulated utilities which operate the assets, while in transportation it owns actual ships with long-term lease contracts which generate a steady stream of income as well as other assets.

JPMorgan Global Core Real Assets has a target return of between 7% and 9% a year net of fees and expenses once fully invested, which is almost the case as cash is just £8 million.

Of that return, between 4% and 6% is expected to come from the dividend and the rest from capital appreciation. It has a 0.36% ongoing charge. [IC]



Buy i3 Energy to play oil price strength and imminent dividends

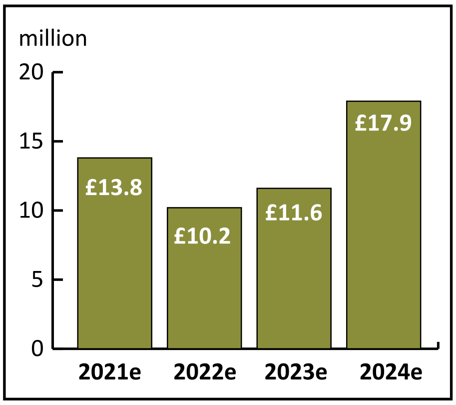
The company's strategy of acquiring low-cost oil and gas assets in Canada should help deliver plenty of cash flow

Investors looking for a way to play the current strength in oil prices should snap up **i3Energy (I3E:AIM)**. It is buying up conventional oil and gas assets in North America cheaply and plans to pay dividends from the resulting cash flow.

The company's strategy echoes the one pursued successfully by former AIM peer **Diversified Gas & Oil (DGOC)**, which is now a FTSE 250 company. While Diversified is much larger and focused on the Appalachian region, i3 is active in Canada.

The approach is refreshingly straightforward and i3 plans to pay a special dividend of £1.17 million in late July and dole out a first half dividend in September encompassing up to 30% of that period's free cash flow.

i3Energy forecast free cash flow



Source: Tennyson Securities

i3ENERGY
BUY
(I3E:AIM) 11p
Market cap: **£79 million**

The company is hedging its production to protect the revenue stream underpinning the dividend. Based on 2022 forecasts from broker Tennyson Securities the shares offer a prospective dividend yield of 5.9%.

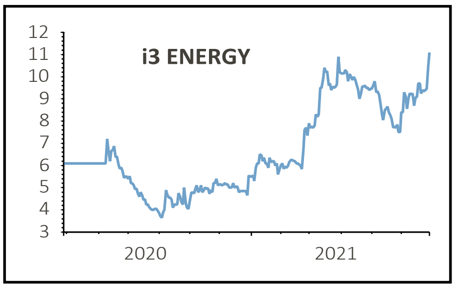
The firm began acquiring assets when prices were extremely depressed in the wake of the pandemic in 2020. As a result, these transactions were completed at an average of just one times a year's worth of net operating income – which CEO Majid Shafiq explains to *Shares* compares with a more typical level of four times.

Having invested at such low prices the economics on the barrels it produces will be highly attractive and the assets picked up, generating 9,000 barrels of oil equivalent per day of production and encompassing 53 million proven and probable reserves, are so far performing better than expected.

While the cost of transactions is gradually returning to more normal levels, i3 still sees M&A opportunities and it also has the option of investing in drilling to boost output from its existing portfolio having identified hundreds of potential well locations.

This gives it flexibility in the event of future volatility in commodity prices, buying assets cheaply when these markets are depressed and investing for organic growth when prices and therefore the costs of deals are more elevated.

As well as the lower risk Canadian business, the company also has the 100%-operated Serenity oil discovery in the North Sea. It hopes to bring in a partner in the second half of the year to help fund the costs of proving up the find. [TS]



GLAXOSMITHKLINE

(GSK) £14.21

Gain to date: 7.6%

Original entry point:

Buy at £13.21, 5 November 2020

GLAXOSMITHKLINE (GSK) reassured investors at its latest investor day (23 June) by providing ambitious plans and growth targets for the biopharma business and the planned demerged of its consumer health business.

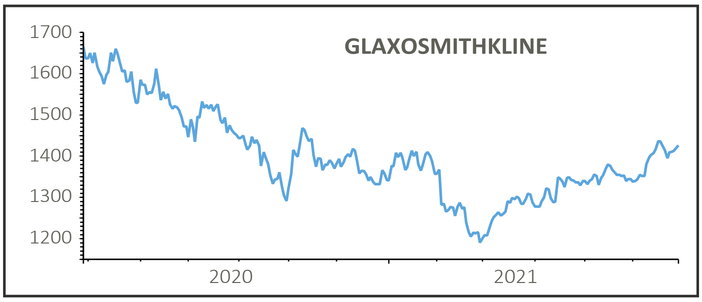
The company is targeting a compound average growth rate of 5% in revenues and 10% in adjusted operating profits over the next five years to 2026 and hopes to generate at least £33 billion of revenues by 2031.

The current pipeline of approved drugs is expected to get the company 60% of the way to its targets with the rest coming from anticipated approvals over the next five years.

There was some concern that the dividend would halve following the demerger of consumer healthcare next year, but GSK said it would rebase the payout to 55p from 80p this year.

This will comprise a 44p per share dividend from the new biopharma business and 11p from the forthcoming demerged consumer healthcare arm. From 2023 the new GSK dividend is expected to be 45p per share.

GSK will demerge at least 80% of consumer healthcare via a premium listing on the London Stock Exchange, which it said was intended to be tax efficient compared with other ways of separation.



SHARES SAYS:

The new targets support our original investment thesis while having an activist investor on the register should keep management on its toes. Stick with the shares. [MG]

BURBERRY

(BRBY) £20.73

Gain to date: 26.9%

Original entry point:

Buy at £16.34, 19 Nov 2020

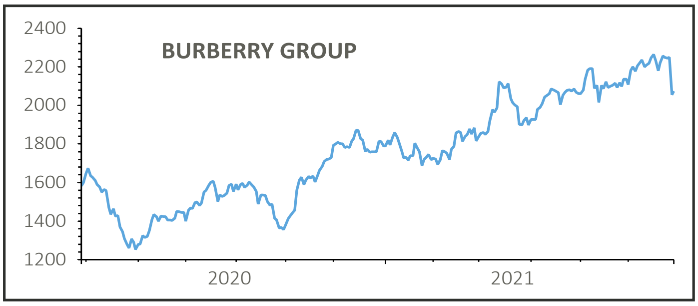
OUR BULLISH CALL on luxury goods leader **Burberry (BRBY)** is 26.9% in the money, although the shares were marked down on the disappointing news that Marco Gobbetti plans to step down as chief executive and leave the company at the end of 2021.

Set to return to Italy and take charge of Salvatore Ferragamo, Gobbetti is credited with the positive transformation of Burberry and for taking the brand more upmarket.

His forthcoming departure creates uncertainty, although the appointment of a new broom could act as a positive catalyst and our fundamental thesis remains intact.

Burberry's shares have recovered from their pandemic-induced slump on the expectation the trenchcoats-to-cashmere scarves seller should prosper as a wealth of unleashed pent-up demand drives a massive boom in luxury goods spending.

Full year results (13 May) confirmed an encouraging sales recovery during the year to March 2021. And in a show of confidence, Burberry reinstated the full year dividend at 2019 levels of 42.5p on the back of strong cash generation, although it also cautioned operating margins will be hit by increased investment and costs normalising in the current financial year.



SHARES SAYS:

Gobbetti's exit comes as a shock, but we still believe Burberry is a buy. [JC]

MOTORPOINT
(MOTR) 367p

Gain to date: 93.2%
Original entry point:
Buy at 190p, 14 May 2020

SHARES IN USED car retailer **Motorpoint (MOTR)** have increased by 93% in value since we urged readers to hop behind the wheel in May 2020.

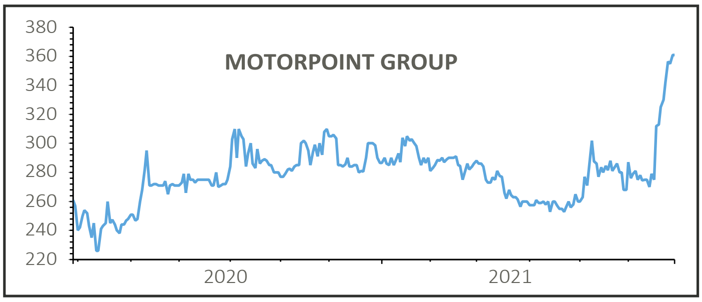
The used car seller's share price recently shot up after management, encouraged by the growth in online sales, outlined exciting new growth ambitions for the group alongside resilient full year results (16 Jun).

These showed better than expected, pandemic-impacted pre-tax profits of £9.7 million (2020: £18.8 million) and Motorpoint also flagged strong trading since its branches reopened.

Motorpoint's new target is to at least double annual sales to over £2 billion in the medium term, of which more than £1 billion is targeted to be online sales.

This is to be achieved with margins improving and strong cash generation through increased investment in technology, marketing and data, and expansion of the group's physical presence.

'The strategy is in effect an acceleration of the existing one, building on the success of the omni-channel proposition that we think is already highly defensible versus online disruptors,' explained Liberum Capital.



SHARES SAYS: ↗
We're excited by Motorpoint's accelerated growth strategy. Keep buying. [JC]

Shares' top picks for 2021: still outperforming after 6 months

Almost 60% of our selections are beating the market with only two out of 12 picks losing money

SHARES' TOP PICKS FOR 2021
+15.2%
UK STOCK MARKET*
+11.9%
*FTSE ALL-SHARE

Every December *Shares* selects a group of stocks to own for the year ahead. The selection for 2021 have performed well with an average share price gain of 15.2% over the past six months compared with a return of 11.9% for the FTSE-All Share index.

Although the list isn't intended to be a portfolio, to calculate the return we have assumed that each holding has an equal weighting.

The hit rate or number of stocks beating the market has been good with seven of the 12 shares delivering a better return than the index.

There are two non-UK stocks on the list, Paris-listed product and environmental testing firm Eurofins and China's Amazon equivalent in the e-commerce and cloud computing space, Alibaba.

