STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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NETFLIX

TUNE IN OR SWITCH OFF?

We consider if the shares are worth buying today

STOCK ANALYSIS: Our views on big news from Tesco, Next, EasyJet and ASOS

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CFA UK Publication of the Year CFA UK Journalism Awards 2019

News Provider of the Year (Highly Commended) CFA UK Journalism Awards 2020

UK sell-off: looking for stocks that have been unfairly sold down

Quite a few shares have seen double-digit share price declines in recent weeks despite the absence of any news

Look beyond the headline indices and you'll see some brutal damage to investment portfolios over the past month or so.

While the FTSE All-Share index, which is a good representation of the UK stock market, is down 2.4% since its year-to-date peak on 6 September, *Shares* has found that 502 London-listed stocks have seen a share price decline of 10% or greater in those five weeks.

That paints a different picture to the mainstream news which would suggest that global markets have had a wobble of late, but nothing too serious.

Since the FTSE All-Share peaked last month, 72 stocks have fallen by more than 25%. Some of these names were big winners in 2020, such as **Polarean Imaging (POLX:AIM)** which recorded a 209% share price gain last year. It has fallen by 32% in the past five weeks after the US authorities rejected its new drug application.

Parsley Box (MEAL:AIM) is down 65% in five weeks and is now trading 79% lower than the 200p at which it first joined the market in March, caused by two big downgrades to earnings guidance in quick succession.

In these situations, there was specific news driving the stock down. But that wasn't case across the board. There has been some indiscriminate selling as investors became spooked by broad inflation issues, the energy crisis and the prospect of interest rates going up sooner than previously expected.

For the savvy investor, now is the opportune time to sift through the wreckage to see if the market has oversold any stocks.

Musical equipment specialist **Gear4Music (G4M:AIM)** is down by 23% in the past five weeks, no doubt as investors fret over product availability and potential shipping delays. While these are clear risks, investors must ask if this potential bad news is now already priced in.

It is harder to understand why **Homeserve (HSV)** is down 18% in just over a month. Demand for its home emergency services won't be affected by inflation, supply chains or interest rates, beyond the customer's ability to afford its policies. Given they are not very expensive, one can only suggest its shares have suffered from investors selling indiscriminately.

The one stock that really catches our eye is online greeting cards seller **Moonpig (MOON)**. The shares are down 19% in five weeks, yet analysts have been upgrading earnings forecasts. Earnings upgrades are traditionally a catalyst for pushing up a share price.

Chairwomen Kate Swann saw the opportunity to buy more stock at a better price, investing £199,086 of her own money in Moonpig shares on 6 October.

The big question is whether Moonpig's shares were priced too high before the recent pullback or whether they are now too cheap.

Among the analyst community, Jefferies calls the stock 'attractive', but Davy says the valuation looks full, even after the recent share price retreat.

It's well worth studying price movements such as the ones we've just seen as you never know what opportunities they throw up. As for the split analyst views on Moonpig, a difference in opinion is what makes a market.

By **Daniel Coatsworth** Editor

Knock-on effects from higher gas prices are wider than many think

Multiple industries face further cost pressures which could lead to reduced consumer spending

A perfect storm has created a nasty energy shock which has seen natural gas, oil and coal prices soar this year. This isn't just a UK issue, but a global problem in part exacerbated by the strong economic rebound. The fallout could soon be seen in the results from manufacturers and other sectors.

Despite the UK economy being around three times larger than it was in the 1970s it today consumes two thirds less energy according to government data. This is testament to the efforts made to reduce energy intensity as well as a big shift from a manufacturing and agricultural-led economy to one based on services.

For example, manufacturing and heavy industry used to consume around two-thirds of the country's energy needs in the 1970s but that has since dropped to around a fifth.

Natural gas is used across many industries from steel and fertiliser production to ceramics, glass and food and beverages. Gas is an important ingredient for manufacturing certain types of fertilisers, and the closure of capacity has resulted in a shortage of carbon dioxide, which is a byproduct of making ammonia.

While fertiliser plants can be switched off when the cost of gas becomes prohibitive, that's not the same for glass furnaces which operate non-stop all year round until the end of their useful lives, usually around 20 years.

Carbon dioxide is essential to the meat and poultry trade, fizzy drinks and beer manufacturers and is even used as a coolant for the nuclear industry.

Housebuilders have flagged inflationary pressures with building materials for some time and they now face energy cost pressures as well. The problem could get worse if energy-intensive suppliers such as brick manufacturers pass on extra costs that they've had to endure from higher power prices.

Across multiple industries, companies will no doubt try to pass on increased costs which, with a lag, will deliver a double whammy shock to consumers already bracing themselves for higher energy bills.

We've recently seen several retailers including **ASOS (ASC:AIM)** and **Boohoo (BOO:AIM)** reporting a slowdown in sales growth, and now we face further pressure on consumer spending as higher energy prices leave less money in the public's pocket.

A more comforting piece of news for consumer prices was offered up by columnist John Dizzard who argues in the *Financial Times* that the global supply chain crisis is past its peak.

He flags data which shows that traffic through global ports is finally starting to ease as backlogs clear. If true, that should lead to lower price pressures on many companies, but how quickly that feeds into lower end selling prices is another question. On a downbeat note, Dizzard's prediction of a resulting inventory recession is less soothing. [MGam]

ASOS shareholders hope new CEO can revive share price growth

Online fast fashion purveyor parts ways with Nick Beighton after six years of mixed success

ASOS (ASC:AIM) shareholders might be glad to see the retailer search for a new chief executive, given how the share price has performed poorly for chunks of Nick Beighton's six-year tenure running the company.

Like rival **Boohoo (BOO:AIM)**, ASOS is suffering from an uneven demand recovery and global supply chain challenges.

ASOS has massaged down sales growth guidance for the year to August 2022 to between 10% and 15% and expects first half sales growth to slow to mid-single digits.

This year's adjusted pre-tax profit is now expected to be in the £110 million-to-£140 million range, so potentially as much as 40% below last year's £193.6 million haul, as return rates normalise and ASOS feels the pinch from Brexit duties and rising freight, delivery and labour costs.

Beighton did have some success at the business, having overcome warehouse problems and stock availability challenges. He can't be blamed for cost inflation as that is affecting multiple industries on a grand scale.

He helped to drive ASOS's continued global expansion, with revenue rising from below £1.5 billion to approaching £4 billion during his tenure.

In-roads were made in the US, ASOS capitalised on the closure of rivals' brick and mortar stores during the pandemic and snatched assets including Topshop out of the collapsed Arcadia empire, a stable of brands ASOS insists have seen 'sustained triple digit sales growth' since acquisition.

However, *Shares* is disappointed with ASOS' recent share price performance. At £22.86, the stock is now more than 50% below the £48.79 level at which we said to buy in January 2021.