Currency exposure has distracted 0.7% from the performance of our picks over the past six months due to the strength of pound against both the US dollar and the euro.

SHARES' 2021 PORTFOLIO

Company	Entry price (p)	Price now (p)	% gain / loss
Tracsis	630	931.75	47.9
Inspecs	271	376	38.7
Eurofins Scientific	€69.99	€96.00	37.2
Wetherspoon (JD)*	1007	1218	21.0
Diageo	2945	3467	17.7
ConvaTec	204.6	237.4	16.0
Qinetiq	299	341.4	14.2
BHP	1983	2151	8.5
RWS	534	570	6.7
PZ Cussons	233	241.5	3.6
Ocado	2301	1965	-14.6
Alibaba	$256.22	$218.38	-14.8
TOTAL			**15.2**
FTSE All-Share	**3624.3**	**4056**	**11.9**

Entry prices taken 21 Dec 2020. Latest prices taken 25 June 2021. *Wetherspoon position closed on 25 June 2021.

BEATING EXPECTATIONS IS WHAT COUNTS

Share price performance should be viewed against the evolving fundamentals of the business because the stock market is forward looking. Share prices respond to how well a company is performing against expectations. Just meeting them is good, but it may not be enough to see the shares outperform.

To get an insight into this, we have calculated the change in earnings estimates over the past six months using data provided by Stockopedia and Refinitiv.

Iron ore and copper miner **BHP (BHP)** has seen a big increase in earnings expectations since we wrote about the stock last December. Analysts' earnings per share estimates for its 2022 financial year have risen from of $1.96 to $3.42. However, the shares have lagged the index despite the upward march of expected earnings. The company will report an operational review for the past financial year on 20 July, which could act as a share price catalyst.

TRACSIS IS THE BEST PERFORMER

The best performing stock in our selection has been transport infrastructure and analytics company **Tracsis (TRCS:AIM)**.

At the half year results (8 Apr) the company said it was starting to see an increase in new business enquiries across those parts of the business hardest hit by the pandemic, which increased confidence around future growth prospects.

The company was also given a boost by the Government's recent strategic report on the future of the railways. Tracsis said it was well positioned to benefit from the commitment to greater digitalisation of the railways.

Another high flyer in terms of share price performance has been eyewear frames and optically advanced spectacle lenses maker **Inspecs (SPEC:AIM)**, which has gained 38.7%.

Alongside figures for its 2020 results, the company said the business had performed well during the first five months of the new financial year.

The group continued to win new customers resulting in order books being higher on a like-for-like basis than at the same time in 2020.

The enlarged group now has a worldwide distribution network serving over 70,000 retail outlets which will provide further growth opportunities.

The company said its focus for 2021 will be integrating the companies acquired in 2020 and creating synergies to support growth.

CALLING TIME ON WETHERSPOON

Pubs group **JD Wetherspoon (JDW)** has been a beneficiary of the pent-up demand in hospitality and the shares have gained 21% since we explained the investment case for the stock in December 2020.

However, the latest Government delay to the removal of restrictions has taken the shine off the reopening excitement and the shares have drifted in recent weeks.

We note a sharp fall in earnings expectations since we originally said to buy, which looks anomalous with the rise in the shares. Back in December analysts were forecasting the company to swing back into profit in the year to 31 July, while that now seems to have been postponed to the 2022 financial year.

Given the disparity between share price and earnings expectations, now is the time to lock in the profit and sell. There is a real risk that many hospitality stocks have rallied too hard and so much future growth is now priced in. That leaves them vulnerable to sharp share price corrections if the strong earnings expected by investors do not materialise.

OCADO AND ALIBABA ARE LAGGARDS

Looking at the other end of the performance spectrum, the most disappointing stock picks have been online retailer **Ocado (OCDO)** and Alibaba, down 14.6% and 14.8% respectively.

Both shares have been impacted by the market's shift towards reflation and recovery value plays at the expense of growth shares.

Recent industry data from Kantar showed Ocado taking market share. However, the stock market has been disappointed with a lack of new corporate contracts where Ocado licences its logistics platform to third party grocers. We are confident that Ocado will continue to experience strong growth, so stick with the shares.

Alibaba has been impacted by worries over tightening regulatory scrutiny and increased competitive threats from JD.com and Pinduoduo.

Andrew Cheng, analyst at KGI Greater China Research, believes that regulatory action will have limited impact on the company's leading position as merchants will maintain their reliance on the firm's operating platforms.

Despite the concerns we believe Alibaba remains well placed to exploit online growth and digitalisation of the Chinese economy. Keep buying the shares.

NEW CEO FOR RWS

Shares in leading provider of language services and language technology company **RWS (RWS:AIM)** have risen 6.7% since late December 2020.

The company reported a positive first half to 31 March, ahead of the board's expectations with adjusted earnings up 12% year-on-year. Trading since then was said to be good, in line with the board's expectations for the full year. According to Refinitv, analysts have increased their earnings expectations by around 5% since the start of the year.

The company announced that chief executive Richard Thompson would step down to be succeeded by Ian El-Mokadem. The latter brings over 20 years of experience in senior management roles in large and international services businesses, most recently as CEO of V.Group, a leading ship management and marine support services business.

OTHER UPDATES

Shampoo to hand gel supplier **PZ Cussons (PZC)** reported a positive third quarter trading update to 27 February. Analysts' earnings estimates have moved higher since the update and the market is paying more attention to its turnaround efforts.

Medical products group **Convatec (CTEC)** has risen 16% in the past six months as elective procedures in hospitals continue to normalise. On 23 June, Numis said it saw the potential for more upgrades to 2021 earnings forecasts as healthcare restrictions ease across the globe and the benefits of past investments begin to be reflected in sustained improvements in organic growth.

By **Martin Gamble**
Senior Reporter

Studio Retail: selling down by a big shareholder could be positive

Some companies would love a big shareholder like Mike Ashley's Frasers, but perhaps not this one

When a heavyweight investor takes a significant stake in a business, many companies talk up that strategic investment. This is often the case in mining, where junior companies shout from the hill tops when one of the sector's big players pop up on their share register.

If anything, online value retailer **Studio Retail (STU)**, formerly known as Findel, has tended to play down the presence of Mike Ashley's **Frasers (FRAS)** on its shareholder register, which may have distracted management in periods past while acting as an overhang. Some investors may have even been put off from buying the stock because they didn't trust Ashley's presence or were perplexed as to his intentions.

Sports Direct-owner Frasers remains a large shareholder, yet *Shares* notes it has reduced its stake from 36% to 27.1% at last count. And as a result, a relationship deal between these two companies, put in place to comply with the stock exchange's 'controlling shareholder regime' listing rules, has been terminated.

Unpredictable retail magnate Ashley loves to make strategic investments in other retailers and brands, but he never bid for Studio Retail, to the likely disappointment of many investors.

The fact that Ashley is loosening his grip may work in the company's favour. Unlike junior miners which so often desperately want the credibility of a big player on their shareholder register, Studio Retail may secretly welcome this dominant figure backing off. It could be the trigger for investors to reappraise the stock, particularly as the underlying business is making clear progress.

However, there is the question of who might pick up Frasers' remaining stake, given it is still significant in size.

VALUE STOCK

Trading on a price to earnings ratio of 7.9 for the year to March 2022, according to Refinitiv data, Studio Retail falls under the banner of a value stock. This low rating is more about the past than the present.

It reflects a chequered past under its previous guise as the indebted Findel, as well as low awareness among investors (and indeed shoppers) of its efforts to improve the business which new CEO Paul Kendrick is seeking to address.

The business was put up

for sale last year after being encouraged by Frasers and second biggest shareholder Schroders to conduct a strategic review. The former said the business was 'misunderstood'.

In the end, Studio Retail decided to sell just its education division to private equity (which went for £30 million). The remaining focus is a thriving online retail business, and a strengthened balance sheet which provides a sturdy platform for growth.

Studio Retail increased revenue in the year to 26 March 2021 by a third to £578.6 million. Adjusted pre-tax profit from continuing operations increased by 79% to £48.8 million.

As *Shares* went to press (30 June), the company was scheduled to have held a capital markets day event online to give investors and analysts greater insight into the business and its medium-term ambition to reach £1 billion of sales. This teach-in could lead to increased analyst coverage, another factor in its favour.

IN A SWEET SPOT

Studio Retail was growing organically, adding active customers and taking market share even before lockdown, which drove even more shoppers online and forced brick and mortar rivals to temporarily pull down the shutters. It sells a broad range of affordable products including clothing and homewares, toys and gifts, many of which can be personalised in the company's in-house facilities.

The company also has a flexible credit offer that appeals to cash-strapped consumers.

Kendrick points out this integrated credit model gives his charge the additional margin from financial services to help offset the costs of marketing and drives 'significant customer loyalty'.

Shoppers can pay by credit or debit card, but the bulk of its customers open a flexible payment account that allows them to pay immediately or spread the cost over a number of months, with Studio charging interest on outstanding balances each month.

Studio Retail's biggest shareholders

Frasers	27.1%
Schroder Investment Management	19.2%
Fidelity International	10.0%
Janus Henderson Investors	5.2%
Lombard Odier Asset Management	4.8%

Source: Refinitiv, 25 June 2021

RECENT TRADING

Trading in its fourth quarter, traditionally quieter as it follows the Christmas rush, proved exceptionally strong, with product sales in the 13 weeks to 26 March 88% ahead of the prior year. Despite the economic havoc wreaked by Covid and growth in new credit customers, the arrears profile of the credit receivables book improved versus the same point in the previous year.

Core net debt, which represents drawings under its revolving credit facility net of cash held by the company, ended the year at £27.6 million, down from £51.8 million in March 2020.

And following the receipt of the education proceeds and drawings under the increased securitisation facility, Studio Retail had moved to a core net cash position as of 16 April 2021 – i.e. cash exceeded drawings on the group's revolving credit facility.

Following the receipt of regular contributions from the company plus a £9 million special contribution following the education business sale, the pension scheme is now in a strong surplus against its funding targets, meaning Studio Retail has greater financial flexibility to grow the business.