To regain lost ground, ASOS will need to turn product designs around quicker to stand out from the fast fashion crowd and accelerate the growth of Topshop in North America. With fast fashion's practices in the firing line, it will also have to execute against ambitious new 2030 ESG (environmental, social and governance) goals.

We are heartened to hear ASOS' plans to become a £7 billion revenue business within three to four years by doubling the size of the combined US and Europe business, growing own-brand sales by at least £1 billion and strengthening the ASOS platform through the launch of 'Partner Fulfilment'.

We think it is worth sticking with the shares despite the near-term challenges. [JC]

Six year performance under Nick Beighton's stewardship

Year to August	Sales (£bn)	Pre-tax profit (£m)
2016	1.44	63.7
2017	1.92	80.0
2018	2.42	102.0
2019	2.73	33.1
2020	3.26	142.1
2021	3.91	193.6

Source: ASOS company results • Created with Datawrapper

IPOs still coming thick and fast despite some cancellations

Pod Point and Pantheon Infrastructure are among the latest names heading to the UK stock market

UK investors seem to have got over the blow of **Deliveroo (ROO)** and other flop IPOs (initial public offerings) with London's new listings matching Europe's bulging pipeline.

Despite ongoing inflation and interest rate hike threats, supply chain blockages and a stubborn Covid virus that refuses to go away, investors continue to be willing to back high-quality businesses that have a distinctive story and a reasonable price tag.

According to data from Bloomberg, nearly 20 companies have kicked off the stock market listing process already this month, including Swedish automaker Volvo Cars and several electric vehicle charging firms, of which Pod Point is one.

EDF-owned Pod Point owns, operates and sells car charging points, with a network of around 79,000 of its own UK-connected charging points. EDF plans to keep at least a 50% stake post-listing and support growth plans which include investing to expand its network.

Investment trust Pantheon Infrastructure is looking to raise £300 million as part of its London IPO. It is targeting between 8% and 10% per year net asset value total return and a 4% dividend yield once it has fully invested the money raised at IPO. Target investments include data centres, renewable energy infrastructure, ports and airports.

In the smaller company space, Tungsten West is seeking to join AIM and restart the Hemerdon tungsten and tin mine located near Plymouth, previously owned by AIM-quoted Wolf Minerals before it went into administration due to financial difficulties.

Other names potentially coming to the London market include buy now, pay later financing firm Klarna, online make-up seller Beauty Bay and

Zoom and Microsoft Teams video conferencing rival Starleaf.

Market speculation points to possible London listings for beer maker Brewdog, Jaguar Land Rover and online challenger banks Monzo and Starling, while Tik Tok-owner Bytedance and payments firm Stripe are rumoured to be set for international IPOs this year or next.

But with major global stock markets having traded sideways for six months and experiencing heightened volatility, nothing is certain. Several IPOs have been pulled such as mental health and nursing homes operator Icade Sante, language learning app Babbel, Virgin Atlantic Airways and pitched roof systems manufacturer Marley.

Patchy 2021 post-IPO performance is also undermining investor confidence in some cases. While the likes of **Darktrace (DARK)**, **Auction Technology (ATG)** and **Oxford Nanopore Technologies (ONT)** have lit up the UK stock market this year, **Made.com (MADE)**, **Victoria Plumbing (VIC:AIM)** and **Alphawave IP (AWE)** have disappointed.

According to Bloomberg data, more than 40% of the largest deals in Europe this year are now trading below their IPO prices, as investors turn cautious on highly valued companies. [SF]

Chubb's $5.7bn Asian deal has positive read-across to Prudential

The large transaction will put the spotlight on the Asian opportunity

American insurance company Chubb has acquired the life and health businesses of Cigna in seven Asia-Pacific markets for $5.7 billion in cash. This move validates **Prudential's (PRU)** increasing focus on the appealing dynamics in the Asian insurance market.

Penetration rates of savings, protection and health products are low in Asia, with China below 10% and India, Indonesia, Philippines and Thailand sub 5% in terms of premiums to GDP.

While there is meaningful population growth in these countries (excluding China), there's also a sizable aging population that isn't adequately covered, and there's growing interest among the middle-class to buy products for their retirement and to shore up their parents' situation.

Prudential has a leading position in fast-growing and increasingly affluent Asian markets, where it focuses on savings, health and protection.

Asian life insurance continues to grow strongly, and Prudential's agency distribution network seems well placed to capitalise on strong medium-term trends to higher insurance penetration.

UBS analyst Colm Kelly recently argued that 'Prudential's Asia business is intrinsically undervalued to the tune of 40%'. Chubb's acquisition of Cigna assets may act as a catalyst to close this valuation gap as more investors look at the opportunities on offer. [MGar]

Entain's silence on DraftKings takeover approach is puzzling

It has had three weeks to consider DraftKings' offer and shareholders need to know what management is thinking

INVESTORS HOPING that Ladbrokes and Coral owner **Entain (ENT)** would provide an updated response to September's unsolicited takeover approach from US fantasy sports company DraftKings at its third quarter trading update on 12 October were sorely disappointed.

If Entain's management wanted the numbers and continuing trading momentum to speak for themselves, they showed a strong hand, delivering a 23rd consecutive quarter of double-digit online growth, taking year-to-date growth to 21%.

Meanwhile US joint venture partner BetMGM continued to take market share and is now challenging for the number one position while in i-gaming it is the clear market leader.

Shore Capital believes the better than expected trading performance underpins Entain's target to deliver $1 billion of US net gaming revenues in 2022.

But it's not just about delivering progress in the US; Entain has ambitions to become the leading player in regulated gambling jurisdictions worldwide as well as entering adjacent markets to exploit the convergence of the media, entertainment and gaming industries.

The wider ambition sees the company's total addressable market tripling to over $160 billion.

Dangling impressive growth targets in front of investors might convince them to stay on board for the ride and means DraftKings might have to make a far superior offer than the £28 per share deal put forward, if it is to get enough shareholder support for the takeover. [MGam]

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EasyJet shares are underpricing the airline's recovery potential

If revenue forecasts are even vaguely right, earnings could surprise positively

It's perceived wisdom that ever since the Wright Brothers took to the skies over a century ago the airline industry hasn't turned a profit. For every boom there has been a more severe bust which has wiped out earnings leaving the industry in net losses.

Having said that, until the arrival of the perfect storm in the form of Covid-19, **EasyJet (EZJ)** had posted a profit every year since it was founded in 1995, demonstrating the strength of its business model.

EASYJET
BUY
(EZJ) 633.73p
Market cap: £4.8 billion

We believe, as the return of leisure travel accelerates over the course of the next 12 months, EasyJet is likely to return to profitable growth faster than anticipated and is being undervalued by the market.

LEANER AND FITTER

In the quarter from April to June last year, the firm's entire fleet was grounded for all but two weeks. In the same quarter this year, capacity was still only 17% of 2019 levels due to on-off restrictions, but in the quarter to September it was 58% and this quarter it should be 70% of 2019 levels.