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

Sizing up US smaller companies

Knowledge is power when it comes to investing in US smaller companies. In this article we examine the way US asset manager Brown Advisory leverages its networks to gain an informational advantage...

There is a strong case for considering an allocation to US small-cap stocks in most investors' portfolios. Small-caps offer diversification from their large cap peers; with different performance and risk characteristics which can reduce their correlation to large-caps, and offering exposure to sectors from which their larger peers are absent.

Now, with vaccinations rolling out in America and pandemic restrictions rolling back, the US economy is experiencing a boost in its recovery, recording its second-strongest expansion since 2003 in Q1 2021. Small-caps, which are generally domestically oriented, are benefitting. With stimulus likely to continue, the outlook is strong for the sector.

However, with the US small-cap benchmark containing over 2000 companies, tapping this opportunity can be challenging. One issue is that the dynamics of the US economy and US companies are unfamiliar to UK investors.

On average, each company in the Russell 2000 Index is covered by 5.6 analysts, while those in the S&P500 are covered by 20.6 according to Furey Research. Investors seeking exposure to US small-caps, therefore, have far less information at their fingertips when it comes to choosing the right investment – making it much harder to identify winning stocks.

Selection of a manager with deep experience is crucial to gaining the informational advantage that might lead to success.

Brown Advisory is a good example. It was recently appointed manager of **Brown Advisory US Smaller Companies (BASC)**, an investment trust previously under the stewardship of Jupiter Asset Management.

The group has a rich history of investing in this space having been active in US small-caps since the early 1990s.

The trust's named manager, Chris Berrier, has been running the Brown Advisory US small-cap growth strategy since 2006 and an equivalent open-ended UCITS fund since 2007, with demonstrable success – the fund has outperformed both the Russell 2000 Growth and Russell 2000 on a per annum basis since Chris took over 15 years ago. Total assets managed by Chris in the small-cap growth strategy now stand at $7.6bn.

A key aspect of this success has been the size and structure of the team around Chris. Brown Advisory has a large bank of analysts which offers significant coverage of the US small-cap space.

This strength in depth means that the equity research team is able to conduct around 500 meetings with small-cap companies per year.

Another aspect of the Brown Advisory culture which gives the team additional informational firepower is the firm's private equity expertise. This private equity 'lens' can be crucial when assessing the operations of shortlisted businesses, providing sectoral context, and offering additional insight into companies newly joining the listed small-cap arena.

The pace of new entrants coming to the market through IPOs, and the recently popular special purpose acquisition companies (SPACs), has reached historic levels in the last year or two. While that trendiness warrants selectivity, it has created a flurry of new opportunities for the strategy, with its investment team participating in twelve IPOs over the last two years (investing via the open-ended strategy initially).

With all these factors combined, Brown Advisory's access to additional information and insights about smaller companies lends itself to a portfolio that is highly differentiated from its peers. It typically has an active share of over 90%, meaning it is constructed differently to its benchmark, and the open-ended strategy has a strong track record of generating alpha – returns in excess of the benchmark – as a result of rigorous stock selection.

To read more on the expertise at Brown Advisory click **here**.

QUALITY STOCKS TO BEAT INFLATION

As the world economy starts to get back to something approaching normal, and with supply chains struggling to keep pace, inflation has once again reared its head.

From the UK to Europe, the US and China, consumer and producer prices are rising at a faster pace than politicians and central bankers would like.

For investors, this year has been a test of how their portfolios might perform if there were a sustained rise in inflation at some point in the future. Some strategies have held up, while others have fared less well.

We think this could be the time to focus on quality businesses with strong competitive positions and sustainably high returns on capital and margins, with low levels of leverage.

By **Ian Conway** Senior Reporter

HISTORICAL PRECEDENT

Central bankers in Europe and the US are keen to reassure investors that the current spike in inflation is 'transitory', that is the product of short-term supply-side shortages created by the pandemic.

However, there is a growing divergence among central bankers and treasury officials between the 'transitory' camp and those who believe we are at a tipping point ahead of a generational shift higher in prices.

US asset manager GMO recently published a

Quality returns in inflationary periods			
Period	**Quality Return**	**Quality + Value**	**S&P 500**
1933 to 1935	14.4%	14.7%	4.9%
1940 to 1943	12.8%	18.5%	13.4%
1946 to 1948	5.3%	7.7%	1.9%
1950 to 1951	28.1%	35.6%	27.3%
1968 to 1970	3.3%	5.2%	-0.5%
1973 to 1982	2.5%	7.1%	4.8%
1988 to 1991	14.6%	14.3%	11.8%
2007 to 2008	-2.0%	-5.5%	-5.0%

Source: GMO
Inflation above 5% for a period of one year or more

paper showing that quality stocks have tended to perform well compared to the broader US market during times of rising prices, while adding a valuation bias to the stock selection process delivered even better results.

High-quality stocks beat the index in six out of eight inflationary periods and cheaper high-quality stocks beat it in seven out of eight periods. Moreover, in most cases stocks that combined quality and value beat inflation while the broader market lagged rising prices.

GMO's quality strategy manager Tom Hancock typically invests in relatively high-margin businesses where cost inflation affects a lower proportion of revenues than for the broader market.

'If we assume that, like death and taxes, cost increases are more reliable than revenue increases, then quality companies' margins are less at risk than the average,' says Hancock.

He adds: 'The reality, however, might be even better, as we would expect the majority of the businesses in which we invest to be able to raise their own sales prices given their entrenched advantages.'

While the firm doesn't reveal its stock selection process, its quality strategy, which has over $12 billion of assets, has beaten the S&P 500 index and the MSCI World index every year except one (2013) in the past decade, typically by a substantial margin.

Most of the main holdings are asset-light, which means routine maintenance capital expenditure is lower than for the market, and their main assets are intangible so they aren't directly exposed to factors like commodity prices, although they still need investment in technology.

GMO quality strategy top 10 holdings

Stock	Weighting
Microsoft	5.8%
Alphabet	4.9%
UnitedHealth	4.7%
US Bancorp	4.2%
Coca-Cola	3.9%
Oracle	3.8%
Apple	3.8%
Accenture	3.8%
TSMC	3.5%
Lam Research	3.3%

Source: GMO, May 2021
TSMC = Taiwan Semiconductor Manufacturing Corp

Fundsmith quality 'look-through' ratios FY20

Metric	Fundsmith	S&P 500	FTSE 100
Return on Capital Employed	25%	11%	10%
Gross Margin	65%	44%	39%
Operating Profit Margin	23%	12%	9%
Interest Cover	16x	6x	6x

Source: Fundsmith, Bloomberg, Shares

QUALITY WITH PRICING POWER

One of the most popular funds among UK investors which targets quality stocks is **Fundsmith Equity (B41YBW7)**, which focuses on businesses with sustainably high returns, competitive moats, strong cash flows, little or no debt, and attractive valuations.

Looking at the Fundsmith portfolio at the end of 2020 – a year when the fund returned 18.3% against 12.3% for the MSCI World index (in pounds) – its superior quality is clear from the table.

Even in a year of such dramatic change, the portfolio's weighted average return on capital employed was still 25%, more than double that of the S&P 500 and the FTSE 100.

At this year's annual shareholders' meeting it was the portfolio's average 65% gross margin – that is, the difference between revenues and the cost of goods sold – which founder Terry Smith flagged as the biggest indicator that his holdings have pricing power in an inflationary environment.

'Companies take in goods and services and mark them up before selling them on to customers. Clearly, making something for 35 and selling it for 100 (a gross margin of 65%) is better than making something for 60 and selling it for 100 (see the FTSE 100 gross margin of 39%),' says Smith.

'If you get higher inflation, our companies are the kind you want to own,' he adds. 'Having high gross margins means they can pass on input cost inflation to their customers. Also, if inflation goes to 10%, our companies have a return on capital of 25% whereas the average FTSE company has a return on capital of 10% and would make no return at all,' says Smith, assuming higher costs aren't passed on to customers.

Where rising inflation could impact higher-quality stocks is in terms of valuation, says Smith. More expensive, bond-like stocks are likely to face a greater valuation headwind in an inflationary environment than cheaper, low-quality stocks, but he believes their superior operating performance should compensate for that situation.

GOOD TIMING

Joachim Klement, senior strategist at stockbroker Liberum and the author of *Seven Mistakes Every Investor Makes*, believes the second quarter earnings season could provide 'a reality check' for investors, and recommends tilting portfolios towards quality stocks with high profitability and high margins which are better able to withstand cost pressures.

'Analysts have upgraded earnings (forecasts) for 2021 at ever-increasing speed. Our analysis

Low-beta UK stocks with a quality tilt

Stock	Return on Equity	Gearing	Market Cap
Plus500	119%	-1.1	£1.4bn
Pennon Group	80%	-0.2	£4.9bn
Softcat	75%	-0.5	£3.6bn
Games Workshop	64%	-0.3	£3.7bn
IG Group	38%	-1	£3.2bn
FDM Group	38%	-0.9	£1.1bn
Howden Joinery	22%	0.5	£4.6bn
Spirax-Sarco	21%	0.8	£9.8bn
Persimmon	19%	-1.5	£9.8bn
Tate & Lyle	18%	0.8	£3.6bn

Source: Liberum. Market cap data as of 14 June 2021. Gearing = net debt/EBITDA, a negative figure means the company has a net cash position

shows that in an environment of rapidly rising inflation and long-term bond yields, this is likely to be too optimistic,' says Klement.

The rapid rise in inflation and long-term bond yields is creating margin pressures for companies which cannot adjust their end customer prices fast enough, meaning a margin squeeze which could lead to earnings growth disappointing in the second half of the year, he adds.

'This is currently not priced into analyst earnings expectations and should lead to a weaker phase in markets overall during the second half of this year. In particular, value stocks should underperform as investors re-assess the speed of the recovery.'

Meanwhile, says Klement, quality stocks with high gross margins and returns on capital should be able to cope better with the pressure of rising cost inflation and should start to outperform.

DIFFERENT PORTFOLIOS

Liberum has constructed several 'factor' portfolios, each of 20 stocks, equally weighted. Taking the portfolio of low-beta UK stocks with a quality tilt – meaning an attractive mixture of return on equity, return on assets and low gearing or net cash – the top 10 stocks ranked by return on equity throws up some interesting names.

Low beta refers to stocks that are less volatile, or ones that have fewer share price swings, than the aggregate market.

High-quality UK stocks with a value tilt

Stock	Return on Equity	Price/ Book	Market Cap
Luceco	48%	8.1	£586m
Ferrexpo	45%	2.5	£2.7bn
ITV	29%	4.7	£5.3bn
IMI	23%	6.1	£4.6bn
Howden Joinery	22%	6.4	£4.6bn
Serco	21%	2.5	£1.7bn
XP Power	21%	6.3	£1.0bn
Sirius Real Estate	17%	1.4	£1.1bn
Croda	16%	6.5	£10.1bn
Electrocomponents	16%	5.4	£4.9bn

Source: Liberum. Market cap and price/book data as of 14 June 2021

Five of the highest return companies – **FDM Group (FDM)**, **Games Workshop (GAW)**, **IG Group (IGG)**, **Plus500 (PLUS)** and **Softcat (SCT)** – are asset-light businesses, consistent with GMO's preference. They also have net cash rather than net debt, meaning their balance sheets are robust.

A screen of the FTSE 350 on SharePad using two of Fundsmith's metrics – high return on capital employed and high gross margins – throws up another interesting list of stocks.

FTSE 350 high ROCE and gross margin screen

Stock	ROCE	Gross Margin
Big Yellow	16%	69%
Dr. Martens	36%	61%
Dunelm	27%	51%
Games Workshop	64%	71%
Howden Joinery	19%	60%
Moneysupermarket.com	35%	67%
Moonpig	70%	52%
Safestore	17%	67%
Spirax-Sarco	15%	76%
Spirent	21%	73%

Source: Sharepad, Shares . ROCE = return on capital employed
All data correct as of 23 June 2021

SHARES' TOP PICKS

Shares has selected five stocks which have what it takes in terms of business model, margins and returns to protect them from rising input cost inflation, and which look attractive price wise. All five are worth buying for the current environment, so is Fundsmith Equity fund which is profiled at the end of this article.

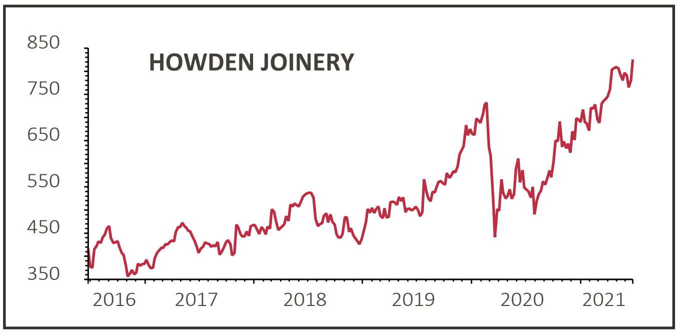
Howden Joinery (HWDN) 829p

BUY

While the pandemic had a significant impact on trading last year, **Howden (HWDN)** managed to limit the impact on sales to just 2%. It also maintained a 60% gross margin, despite higher costs, by raising prices to its customers.

Once stores were permitted to reopen last June, pent-up demand from the repair, maintenance and improvement market saw sales accelerate 16% in the second half compared with 2019 levels.

That momentum has continued into the current financial year, with UK revenues to April 2021 up 47% on 2020 and 13% on 2019, while the firm's European store network saw sales up 108% on last year and nearly 38% on 2019 in the first four months.



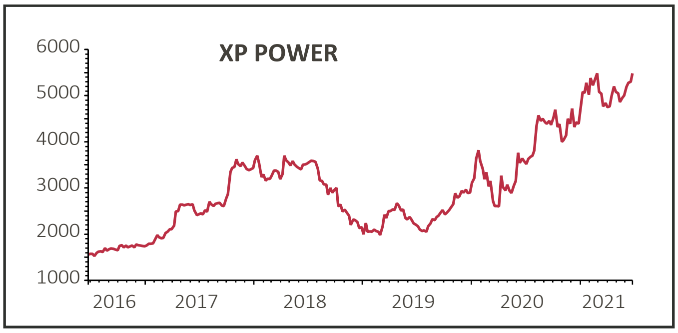
That has given Howden the confidence to roll out 35 new UK depots this year compared with three last year and 11 new depots in Europe, increasing its network by a third, on top of its refurbishment plans.

Uniquely, Howden appears on three of the tables in this article, ticking every box from return on capital to gross margin, balance sheet strength and a reasonable valuation. (IC)

XP Power (XPP) £55

BUY

XP Power (XPP) is a specialist electronics engineer, producing critical power equipment solutions for applications which require custom output voltage combinations, unique control or status signals, and specific mechanical packaging for optimal performance.



Its markets include aerospace and defence, health care and semiconductors, with all sectors seeing healthy demand, especially semiconductor manufacturing. By the end of the first quarter the book to bill ratio was back to 1.29 compared with 0.94 in the final quarter of 2020.

XP's high level of research and development spending – on average 12% of revenues per year since 2002 – gives it proprietary intellectual property which few peers can match, making customers and revenues sticky.

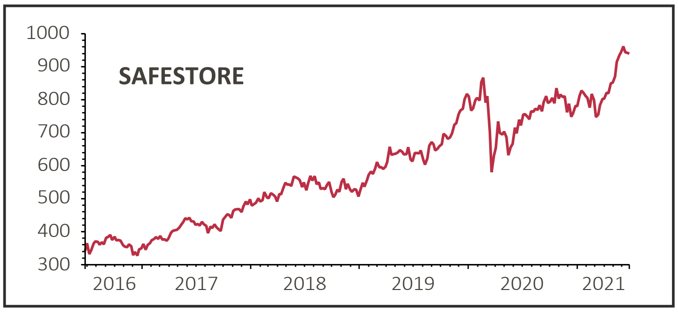
Last year the firm was able to increase revenues and lift its gross margin to over 47%, which is outstanding for a manufacturing business.

With an estimated 6% market share, the firm has plenty of potential to grow, and while the shares are close to all-time highs, we see the business continuing to deliver strong results. (SF)

Safestore (SAFE) 947.5p

BUY

Shares in **Safestore (SAFE)** may not be cheap, trading at 1.7 times net asset value, but it is a high-quality business with an excellent track record worth paying up for.



Safestore provides low cost, secure storage space for companies and individuals – with demand in this market outstripping supply.

Self-storage has benefited during the pandemic for several reasons. First, the nature of these sites means it was relatively easy to make them Covid secure.

People have needed to declutter their homes to make space for home working and a boom in the housing market has increased demand from people who are between properties, while on the corporate side the explosion in online retail has driven demand, particularly from smaller operators.

Perhaps the more relevant and long-lasting change is what Numis describes as a shift from ‘just in time’ to ‘just in case’ supply chains. That means even greater demand for storage space.

Safestore has £128 million in unutilised bank facilities which should support the company’s expansion in the Benelux countries and Spain. (TS)

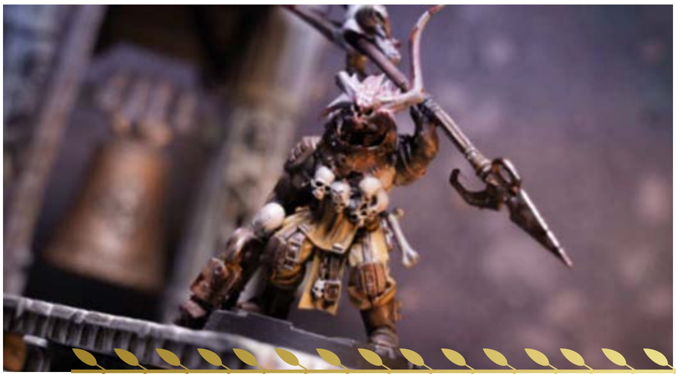
GAMES WORKSHOP

BUY

Fantasy miniatures and table-top war games manufacturer and retailer **Games Workshop (GAW)** is a high-quality business based on several metrics.

For example, the company has achieved an average return on capital employed and return on equity of 55% over the past five years, while the gross margin has averaged close to 70%, according to Stockopedia data.

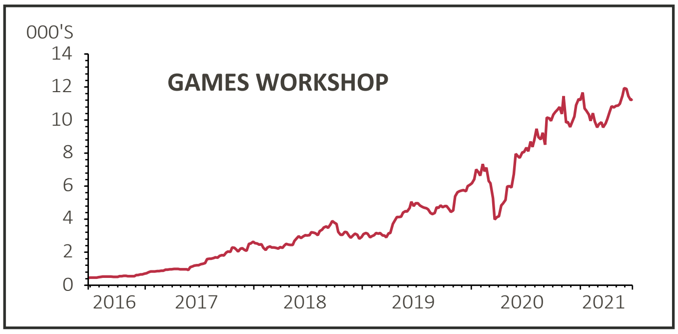
The reason the company can sustain such high returns are related to the economic advantages that it enjoys, including intellectual property, state of the art manufacturing scale and a large loyal fan base.



Another important characteristic of the business model which is often overlooked is the advantages of vertical integration. The company effectively controls the entire value chain from design, manufacture and distribution, which means it can control costs and set its own prices.

The company distributes directly to its customers via around 529 Warhammer stores, online, and via approximately 6,000 trade partners across the globe.

Arguably Games Workshop has only just scratched the surface of the global revenue opportunity, while its developing royalty business potentially adds more quality to the group. (MG)



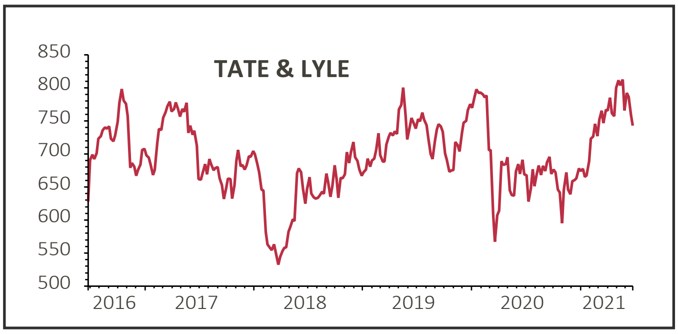
TATE & LYLE

BUY

Food producer **Tate & Lyle (TATE)** is a cash generative, progressive dividend payer with a quality tilt.