Due to UK travel restrictions, aircraft have been switched to its most popular European routes, increasing the airline's presence in many markets in the process, and bookings for the next six months are already double year-ago levels.

In the three months to September headline losses were halved and operating cash flow turned positive. Cash burn has been significantly reduced and the firm expects to deliver structural cost savings of £500 million this year, of which almost half will be sustainable on an ongoing basis.

To bolster its balance sheet and give it flexibility to grow, it launched a £1.2 billion rights issue last month. The airline believes there will be 'considerable opportunities' to grow as legacy carriers restructure their short-haul businesses.

GREATER COMPETITION

In our view, the biggest threat to EasyJet's recovery comes from its rivals. For decades, most airlines have only covered their costs flying tourists in economy class and have relied on business passengers to make the bulk of their profits.

When business travel came to a standstill during the pandemic, airlines around the world suspended their first class and business class services. Although business travel has tentatively returned, executives are increasingly opting to use private jets for short flights. And while the UK to US route has reopened, the lucrative long-haul business market is unlikely to ever return to the same size.

As a result, many European

airlines have ripped out first class and business class seats and replaced them with 'premium economy', offering passengers more space at a higher price than the cheapest seats but a discount to business class.

'Premium economy is the most profitable real estate on the aircraft, and the pandemic has reinforced that,' says Finnair chief executive Topi Manner.

According to Lufthansa, premium economy generates 33% more revenue per square foot than economy and 6% more than business. It's also more profitable than business because it's cheaper to install and takes up less space.

THE WRONG PRICE

Even allowing for greater competition, we think EasyJet shares are under-pricing the company's recovery potential. We aren't looking at the price to earnings multiple – which is distorted due to a rise in the number of shares – but at the market's low expectations for the next year.

The shares are priced for losses of more than £1 billion for the year just ended and only £88 million of pre-tax profits for the year to next September, against an average run-rate of £430 million to £440 million of profits in 2017/18 and 2018/19.

This seems odd to us as, while revenues for the year just ended are seen shrinking to £1.4 billion from around £6 billion pre-pandemic, for next year they are seen recovering to over £5 billion and by 2023 they are seen well above their historic average.

Based on these revenue forecasts and considering the effort the firm has made to reduce costs, we think earnings are likely to surprise to the upside.

A TEMPTING TARGET

We clearly aren't the only ones who think the shares are mis-priced, as this summer the firm rebuffed a takeover bid, widely believed to be from low-cost rival **Wizz Air (WIZZ)**.

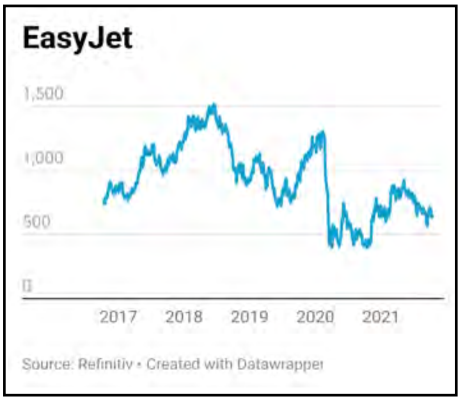
EasyJet chief Johan Lundgren said he wasn't against a deal in principle, but it needed 'to be able to deliver value for shareholders and to deliver a reason to believe in a successful outcome'.

Ryanair (RYA) chief executive Michael O'Leary, never one to shun the limelight, was quick to stir the pot saying it would be 'sensible' for EasyJet and Wizz to merge.

However, we suspect British Airways, owned by **Intercontinental Airlines (IAG)**, is a more likely suitor, and it is unlikely to get a better opportunity. The airline has just restarted operations from Gatwick, EasyJet's main hub, and has been looking at options to starting its own low-cost operation.

Moreover, EasyJet founder Stelios Haji-Ioannou, who has had his differences with the current management, no longer owns a 25.4% blocking stake after refusing to take up his shares during the latest rights issue. The family's stake is now just 15.3%, big but not big enough to block an approach.

Investing in EasyJet means having the stomach to cope with a share price that could experience wild swings up and down. However, for those comfortable with this situation, the stock looks like a screaming buy at the current price. [IC]

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The fund that seeks to defend against inflation

Latitude invests in stocks for long-term growth but balances this with lower-risk non-equity investments

We could be about to enter a trickier period for stock markets as risks around slowing economic growth and rising prices mount.

A fund which maintains exposure to shares with long-term growth potential and with exposure to more defensive bonds looks like a good option. **Latitude Horizon (BG1TMR8)** fits the bill and has demonstrated a decent level of performance, achieving a three-year annualised return of 8.1%.

It has an ongoing charge of 1.28% which is higher than a typical global or UK equity fund, reflecting the fact that it is doing a lot more than just picking stocks.

The £234.5 million fund is steered by Freddie Lait, who set up Latitude Investment Management in 2016 having previously established a track record at hedge fund Odey Asset Management.

The strategy is refreshingly straightforward. Around half the portfolio is held in a concentrated list of stocks with annual turnover in the portfolio of around 10%.

The aim with the equity part of the fund is to achieve strong returns through different economic and market cycles by buying quality businesses and diversifying across different sectors and countries.

The fund targets firms which can deliver between 10% and 12% growth in intrinsic value, measured by cash flow, net asset value and earnings.

LATITUDE HORIZON FUND
BUY
(BG1TMR8) 123p

Net assets:: **£234.5 million**

The top holding is currently Autozone, a US firm which sells car parts and accessories. Other names in the portfolio include soft drinks giant Coca-Cola, Facebook and Google-owner Alphabet.

The remaining part of the portfolio is invested in government bonds, inflation-linked bonds, currencies and commodities like gold to offset some of the risk of volatility in the stock market.

This is intended to limit exposure to any market corrections, with the fund potentially pulling back by a little less than half the downwards move in the wider market.

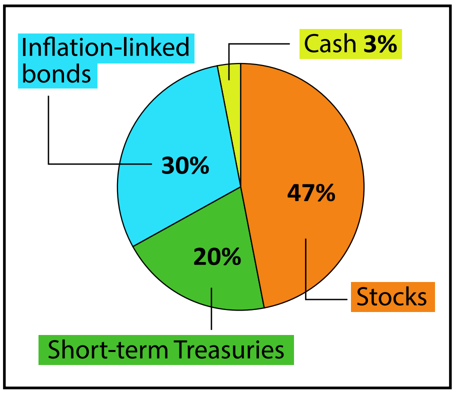
Around 30% is invested in inflation-linked bonds, which should help shield the portfolio from rising prices.

In its most recent monthly commentary, the fund noted: 'We continue to believe that the optimal defence against inflation is a well-diversified, reasonably priced portfolio of large-cap stocks, which offer strong prospects for growth.