According to Liberum Capital, the sweeteners-to-ingredients group generates a healthy return on equity of 18%, while results for the year to March 2021 showcased the resilience of the business in the face of the pandemic.

Adjusted pre-tax profit ticked up 6% to £335 million, free cash flow increased by £3 million to £250 million, and Tate & Lyle also sweetened the total dividend by 4.1% to 30.8p.



Return on capital employed remained strong at 17.2%, while the acquisition of stevia and tapioca interests has expanded Tate & Lyle's customer offering and presence in Asia.

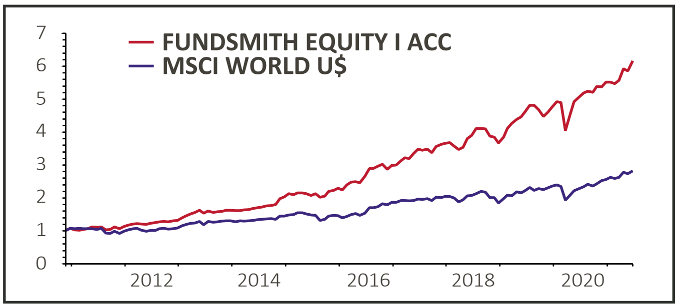
Talks with partners over a potential separation of the higher growth Food and Beverage Solutions unit and its lower growth Primary Products business are ongoing. Break-up talks serve to highlight the value within the group.

Berenberg argues the sale of a controlling stake in Primary Products would lead to a material rerating. On the basis Primary Products is transferred into a joint venture in which Tate & Lyle would have a 40% stake, the investment bank believes 'new' Tate & Lyle could be worth as much as 955p per share. (JC)

FUNDSMITH EQUITY FUND (B41YBW7)

BUY

Fundsmith's flagship investment fund has generated stellar returns since it launched in November 2010. Since inception to 25 June 2021, the fund has returned 510% versus 250% from the MSCI World index, so more than double the benchmark.



It invests in companies around the world, taking a long-term view rather than trading in and out of stocks seeking a quick return.

Fundsmith favours companies that have these qualities:

- High quality businesses that can sustain a high return on operating capital employed
- Advantages that are difficult to replicate
- No requirement to borrow large amounts of money to generate returns
- A high degree of certainty of growth from reinvestment of cash flows at high rates of return
- Resilient to change, particularly technological innovation
- Attractive valuations

Fundsmith's portfolio typically has between 20 and 30 stocks, with the biggest holdings currently including Paypal, Microsoft, L'Oréal and Novo Nordisk.

'The investment philosophy is to buy and hold high-quality businesses that will continually compound in value,' says analyst Robert Starkey at Morningstar.

'Fund manager Terry Smith is an original thinker and has often demonstrated his willingness to bet against the crowd.' (DC)

DISCLAIMER: Daniel Coatsworth and Steven Frazer who contributed to this article both have personal investments in Fundsmith Equity.

Why don't investment trust prices move in line with net asset value?

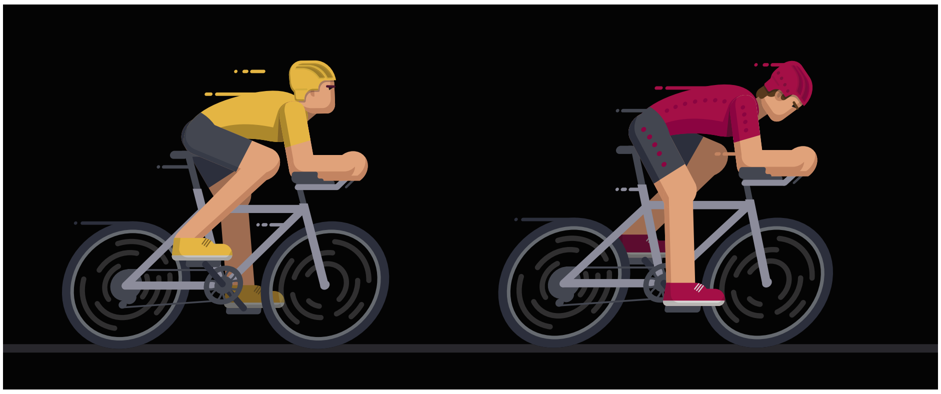
Discover the reasons why the two don't always move in tandem

Have you ever bought an investment trust only for the share price to fall by a greater amount than the decline in its net asset value? There is often a good reason why the shares are reacting in that way.

The structure of investment trusts, which sees their shares traded on the stock market, means they can trade at a premium or discount to the underlying value of their investments or their NAV (net asset value). This is different to funds such as unit trusts which always trade in line with NAV.

In plain English, with investment trusts it is possible to buy 100p of assets for 90p, meaning you've got a 10% discount. Equally, some trusts may cost you 110p to buy 100p worth of assets, meaning you're paying a 10% premium.

Net asset value is the value of all the investments held by a trust minus any debt it is carrying. Trusts can borrow to invest, and these borrowings are deducted from the combined worth of its holdings to calculate the NAV.



Fund managers might prefer to be judged on the net asset value performance, but most investors will look at the share price and dividends to see how much money they've made from their investment.

Investors need to think about all the factors that could move the share price of each underlying company in a trust's portfolio, and they need to think what could influence the share price of the trust itself.

These are some of the key factors that can influence the price of a company in a trust's portfolio:

- News flow – either directly or indirectly such as news from a company in the same sector
- Financial strength or weakness
- General market sentiment
- Political developments
- Economic developments
- A change in the rating that investors are willing to pay for the stock (such as price to earnings)
- Hype

The aforementioned factors will play a role in whether the companies in an investment trust portfolio see their share price rise or fall. Then there are additional factors which can also move an investment trust's own share price including:

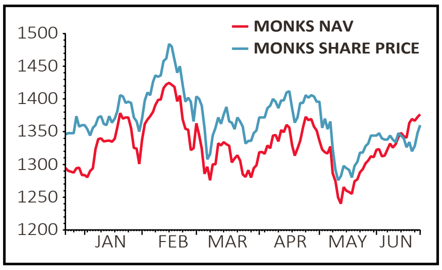
- Market sentiment towards investment style, sector

or geography
- Change in fund manager
- Marketing activities
- Assets hit a milestone (such as £200 million) which increases the trust's appeal to a wider range of investors

MONKS INVESTORS TAKE A HIT

Baillie Gifford-managed **Monks Investment Trust (MNKS)** is an example of trust whose share price, at the time of writing, was not moving in tandem with its net asset value.

On 12 February 2021, its share price was £14.62, and its NAV was £14.22, meaning it traded at a 2.8% premium. By 18 June 2021, its share price had fallen to £13.20, and its NAV stood at £13.75, meaning it was trading on a 4% discount to NAV.



Someone who had bought on 12 February would therefore have seen their investment fall 9.7% by 18 June, even though Monks' net asset value had only declined by 3.3%. They suffered because the value of the portfolio not only fell, but also the trust went from a premium to a discount – so a double hit.

Monks invests in growth stocks which were less in favour in the first half of 2021 as the market rotated in favour of value stocks. That could be one reason why the investment trust's shares moved to trade below the value of its assets.

Monks invests in fast growth stocks like Chinese food delivery platform Meituan, which has recently lost favour with investors

Another reason behind Monks' derating might be investors banking profits in all things related to Baillie Gifford. The asset manager had enjoyed a stellar run for several years up to late 2020 and its funds and trusts became incredibly popular with investors. In a way, it could have been the victim of its own success, and at the first sign of performance tailing off, some investors have lost interest.

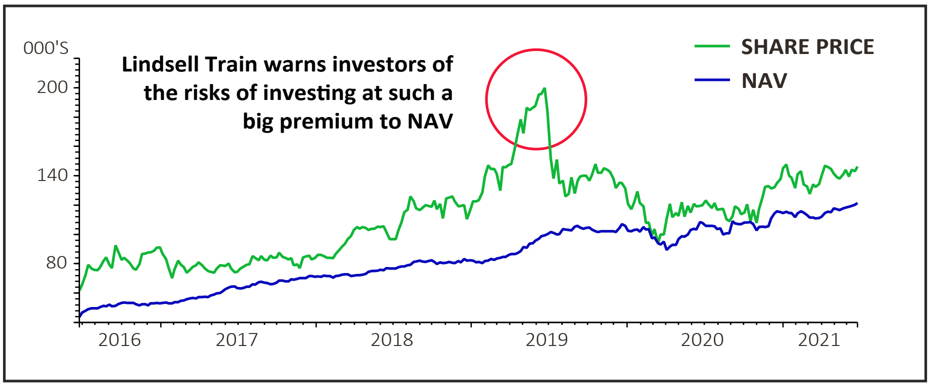
Sometimes the opposite can happen – factors occur which push up the value of an investment trust's shares by a greater amount than the rise in net asset value. This can be down to a trust's investment style coming into favour, the trust providing a way to access a hot theme or the fund manager having a run of good luck that attracts more investors.

DEALING WITH PREMIUMS

When a trust's shares trade at a premium they may seek to control it by issuing new stock or they might even warn investors about the risks of investing at over the odds levels.

Lindsell Train (LTI) did this consistently in 2018 and 2019 when at times its premium topped 90%. A big part of the reason behind this eye-watering premium was the perceived undervaluation of its substantial holding in asset manager Lindsell Train Limited.

These warnings proved prescient as the current premium has shrunk to just 13.5% at the time of writing as the trust and its investment style has gone out of fashion.



TRYING TO CLOSE DISCOUNTS

There are two main avenues available to a trust seeking to trim the discount to its NAV. These are sometimes formalised as 'discount control mechanisms' which automatically kick in when the discount is anywhere between zero and 10% or sometimes higher.

This could involve a trust purchasing its own shares in the market. By reducing the number of shares in issue this increases the NAV attributable to the remaining shares.

Tender offers or redemptions, which see the trust provide shareholders with an opportunity to sell a proportion of their shares back to the company at either a fixed discount to NAV or a price close to the NAV itself, are also used.

Another measure is a continuation vote, with trusts putting their continued existence to shareholders at a meeting, with the option of the trust being wound up and its assets sold off. The proceeds would then be returned to investors.

OTHER WAYS DISCOUNTS NARROW

A change of manager is often a catalyst for a discount to NAV to narrow. For example, since **Scottish Investment Trust (SCIN)** announced it was considering options to replace underperforming portfolio manager Alasdair McKinnon the discount on the trust has narrowed from more than 10% to less than 9%.

Should a new manager be appointed, and assuming investors like what they see, it is possible the discount could narrow further as the market effectively reappraises the trust.

A trust can trade at a discount because of a low profile. Often all it needs is a concerted effort on the marketing front to raise its profile and see a discount narrow.

Passing certain milestones for assets under management can also trigger a rerating. For example, breaking through the £200 million AUM mark can be a key turning point in how the market views a trust.

Some wealth managers and high net worth individuals will only look at a trust once it is worth £200 million or more, as at that point it could have better liquidity – the ease at which you can buy and sell shares.

Qualifying for one of the major FTSE stock market indices is another trigger for a trust's share price to rise out of step with its net asset value. Tracker funds would become active buyers of the stock at this stage.

None of these catalysts are guaranteed to reduce the discount though and, particularly if you are investing for the long term, getting too hung up on modest variations in the premium or discount at which a trust trades is probably a mistake.

The track record and the extent to which the investment approach fits with your risk appetite and goals is more important.

Scottish Investment Trust's holdings include US restaurant and food distributor Cheesecake Factory

WHERE TO FIND USEFUL DATA

You can find the NAV of most investment trusts on the website of industry body the AIC (Association of Investment Companies). Information is also available on fees, historic performance and the relationship between the share price and the NAV.

If you spot an investment trust trading at a significant premium or discount to NAV it probably warrants further investigation. One thing you can do is to examine the Z-score – you can find this on the relevant investment trust information page of the AJ Bell Youinvest website under 'Z-statistics'.

Not to be confused with the Z-score metric used to measure the risk of bankruptcy, the Z-score for trusts shows how the current discount or premium NAV compares with the one-year average.

As a rule of thumb, a Z-score of -2 or less shows a trust is trading materially below its one-year average premium or discount to NAV while a score of 2 or more demonstrates the opposite.

DISCLAIMER: AJ Bell is the owner and publisher of Shares magazine. The authors own shares in AJ Bell.

By **Tom Sieber and Daniel Coatsworth**

RUSS MOULD
AJ Bell Investment Director

Can miners and oils dig the FTSE 100 out of its Brexit hole?

The UK stock market has disappointed in the five years since the EU referendum vote

The fifth anniversary of the UK's referendum on its membership of the EU (23 June) appears to be passing with barely a murmur.

Perhaps both 'Remainers' or 'Leavers' may be thinking there is no debate to be had, given the result and the UK's withdrawal from the economic bloc on 31 January 2020.

Both may have other things on their mind. In addition to the pandemic rumbling on, there are issue to consider such as a possible shift toward greater State (and central bank) intervention in the economy, technological change, record levels of indebtedness and the new Cold War with China.

Given all of this, it is easy to see why Brexit is getting less attention, after several years of vitriolic debate. Yet one thing is undeniable – the UK stock market has been an appalling performer over the five years since that vote. The question that investors must address now is whether that period of marked underperformance mean UK equities represent good value and worth a fresh look.

BOTTOM OF THE PILE

In local currency, capital return terms, the FTSE 100 is the single-worst performer among a list of major equity indices since the Brexit vote.

If the numbers were to be presented in sterling terms, then the performance gap would be slightly bigger, as the pound is down by 6% against the dollar, 10% against the euro and 2% against the yen since the referendum. Those falls only serve to increase the value of overseas assets once their value is translated back into pounds.

FTSE 100 is the worst performing major index since the Brexit vote in June 2016

Index	Country	since 23 June 2016
NASDAQ Composite	US	194.0%
BOVESPA	Brazil	147.0%
S&P 500	US	103.0%
BSE 100	India	92.3%
Dow Jones Industrials	US	90.3%
Nikkei 225	Japan	78.9%
RTS	Russia	78.8%
FTSE All-World	Global	76.6%
FTSE AIM All-Share	UK	72.2%
DAX	Germany	51.9%
SSMI	Switzerland	49.7%
CAC-40	France	47.1%
Hang Seng	Hong Kong	40.3%
FTSE 250	UK	30.2%
Shanghai Composite	China	24.7%
FTSE 100	UK	11.8%

Source: Sharepad

Even though the FTSE AIM All-Share can point to a better showing than the FTSE 100, the junior London market represents a low single-digit percentage of London's total market value, so that provides cold comfort at best.

Brexit and the political and economic uncertainty which followed the vote to leave may be one reason why UK stocks have lagged, as might be the tortuous journey of the necessary legislation through Westminster and Brussels. Perceptions that the UK dealt poorly with the earlier stages of the pandemic, and that its economy has been particularly hard hit, may be another.

But the FTSE 100 derives the majority of its earnings from overseas, so such domestic considerations should be an inconvenience at best, not a deadweight on its back.

Perhaps the real reason lies with the index's constituents and its sector mix. The combination of unpredictable miners and oil companies; banks whose margins are being ground away by record

FTSE 100 is dominated by miners, oils and financials

Percentage of market cap	
Financials	19%
Consumer Staples	17%
Industrial goods & services	13%
Mining	11%
Consumer Discretionary	11%
Health Care	10%
Oil & Gas	9%
Utilities	3%
Telecoms	3%
Technology	2%
Real estate	1%
	100%

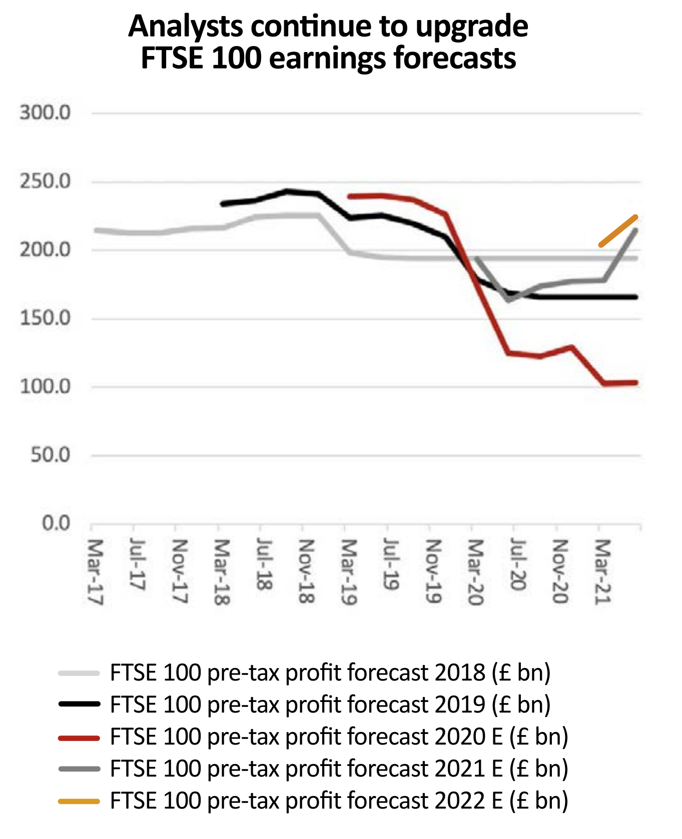
Percentage of profits	2021 E	2022 E
Mining	31%	26%
Financials	21%	21%
Oil & Gas	14%	13%
Consumer Staples	13%	13%
Industrial goods & services	7%	8%
Health Care	5%	6%
Consumer Discretionary	3%	6%
Telecoms	2%	3%
Utilities	2%	2%
Real estate	1%	1%
Technology	0%	1%
	100%	**100%**

Percentage of profits growth	2021 E	2022 E
Oil & Gas	36%	-14%
Mining	35%	-93%
Financials	13%	29%
Consumer Discretionary	7%	67%
Industrial goods & services	6%	26%
Consumer Staples	4%	25%
Real estate	2%	7%
Utilities	0%	5%
Telecoms	0%	9%
Technology	0%	4%
Health Care	(3%)	36%
	100%	**100%**

Source: AJ Bell, Company accounts, Refinitiv data, consensus analysts' forecasts

RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues



Source: Company accounts, Marketscreener, consensus analysts forecasts

low interest rates and quantitative easing; and plodders like pharmaceuticals and utilities does not necessarily fire the imagination.

This is important given a period when economic growth is modest, inflation equally so and investor sentiment turning cooler by the minute on industries like mining and oil because of the perception that the holes they drill and products they sell cause environmental harm.

A hefty weighting toward, and contribution from, consumer staples provides some ballast, but that includes two tobacco giants, whose business is not exactly flavour of the month with a lot of investors for ESG reasons either.

HEAVY METAL

All may not be lost. The earnings and market cap mix may sound unappealing when global growth is weak and inflation not an issue. But there still remains the possibility that this scenario is just about to change, and if so it seems logical to expect strong growth, rising prices (and presumably) higher bond yields and steepening yield curves to favour a market such as the UK, which is tightly plugged into the global economic cycle.

Strong momentum in FTSE 100 earnings would suggest as much. Buoyed by the miners and oils, and to a lesser degree the banks, aggregate profit estimates for the UK's leading index are marching higher. Analysts have increased their FTSE 100 pre-tax profit forecasts by 21% for 2021 and 9% for 2022 in the past three months alone.

The FTSE 100's failure to progress even as analysts are chalking up higher forecasts speaks of investor scepticism about oil's recovery, talk of a mining supercycle and the inflation trade more generally – note how analysts expect oils' and miners' earnings to fall sharply in 2022. But perhaps there lies an opportunity if growth and inflation do surprise on the upside.