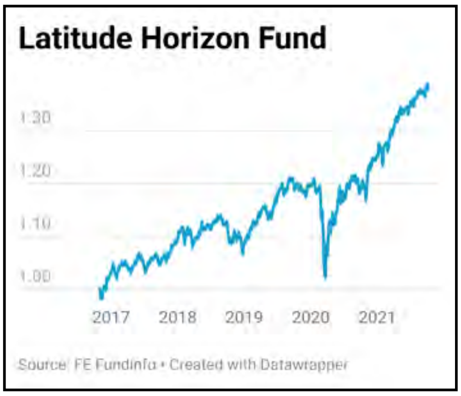
'Including many companies with pricing power, and those which benefit from rising rates and inflation further lowers the risk.

'Short-dated inflation-linked bonds are still under-pricing inflation risk and are a more attractive option at this point to alternative solutions, or even gold. This has been our core asset allocation within the fund for the past couple of years, weathering numerous market environments well. We remain committed to it.' [TS]

Latitude Horizon asset allocation



Source: Latitude



JAPAN – RESILIENCE IN A TIME OF CRISIS

Covid-19 may have been less catastrophic than the seismic events regularly afflicting the island nation, but the stay-at-home 'demand shock' of the pandemic may ultimately have a bigger impact on consumption patterns than recurrent earthquakes and tsunamis.

The value of your investment and any income from it can go down as well as up and as a result your capital may be at risk.

To the managers of Baillie Gifford's Japanese Fund, 2020 demonstrated the country's impressive resilience in times of crisis, while boosting some of its most exciting companies. Performance throughout the year further justified managers' belief in Japan's underappreciated potential and range of opportunity.

Long-familiar names as well as relative upstarts within this concentrated, low-turnover portfolio have emerged in good shape, defying the pandemic just as they have the country's endemic problems with demographics, its deflationary mindset and its weakness for sub-optimal corporate governance.

The fund's most obvious strength is its 30 per cent weighting in internet-based companies. Key beneficiaries of shifting consumption habits, they have long been seen by managers as a strong source of future growth. Ecommerce penetration in Japan is still low by global standards and the rate of catch-up looks set to accelerate post-Covid. On the other side of that coin, managers have trimmed some big name offline 'old Japan' companies, including some that the market still generally favours.

But it's not just 'new Japan' companies, such as ecommerce pioneers Rakuten and GMO Internet, or gaming and social media companies such as Mixi and Gree that excite Japanese Fund stock-pickers. They are also looking at opportunities that emerging technologies offer Japanese world-beaters such as tire maker Bridgestone, and robotics specialists Fanuc and SMC.

Against a background of heavy blows to demand and profitability across corporate Japan, performance has vindicated the Japanese Fund managers' belief that diverse stock-picking themes and growth styles (secular growth; growth stalwarts; special situations and cyclical growth) are the best insurance against contingencies and shifting consumer behaviour.

ANNUAL DISCRETE PERFORMANCE					
	30/06/16-30/06/17	30/06/17-30/06/18	30/06/18-30/06/19	30/06/19-30/06/20	30/06/20-30/06/21
Baillie Gifford Japanese Fund - Class B-Acc (%)	34.6	16.1	0.4	4.7	18.0
TOPIX (%)	24.2	9.5	-2.1	6.1	10.7
TOPIX +1.5 (Target) (%)	26.1	11.1	-0.7	7.7	12.4
IA Japan Sector Average (%)	24.9	10.7	-3.4	7.8	13.2

Past performance is not a guide to future returns

All data as at 31 July 2021 and source Baillie Gifford & Co Limited unless otherwise stated. Past performance is not a guide to future returns.

Performance source: StatPro, FE, Tokyo Stock Exchange, total return in sterling.

The manager believes that the TOPIX +1.5% is an appropriate target given the investment policy of the Fund and the approach taken by the manager when investing. In addition, the manager believes an appropriate performance comparison for this Fund is the Investment Association Japan Sector.

Changes in the rate of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested. The Fund's share price can be volatile due to exposure to a single market, a single currency, movements in the prices of the underlying holdings and the basis on which the Fund is priced.

This article does not constitute, and is not subject to the protections afforded to, independent research. Baillie Gifford and its staff may have dealt in the investments concerned. The views expressed are not statements of fact and should not be considered as advice or a recommendation to buy, sell or hold a particular investment.

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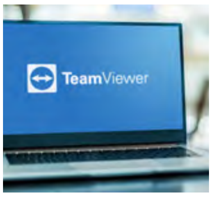
TEAMVIEWER
(TMV:XETRA) €15.20

Loss to date: 59.3%
Original entry point:
Buy at €37.38, 8 April 2021



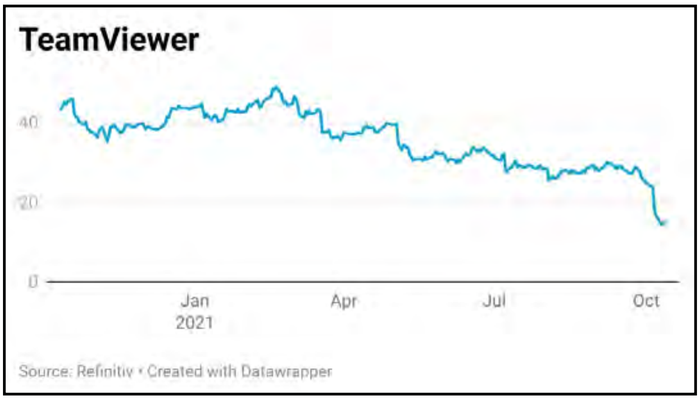
AFTER A HUGELY successful 2019 listing in Germany and months of bullish growth projections, the TeamViewer reality check arrived last week.

In what the company admitted were 'very bad' and 'very disappointing' results, management cut this year's sales and profit guidance and scaled back ambitious medium-term financial goals, warning various headwinds were likely to be 'persistent rather than temporary'.

The share price plunged, losing 40% in just a few days and extending a 2021 decline to 69% since this year's February €49.13 peak.

TeamViewer saw a huge increase in demand for its remote connectivity software through 2020 as many corporate clients were forced to ask their staff to work from home. Unfortunately, fewer than expected customers have renewed their contracts.

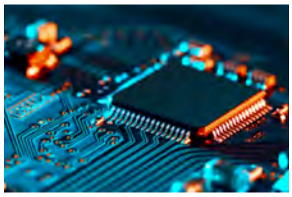
Investors might well wonder if management had their priorities right, announcing high profile sponsorship deals with Manchester United and the Mercedes Formula 1 and Formula E racing units while financial performance was under-shooting promises so badly.