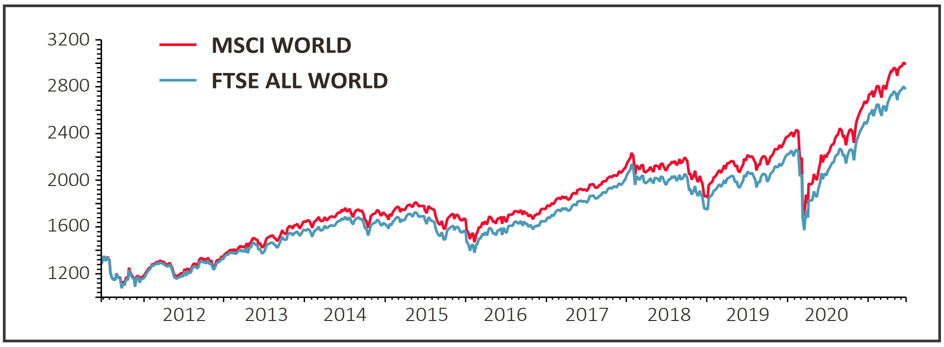
And while the FTSE 100 can point to just two bids for its members over the past year – RSA and now **Morrisons (MRW)** – there have been nearly 50 bids for companies further down the market cap ranks, either from trade or financial (private equity) buyers.

The average bid premium offered so far is 36%, so someone, somewhere thinks that downtrodden, unloved UK equities offer value, five years after the Brexit referendum result even if the outcome of that will only become clear after a long period of time, and not one artificial date.

Global tracker funds: How do they differ?

We compare products that use MSCI, FTSE and Solactive indices

I've been looking at ETFs as a cheap way of getting exposure to lots of global stocks but I've seen different products with different names, including ones which seem to track the FTSE All-World index and MSCI World index. Is there any difference between the two?
Sara



You're off to a good start, as one of the lowest cost ways to get started with investing in stock markets is through exchange-traded funds, and a popular way to get diversified exposure is through a global ETF, a type of tracker fund.

Before picking any ETF that has 'world' or 'global' in the name, there are a few things to consider, most notably which basket of stocks it tracks.

Two of the main indices used are the MSCI World and FTSE All-World. Others which are employed include global indices from Morningstar, S&P and Solactive, but the MSCI and FTSE ones are far more commonly tracked by ETFs.

Both have similar top 10 constituents featuring US giants Apple, Alphabet, Amazon, Facebook, Microsoft and Tesla but there are important differences between the two, which mostly stem from the fact the FTSE All-World includes emerging market companies alongside those in developed markets while the MSCI World is exclusively tracking developed market equities.

This has implications for their US exposure, for example. Around 66.5% of the MSCI index is made up of US stocks compared to 56.6% for the FTSE index. The latter also has the world's largest semiconductor company, Taiwan Semiconductor, in its top 10 while the MSCI index does not.

Generally speaking, the FTSE index also has more exposure to Asia, with a 12.3% weighting to stocks in China, Hong Kong and Japan, making it a more diversified option.

As the chart shows this has resulted in subtly but still noticeably different performance over the past decade.

When picking an ETF, another issue to consider is cost. ETFs are one of the lowest cost ways generally to put your money to work in the stock market, and keeping costs down is important in boosting your investment returns.

The global ETF with the lowest charge is **Amundi Prime Global (PRIW)**, which costs just 0.05% a year and follows the Solactive Global Developed Markets Large and Mid Cap USD Index, but its relatively lower level of assets under management at $365 million means the cost between buying and selling, called the bid/offer spread, could be higher and materially increase the total cost of trading the product.

More popular options tracking the MSCI World include **Lyxor Core MSCI World (LCWL)** which costs 0.12% a year and has $1.1 billion in assets, and **iShares Core MSCI World (SWDA)**, which costs 0.2% a year and has $40 billion in assets.

Vanguard FTSE All-World (VWRL) tracks the FTSE index and has an ongoing charge of 0.22% as well as assets of $8.7 billion.

By **Yoosof Farah**
Reporter

WIN A COPY OF ANDY BELL'S BOOK

Details at the end of the article

Andy Bell: my role in shaping the pension rules

The founder and chief executive of AJ Bell was part of the journey that lead to ministers changing the rules on self-invested personal pensions

Self-invested personal pensions or SIPPs have become the retirement savings product of choice for investors wanting pensions that offer transparency, control, choice and competitive pricing.

CREATING THE SIPP RULES

The current list of what SIPPs can invest in was fixed in 2006. But in the years running up to these new rules, the government had consulted on whether it should radically open up what SIPPs could invest in.

At the time, the press printed story after story suggesting that holiday homes both in the UK and abroad, racehorses, works of art, fine wine, luxury yachts, flats for your kids and many more eye-catching investments might all be allowable in SIPPs, enabling you to acquire these investments with the assistance of tax relief.

Each week the stories became more outlandish, but the government seemed intent on maintaining its position that virtually anything would be acceptable when it came to investing in SIPPs.

This period of intensive press coverage just served to raise the profile of SIPPs in the eyes of pension savers and their advisers. People weren't interested in traditional personal pensions or stakeholder pensions anymore, with their usually limited range of investment options. Everyone wanted a SIPP.

MY VIEW ON THE MATTER

I was quite vocal at the time – both in the press and in discussions with HMRC – that I thought this move was madness. I was taking phone calls from Spanish property agents asking if we would run a branded SIPP for them. Considering the significant property slump in Spain following the banking crisis of 2007/08, I imagine the story wouldn't have ended well.

Anyway, good sense did eventually prevail, and I am led to believe that two events in the run-up to the 2005 Pre-Budget Report, now called the Autumn Statement, caused ministers to change their mind. I was involved in both of those events.

The first involved a *Sunday Times* article, or, more specifically, its headline. One of the big Scottish insurance companies had put out a press release saying that approximately £10 billion of pension money would be invested in residential property come the day when the new rules were introduced.

The journalist who wrote the

story asked me to check her article for technical facts. The article was fine, but I did have a problem with the headline. It read 'Residential property in SIPPs to cost Treasury £4 billion'.

The simple logic applied by the headline writer was that tax relief at 40% would be granted on this £10 billion, so that was the cost to the Treasury. The point I made was that most of the money that would be used to buy residential property was already in SIPPs up and down the country and hence tax relief had already been granted.

My point was ignored but apparently this headline acted as a wake-up call for ministers about the scale of what they were about to sanction.

KEY REASONS TO HAVE A SIPP

- Tax relief on contributions at your marginal rate of tax
- Investments grow free of income and capital gains tax
- A quarter of the value of your SIPP fund can be taken tax-free from the age of 55 (age 57 from 6 April 2028)
- Pension income can be drawn directly from your SIPP instead of buying an annuity
- Benefits payable on death are typically free from inheritance tax (though beneficiaries will have to pay income tax where the deceased was 75 or older when they died)
- Investment flexibility, before and after retirement
- Transparency of charges
- Low cost
- You are in control
- All your pensions are accumulated in one place

KEY REASONS NOT TO HAVE A SIPP

- You are in a company pension scheme that meets your pension needs
- You can only access your benefits from the age of 55 (age 57 from 6 April 2028)
- You can only access your SIPP in the form of a lump sum and taxable income
- SIPPs can't invest in certain assets, such as residential property

WAS I SET UP?

While I can probably claim the moral high ground on the dodgy headline saga, I struggle to do so with the second part of this story.

I received a call just before the 2005 October half-term from a BBC researcher asking if I would be interviewed on *Newsnight* to discuss the impending pension rule changes. Their plan was to do a feature on racehorses, boats, Spanish holiday homes and vintage cars being held in SIPPs. The thought of being on the wrong end of a Paxman-style grilling didn't appeal, but I did see an opportunity to put forward the voice of reason.

After checking my diary, I realised I was in Spain on holiday that half-term week, so it was all academic. 'No problem,' the researcher said, 'we will meet you in Puerto Banus when we are doing the boat piece and interview you then.'

So, I agreed and duly met up with Justin Rowlatt, the BBC presenter, one Thursday morning in Puerto Banus where we boarded a luxury 65-foot Princess Yacht that the BBC had chartered for the day and set out to sea.

WHAT SIPPS CAN INVEST IN

SIPPs offer access to a wide range of investments from around the world, such as:

- Shares quoted on HMRC-recognised stock exchanges
- Unit trusts and OEICs, also known as collective investments
- Government bonds/gilts
- Corporate bonds
- Permanent interest-bearing shares
- Warrants
- Investment trusts
- Exchange-traded funds
- Exchange-traded commodities

Full SIPPs may also be able to hold:

- Commercial property
- Unlisted shares
- Unregulated collective investments

I was asked to stand on the boat, holding a glass of champagne and the filming began. You can probably see what is coming and, to be honest, as the first sip – no pun intended – went down, so could I.

When the interview was aired, the edit did not include my protestations for a government U-turn and instead were replaced with some general musings about pension simplification being welcome.

What was evident to BBC viewers, however, was that the chief executive of this particular SIPP provider would be quids in if these changes went ahead. Look at him celebrate on what could well be his own boat, sipping champagne, soon to be an asset of his SIPP no doubt.

U-TURN

Apparently, ministers were apoplectic with rage and, very soon, I started to hear rumblings

SIPPs offer the same tax advantages as traditional personal pensions, meaning basic-rate, higher-rate and additional-rate taxpayers can get 20%, 40% and 45% tax relief on contributions respectively. There are some nuanced differences for those paying Scottish income tax, but the principles are broadly the same. Investments held within a SIPP also grow free of income and capital gains tax.

While mainstream pension plans typically only offer access to a predetermined selection of funds, SIPPs allow you to invest in a far wider range of assets, including unit trusts, OEICs, shares, bonds, exchange-traded funds and commodities.

A quarter of the value of a SIPP can be taken as a tax-free lump sum from the age of 55 (increasing to age 57 from 6 April 2028). SIPPs also give you the flexibility to remain invested in stocks, shares and other investments while you draw a pension income, as an alternative to buying an annuity. All in all, this means SIPPs are an extremely efficient way of saving for the long term.