SHARES SAYS:
Very disappointing results full of bad news. It's hard to always win with investing and this is an example where we didn't get it right. Cut your losses and walk away. [SF]

ASML
(ASML:AMS) €634.90

Gain to date: 139.9%
Original entry point:
Buy at €264.60, 23 April 2020



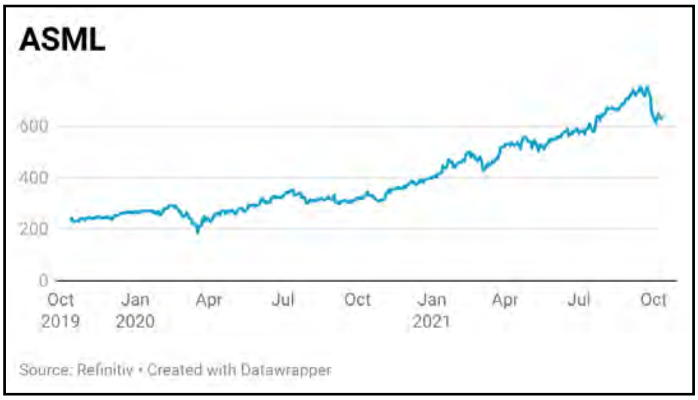
REGULATORS MIGHT NOT like them but investors love a monopoly and Dutch microchip tech firm ASML remains the only company in the world with the extreme ultraviolet lithography machines that chip giants like TSMC, Intel and Samsung need to make the smallest and most sophisticated microprocessors.

In the 18 months since we said to buy the stock has more than doubled. Experts believe substantially more value will be created for investors over the next year or two.

Last month the €262 billion business raised forecasts and said it can see revenue growth of around 11% annually through to 2030 amid booming demand for its products.

That would imply nearly €30 billion of sales, having done €14 billion revenue last year. Gross margins will climb from 46% to 55% this decade, the company believes.

According to Morningstar data, a £10,000 investment five years ago would today be worth close to £65,000. That shows the exceptional value-creation capability of the stock and why we firmly see ASML as a core holding for investors.



SHARES SAYS:
ASML remains a great long-run value creator. Keep buying the shares. [SF]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We invest in ugly ducklings…
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RUFFER INVESTMENT COMPANY
(RICA) 293P

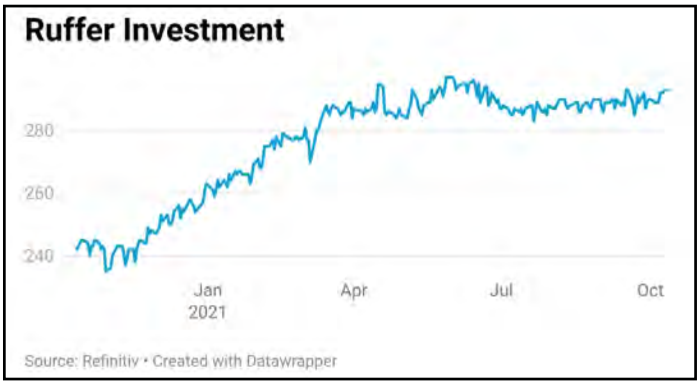
Gain to date: 2%
Original entry point:
Buy at 287.25p, 8 July 2021

OUR BULLISH CALL on capital preservation trust **Ruffer (RICA)** is modestly in the money. Yet with inflationary pressures escalating, we're more convinced than ever this is the right time to hold this multi-asset portfolio built to protect against inflation and financial repression, where saving rates are much lower than inflation.

Ruffer focuses on preserving and growing real – i.e. inflation adjusted – capital, regardless of financial market conditions and has a proven track record of making money in up and down markets.

A portfolio of assets spanning shares, inflation-linked bonds, gold and credit protection leaves Ruffer well-equipped to deal with the increasing inflation and economic and market volatility ahead.

During September, Ruffer's share price rose by 0.2% and NAV edged ahead by 0.9%, which compared with a 1% decline for the FTSE All-Share index. Holdings in inflation-linked bonds and other less conventional protections did their job, enabling Ruffer to deliver a robust performance in the face of falling bond and equity markets.



SHARES SAYS:
Keep buying Ruffer to protect against inflation and for rising dividends. [JC]

FRP ADVISORY
(FRP:AIM) 124p

Gain to date: 1.6%
Original entry point:
Buy at 122p, 16 September 2021

SHARES IN **FRP Advisory (FRP:AIM)**, the insolvency and business advisory firm, have nudged up 1.6% since we said to buy on 16 September. We continue to believe the company is well positioned to benefit from an increase in insolvencies and administrations as the Government winds up pandemic-linked solvency restrictions.

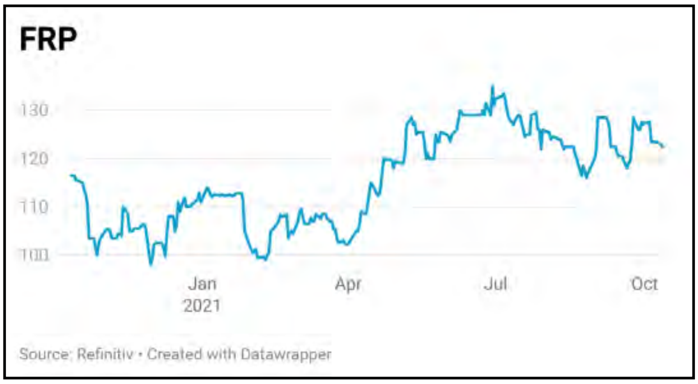
The UK's furlough scheme to support employers expired at the end of September, while Government support loans, commonly referred to as 'Bounce Back Loans', were replaced in March with the Recovery Loan Scheme.

A recent report published by the Bank of England revealed that 33% of small and medium sized enterprises had debt levels of more than 10 times their cash balances, compared to 14% before the Covid-19 outbreak.

According to the Bank of England's financial policy committee 'insolvencies are likely to rise from the fourth quarter of 2021 as Government support is withdrawn as planned'.

The environment for FRP Advisory is improving, and we believe a patient approach by investors will be rewarded, given the potential earnings upside to current market estimates.

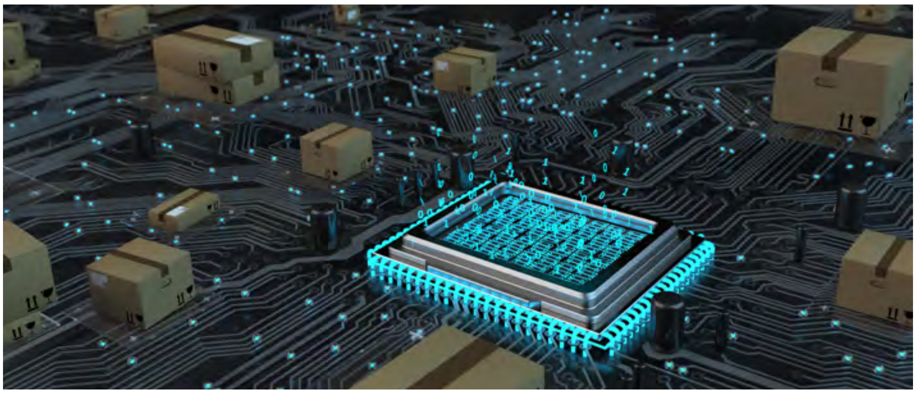
The next catalyst for the share price could be a trading update scheduled for mid-November.



SHARES SAYS:
Keep buying. [MGar]

Next's Total Platform could prove a game-changer

Tucked within the retail star is a logistics solution business which could rival Ocado and THG



A good deal of the excitement (and more recently, backlash) surrounding e-commerce play The Hut Group, aka **THG (THG)**, is linked to its Ingenuity logistics and technology platform.

This is an end-to-end solution offered to third parties in the same way **Ocado's (OCDO)** online groceries platform is sold to global supermarkets.

But hiding within established retailer **Next (NXT)** is a little-known platform business of its own which could have significant potential.

WHAT IS INGENUITY?

To understand the opportunities for Next it is first worth considering THG's experience. Ingenuity is the white-labelling of THG's technology, translation, logistics and marketing capabilities to brand owners to power their direct to consumer websites.

The ready-made online sales platform is a full service covering everything from designing a website to taking payments and delivering goods.

Regarded as THG's future growth engine, Ingenuity offers investors a way to play the need for brand owners to accelerate their adoption of direct to consumer strategies.

Clients signed up to date range from Nestle and Coca-Cola to Toblerone (Mondelez), Homebase, GSK vitamins and PZ Cussons Beauty, as well as **Hotel Chocolat (HTOC:AIM)** and **Revolution Beauty (REVB:AIM)**, while a collaboration deal with Japanese tech investor Softbank has boosted the new business pipeline.

In the first half of 2021, Ingenuity's commerce revenues grew by 165.5% to £18.3 million and consensus calls for a full year haul of £50 million.

Clouding the picture however is THG's share price plunge since founder, chairman and CEO Matthew Moulding outlined plans (16 Sep) to break up THG just a year after its much-hyped initial public offering, jolting investors into reappraising the investment case.

INGENUITY'S GOT ISSUES

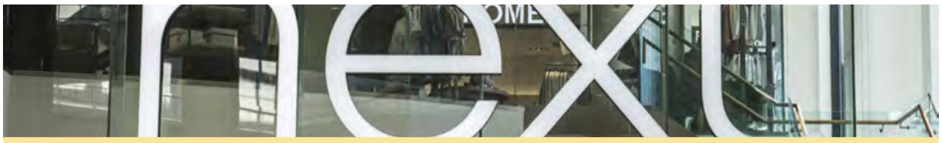
In a note ahead of an Ingenuity-focused capital markets session on 12 October, Numis explained that Nestle's use of THG's platform was an important stamp of approval, although the broker pointed out Ingenuity has 'reasonable reliance' on a number of contracts clinched with the Swiss foods giant.

Transactional websites are live and operational for Nestle's Optifast, Minami and Klean Athlete brands, yet neither the Quality Street nor Purina direct to consumer stores agreed to in 2020 have been launched under the Ingenuity platform so far.

The broker also cautioned that the majority of THG's contracts signed to date are with beauty and fast moving consumer goods brands. 'For many, we aren't convinced there is a scalable customer proposition,' warned Numis.

'A minority of customers may start buying their Toblerone bars and Coca-Cola cans from dedicated websites, but we don't expect grocery shopping missions to disaggregate to any meaningful extent to brand websites.

'If we are wrong, and some of these propositions do scale (and for some of the beauty brands it is easier to envisage this



Next – Total Platform clients, launch dates and equity interests

Client	Launch date	Equity interest
Childsplay Clothing	Oct 2020	
Laura Ashley	Mar 2021	
Victoria's Secret UK and Eire	May 2021	51% share in UK JV with Victoria's Secret
Aubin	Sep 2021	33% share
Reiss	Spring 2022	25% with an option to buy a further 26%
Gap UK and Eire	Summer 2022	51% share in a new UK JV with Gap

Source: Next, first half results

happening), then will THG retain those contracts?'

Numis also flagged the risk that brands could look to take elements of content creation and marketing in-house and questioned whether THG can invest sufficiently to be 'the best-in-class provider of logistics and technology for the range of products and geographies they are looking to offer their services'.

IS NEXT THE LOWER RISK OPTION?

Given the uncertainty around the shape of THG going forwards, investors should familiarise themselves with Next's Ingenuity-like 'Total Platform' operation.

Over the past decade, Next has successfully transitioned from a store-led business model to an online-led one, with physical shops accounting for 67% of sales in full year 2010, falling to 42% in 2020. Liberum Capital sees that reducing to 29% in the year to January 2022.

As succinctly explained on the retailer's website, the Next Platform, which came to the fore during Covid lockdowns, 'draws on all our assets – stores, warehouses, delivery networks, systems, marketing, credit facilities – to create a powerful aggregation business selling hundreds of third-party clothing and home brands alongside our own Next merchandise.'

The online shopping shift is enabling Next to benefit from sales commission on third-party brands and sales into overseas markets without the associated retail overheads.

WHAT IS TOTAL PLATFORM?

Now, Next is leveraging the expertise, infrastructure and software it has developed for its own online business to provide a third-party e-commerce outsourcing service named Total Platform, launched in May 2020 after a pilot exercise.

As Next explained in its first half results (29 Sep): 'Total Platform takes us beyond the confines of our own website, offering client brands the benefits of our technology, warehousing, logistics and other infrastructure, for the benefit of their own online operation.'

Total Platform aims to 'liberate brands from capital hungry, complex and time consuming activities, in which they have little competitive advantage; allowing clients to focus on the areas where they add the most value – the design, buying and marketing of their brand'.

This year, Next expects to fulfil online sales of around £50 million through Total Platform, which should generate £3 million of profit at an operating margin of 6%. In addition, equity stakes in four of its clients should make a profit contribution of around £7 million. These numbers are tiny in the context of the overall group, but investors should view Total Platform as an important strategic initiative for Next rather than a near-term significant earnings contributor.

Total Platform's six clients to date are Childsplay Clothing, Laura Ashley, Victoria's Secret, Reiss, start-up luxury menswear brand Aubin and American clothing company Gap. Four are successfully trading on the platform with the others launching over the next 12 months.

'In the process of developing this new business, we have come to believe that the potential to create value for clients is so great, that it is worth the group investing in new clients as and when they sign up for the service,' continued Next, which has acquired equity stakes in Victoria's Secret UK and Eire (51%), Aubin (33%), Reiss (25%) and Gap UK and Eire (51%).

The delivery of the Reiss Platform in Spring 2022 will be Next's most ambitious and comprehensive to date, taking Total Platform's capabilities to another level.

THE FUND MANAGERS' VIEW

Next is the largest holding in the **TB Chawton Global Equity Income Fund (BJ1GXX3)** managed by Michael Crawford, who says Total Platform 'follows the example of Jeff Bezos at Amazon who has successfully built new revenue streams from assets built for the core business; in their case using their massive computing capacity to provide third party "cloud" computing services.