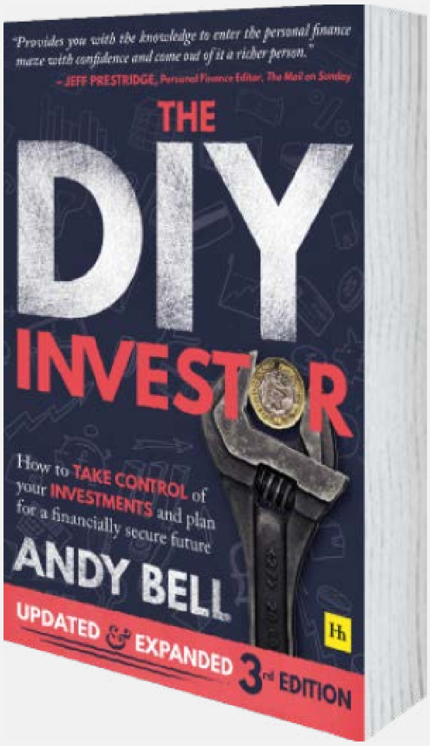
that a U-turn was on the cards. On 5 December 2005, the U-turn was announced, so at least the end result was the right one.

This U-turn introduced the concept of taxable property. It was not the outright ban I had hoped for, but instead, tax charges would be imposed should a SIPP invest in any assets that HMRC deemed inappropriate.

Residential property clearly fell on the wrong side of the line, as did racehorses, vintage cars and most other esoteric assets at the heart of the press excitement. But the rules around some other investments, such as unquoted shares, were – and still are – horrendous and unworkable.

It is possible to hold unlisted shares in a SIPP, but there are complex rules surrounding when it is permitted to do so. Many SIPP providers do not allow unquoted shares because of the complexities of ensuring these rules have not been breached.

WIN!



WIN A COPY OF ANDY BELL'S BOOK, THE DIY INVESTOR

We have five copies of the latest edition of Andy Bell's book, The DIY Investor, to give away. Simply send your name and postal address to editorial@sharesmagazine.co.uk with the words 'DIY Investor book competition' in the subject line.

The deadline for entries is 11 July 2021 and we will pick five winners at random.

This is an excerpt from Andy Bell's book, *The DIY Investor: How to take control of your investments and plan for a financially secure future*, published by Harriman House.

DISCLAIMER. Andy Bell is the founder of AJ Bell, the financial services company which owns Shares magazine. He owns shares in AJ Bell, as does Daniel Coatsworth who edited this article.

Is a pensions tax raid coming soon and how might you be affected?

Rumours suggest widespread changes to tax relief rates and other factors impacting retirement savings

You will have been hard pressed to flick through the financial pages of a national newspaper in the past couple of weeks without reading rumours that the Treasury is considering a tax raid on pensions to help pay for the costs of the COVID crisis.

This is by no means the first time such speculation has arisen, but usually it rears its head before the Budget, when the Treasury likes to fly a few policy kites to gauge public reaction.

There may be some substance to the rumours this time. But just because the Treasury is considering a policy, it doesn't mean it will see the light of day, and there remain many reasons why raising large sums of money for the Exchequer from the pensions system is a non-starter.


© HM Treasury

EQUALISING TAX RELIEF?

The most headline-grabbing reform said to be under consideration is equalising the rate of tax relief provided to basic rate and higher rate taxpayers.

Currently savers get pension tax relief at their marginal rate of tax, so 20% for basic rate and 40% for higher rate taxpayers.

Analysis carried out by the Pensions Policy Institute suggested that equalising these rates at 30% would cost the Government money, while a rate of 25% might save between £2 billion and £3 billion a year, and a 20% rate would save around £6 billion to £8 billion a year. So, if the plan is to raise funds for the Treasury, the flat rate would need to be set well below 30%, and perhaps as low as 20%.

HOW YOU COULD BE AFFECTED

Such huge savings would clearly come at a cost to individuals. A 35-year-old higher-rate taxpayer earning £60,000 a year and paying 4% of salary into a pension until age 67 could miss out on £50,000 of retirement income, if a flat rate of 20% was introduced.

Those earning more or making larger contributions would face an even bigger hit to their plans.

That's not going to play well

with the millions of higher rate taxpayers across the country, or their families, many of whom will be Conservative voters.

Conservative backbenchers are already twitchy about losing core supporters in the wake of the Chesham and Amersham by-election result, and the Government will be under no illusion that a tax grab on the pensions of Middle England will simply sail through Parliament unopposed.

BAD NEWS FOR HIGHER EARNERS?

But there's even a bigger fly in the ointment for reform of pension tax relief, and that's the way guaranteed defined benefit pensions work, with most of these now being in the public sector.

To apply a flat rate of relief to these pensions, a tax charge would need to be handed to higher earning employees.

A higher tax bill for doctors would not sit well with the public

Doctors and senior NHS staff, who have been on the front line dealing with the pandemic, would likely end up with tax bills running into thousands of pounds as a result.

That doesn't sound like a battle the Government would want to take on, considering the likely reaction from both the press and the public.

LIFETIME ALLOWANCE CUT?

There are other reforms which might be under the microscope too. A reduction in the Lifetime Allowance, and taxing employer pension contributions, have also been mooted.

While at first glance such measures might sound more palatable, they would still represent an attack on people's pensions, which will only be as lucrative for the Exchequer as it is painful for savers.

The Government has backed itself into a corner by ruling out increases to income tax, National Insurance and VAT in its election manifesto.

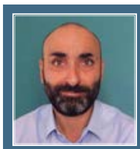
But if the Treasury's bean counters really are greedily looking at the pension system with pound signs in their eyes, there's a fundamental equation which they'll keep banging their heads up against.

The more money they want to save, the more people's pensions they would have to raid, and the bigger the backlash would be. While reform isn't impossible, it would be an uphill battle for a Government that's already got a lot on its plate.

LISTEN TO TOM SELBY DISCUSS THE RUMOURS ABOUT PENSION TAX CHANGES

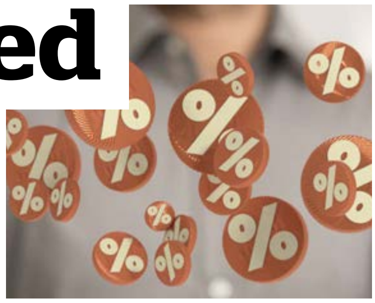
The 25 June episode of *Shares* and AJ Bell's *Money & Markets* podcast features AJ Bell's senior analyst Tom Selby discussing the implications of the rumoured changes to the pensions system.

Click here to listen to the podcast, or go to Spotify, Amazon Music or Podbean to hear this episode and more. The segment can be found at 33:55 minutes into the episode.



By **Laith Khalaf**
Financial Analyst

Why has HMRC charged so much tax on my pension withdrawal?



AJ Bell's Tom Selby explains the rules around 'uncrystallised funds pension lump sums'

I've just taken a £20,000 UFPLS from my pension. I have no other taxable income, so expected a quarter of it (£5,000) to be tax free and the rest subject to a few hundred quid of tax. Yet, HMRC has taken several thousand pounds. Is this right? ***Carol***

Tom Selby
AJ Bell
Senior Analyst says:

UFPLS stands for uncrystallised funds pension lump sum and is one of three primary ways of taking a retirement income from a defined contribution pension, alongside an annuity or entering drawdown.

A UFPLS is an ad-hoc lump sum taken directly from your pension pot, with 25% of each lump sum tax-free and the rest taxed as income.

Therefore, someone who has no other taxable income and takes a £20,000 UFPLS might expect the first £5,000 to be tax-free, with the remaining £15,000 taxed as income.

Based on 2021/22 income tax rates the first £12,570 should fall within the personal allowance, with the remaining £2,430 taxed at 20%. So, in theory, you might expect your total tax bill to be around £486.

This won't be how it plays out if it is your first taxable pension withdrawal of the tax year. Instead, HMRC will have required your pension provider to apply the emergency tax code on a 'Month 1' basis. Your usual allowances will be divided by 12 and applied to the taxable part of your withdrawal.

Note the tax-free portion of your withdrawal should always be tax-free (provided you have sufficient lifetime allowance available).

Let's take the example of someone who has taken a £20,000 ad-hoc lump sum from their pension. The first £5,000 is tax-free, with the rest subject to income tax. If a Month 1 tax code is applied to the rest of the remaining £15,000 withdrawal, the personal allowance is £1,047.50 (£12,570 divided by 12).

The portion taxed at 20% will then be £3,141.67 (the £37,700 basic-rate tax band divided by 12), generating a bill of £628.33.

The portion taxed at 40% will be £9,358.33 (the £112,300 higher-rate tax band divided by 12), resulting in a £3,743.33 bill.

Finally, the remaining £1,452.50 of the withdrawal will be taxed at 45%, generating a bill of £653.63.

That means a total tax bill on the £20,000 withdrawal of £5,025.29 – over 10 times what you might have expected to pay.

This issue tends to only affect the first flexible withdrawal you make in a tax year, either by drawdown or UFPLS.

If you take a regular income, then HMRC should sort out your tax position automatically via your tax code. If you only make one withdrawal then you will need to fill out one of three forms to get a refund, which HMRC says should be processed within 30 days:

- If you've emptied your pot by flexibly accessing your pension and are still working or receiving benefits, you should fill out form P53Z
- If you've emptied your pot by flexibly accessing your pension and aren't working or receiving benefits, you should fill out form P50Z
- If you've only flexibly accessed part of your pension pot then use form P55

If you are happy to wait HMRC will correct your tax position at the end of the tax year.

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.

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

5 July: Panoply Holdings, Hipgnosis Songs Fund.
6 July: Mercia Asset Management, Purplebricks.
7 July: Adept Technology, Enteq Upstream, Creightons.
8 July: Fuller, Smith & Turner, Watches of Switzerland, Jet2.

Half-year results

2 July: Reach. **5 July:** Porvair. **6 July:** RM.
7 July: Schroder European Real Estate Investment Trust.

Trading statements

6 July: Sainsbury's. **7 July:** Ferrexpo, Ten Entertainment.
8 July: Electrocomponents, Persimmon, Entain.
9 July: MJ Gleeson.

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