'The strategy increases utilisation rates and therefore overall group return on capital.'

Crawford adds that Next CEO Simon Wolfson 'stated at the start that he does not know whether, when we look back in five years' time, this will be seen as an important development.

'Currently there seems to be good momentum and no shortage of demand. In fact, the main constraint to growth is resource bottlenecks in areas such as software development and warehouse capacity.'

The Chawton fund manager stresses that under Wolfson, Next has 'always had a focus on profitability and high returns on capital unlike many in new technology areas and so will want an adequate return'.

Wolfson is 'a meticulous planner and so would not be allocating more capital to the project if he does not foresee this. It is still early days, but progress made so far suggests this could develop into a material business for the group'.

Elsewhere, William Meadon, one of the managers of investment trust **JPMorgan Claverhouse (JCH)**, another investor in Next, comments: 'To survive and thrive as a retailer it is essential to have access to the best data and technology.

'Next is an example of a company which, in our opinion, continues to stand apart from its competitors, both in terms of strong leadership and its successful online presence.'

Meadon believes the Total Platform has the capacity to be 'a key factor that will add to Next's attractive growth prospects in the long-term'.

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

The Asian trust going places… but the market isn't looking

Aberdeen Asian Income still trades on a big discount despite being the sector's star performer in 2021

Investors looking for anomalies in the investment trust space should cast an eye on one name in the Asian equity income space.

In recent years, **Aberdeen Asian Income (AAIF)** has generally been the most unpopular of the five trusts in this sector based on how it has typically traded on the biggest discount to net asset value.

However, what's interesting is the fact it is now the best performing stock in the Asian equity income investment trust space over the past 12 months, helped by having low exposure to China which has been a trouble spot this year.

It has returned 21.3% including dividends versus 16.5% from **Invesco Asia Trust (IAT)** and 15.9% from **Schroder Oriental Income (SOI)**, according to data from FE Fundinfo.

Aberdeen Asian Income currently trades on a 10.1% discount to the value of its net assets, in line with the level of discount seen a year earlier despite improvement in performance on an absolute basis and relative to its peers.

The trust's net asset value has increased by 16.3% over the past 12 months – the biggest gain among its peer group – and it offers a 4.1% yield.

WHAT ABOUT THE OTHERS?

Schroder Oriental currently trades on a 2.3% discount whereas **Henderson Far East (HFEL)** trades on a 2.1% premium, albeit a smaller one than its 12-month average of 2.7%, based on figures from Winterflood.

Invesco Asia is losing appeal with investors with the shares now on the biggest discount in the sector at 10.6%, significantly wider than the 7.2% discount seen five months ago. **JPMorgan Asia Growth & Income Trust (JAGI)** currently trades on an 8% discount versus a 1.2% premium 12-month average.

Asia Pacific Income Trusts - premiums and discounts

	Now	12-month average
Invesco Asia	-10.6%	-8.8%
Aberdeen Asian Income	-10.1%	-9.9%
JPM Asia Growth & Income	-8.0%	1.2%
Schroder Oriental Income	-2.3%	-2.6%
Henderson Far East Income	2.1%	2.7%

NAV = net asset value. Positive figure = trades at a premium to NAV. Negative figure = trades at a discount to NAV.
Source: Winterflood, 6 October 2021

TWO TRUSTS HURT BY CHINESE EXPOSURE

Both the Invesco and JPMorgan products have suffered of late because of their exposure to China. A regulatory clampdown on companies operating across the internet and education sectors has spooked the market and led to a general sell-off in Chinese stocks.

Fears that heavy indebted property developer Evergrande could go bust and disrupt the banking, real estate, construction and property sectors has also soured sentiment towards Chinese equities.

The Invesco product has nearly 30% of its portfolio in China-listed companies, with Tencent and Alibaba key holdings, both of which have suffered considerable share prices losses this year (22% and 40% respectively).

The JPMorgan trust has even

greater exposure to the country at 34.5%, holding those two internet stocks as well as names such as Yum China and China Resources Land. That weighting is almost in line with the proportion of China in the MSCI AC Asia ex Japan index (38.9%, as of 30 September 2021).

THIS IS WHERE ABERDEEN DIFFERS

Aberdeen Asian Income has benefited this year from having low exposure to China at just 10%. Rather than being spooked by the regulatory pressures and reducing its weighting to the country this year, the low 10% exposure reflects its long-running investment process which does not favour many of the Chinese stocks found in Asian equity trusts and funds.

'We've always been underweight China in this trust,' says Aberdeen investment director Yoojeong Oh. 'We don't own the Chinese internet stocks because they don't pay dividends. We also don't buy the Chinese state-owned banks even though they are the highest yielding stocks in the China market – that's for reasons linked to transparency, governance and regulations.'

Oh says that three years ago, having low exposure to China was 'painful' as it caused the Aberdeen trust to lag its peer group as Chinese stocks were in vogue. This performance history, together with very low dividend growth levels of approximately 1% in the past few years, are potential reasons why the trust continues to trade at a wide discount to net asset value.

Asia Pacific Income Trusts - 12-month NAV gains

Aberdeen Asian Income	16.3%
Invesco Asia	12.5%
Schroder Oriental Income	10.7%
JPM Asia Growth & Income	5.8%
Henderson Far East Income	-2.2%

Source: FE Fundinfo, 6 October 2021

Asia Pacific Income Trusts - Total return

	1 year	3 years	5 years	10 years
Aberdeen Asian Income	21.3%	29.4%	36.3%	118.0%
Invesco Asia	16.5%	42.1%	62.7%	217.0%
Schroder Oriental Income	15.9%	18.7%	31.9%	183.7%
Henderson Far East Income	1.6%	1.2%	14.0%	103.3%
JPM Asia Growth & Income	0.0%	44.5%	77.8%	209.9%

Source: FE Fundinfo, 6 October 2021

LACKLUSTRE DIVIDEND GROWTH

Investors who buy income products typically expect to see dividends grow at least in line with inflation, so a mere 1% growth level is unattractive. Oh explains that dividend growth has historically been higher but she has been using some of the income from the portfolio to build up a greater revenue reserves, which can be used to smooth dividends during tougher times in the future.

Aberdeen Asian Income invests in quality companies and has large exposure to Taiwan, Singapore and Australia, being three of the highest yielding markets in Asia Pacific.

It has diversified exposure including Samsung and Infosys in the technology space; Taiwan's KMC which is a beneficiary of growing demand for e-bikes; and Power Grid of India which is a play on India's commitment to increase renewables in the country's energy mix.

Other holdings include Singapore's Venture which makes widgets for expensive machines. 'It's a high margin business, has embedded customer relationships and pays good dividends,' says Oh. She also invests in various Singapore banks and Australian property companies, both seen as important sources of income.

ASIA FOR INCOME

It's a good time for investors to be looking at Asia as a source of income. Japan's efforts to be more shareholder-friendly have been well publicised in recent years, but less appreciated by Western investors are similar efforts by other Asian countries to pay more dividends.

'Someone investing in a China, India or Southeast Asian fund might be looking for growth rather than income,' explains Oh.

'But we are seeing more focus on shareholder returns and that comes in tandem with Asian companies wanting to attract more foreign capital, so they are improving their governance standards, their ESG disclosures and their shareholder returns.'

By **Daniel Coatsworth**
Editor

Tesco plots new course to maximise earnings and shareholder returns

There will be a tighter focus on convenience and online instead of big-box stores

On 6 October supermarket **Tesco (TSCO)** surprised the market with better than expected first half results, an increase in full year profit guidance and its first share buyback.

Alongside these milestones were the outlines of a new strategy which the group hopes will not just see it maintain its market-leading share of UK grocery spending but increase it at a time of fierce competition.

In tandem, the firm aims to grow its retail cash flow to a sufficient size to be able to invest, raise its dividend payout ratio and undertake more buybacks to improve shareholder returns.

NEW VISION

Tesco has already strengthened its customer proposition by expanding its Clubcard Prices promotion to Express stores, widening its Aldi price match offer to approximately 650 products and lowering prices on another 1,600 items.

According to the firm, this has given it the strongest price position against the rest of the Big Four and the discounters for five years and driven increased traffic not just in-store but online, where the number of app users and the proportion of customers opting to Click & Collect have both doubled.

New finance director Imran Nawaz, who joined five months ago, has been through the business from top to bottom and has put forward a new set of strategic priorities to capitalise on the firm's entrenched market share, driving up its cash flow generation, with a fresh take to capital allocation plans.

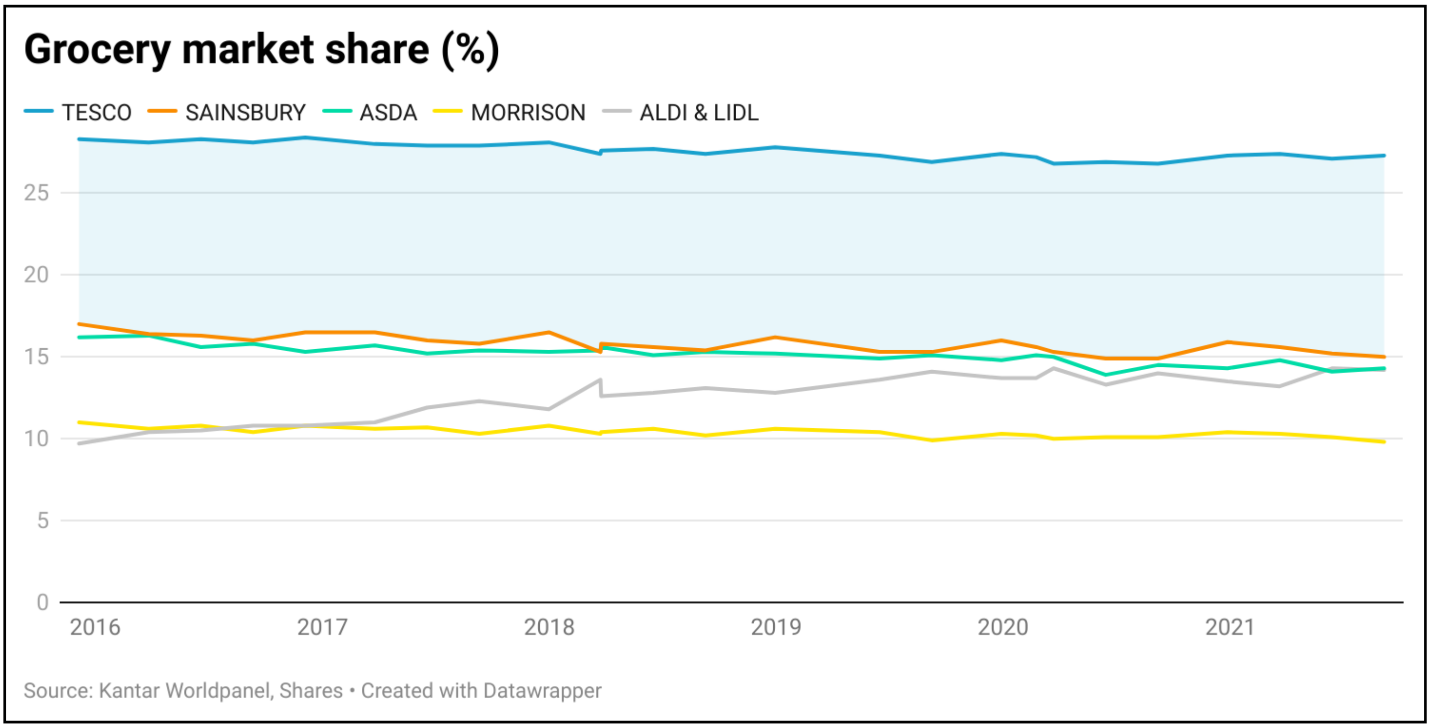
Nawaz's first priority is reinvestment in the business and the customer offering, whether that is spending on store renovations, its online proposition or investing in lower prices, with a capex target of between £900 million and £1.2 billion per year out of retail free cash flow which he predicts will be in the region of £2.5 billion.

As long as the firm can keep its leverage at around 2.5 times net debt to earnings before interest, tax, depreciation and amortisation, commensurate with an investment grade rating, surplus cash will be used to buy back property where economically viable, bringing more of the estate in-house.

Beyond these initiatives any further cash will be returned in the form of dividends, with a target pay-out ratio of 50%, and through further share buybacks.

CHANGING LANDSCAPE

It is no exaggeration to say the retail sector has undergone huge change in the last five years,



and especially since the start of the pandemic. 'Customers are faced with an increasing range of choices as to where, how and when to shop, with Covid accelerating a number of profound shifts in consumer behaviour,' says chief executive Ken Murphy.

'The competitive environment has changed materially,' he adds, 'with a particular emphasis on value and greater importance placed on fuller-service offerings such as grocery home delivery.'

And there has been another fundamental change in the competitive landscape, after Asda was taken private and **Morrisons (MRW)** fell into the hands of a US buyout firm.

Privately-owned enterprises can deploy much higher levels of leverage than publicly quoted companies in order to sweat their assets and produce a greater return.

Also, provided the owners have deep enough pockets they can compete aggressively on price without having to justify to shareholders every quarter why their sales are going up, but profits are going down.

Murphy and his team know better than to take their 27% market share for granted. The German discount duo Aldi and Lidl, both privately owned, have shown what can be achieved with a ruthless focus on value, having cornered a 14% market share between them in a decade, more than either Morrisons or Asda.

FOUR IS THE MAGIC NUMBER

Tesco's new strategy for winning a greater share of customers' grocery spending and increasing margins at the same time rests on four pillars; product price and quality, an enhanced loyalty scheme, greater convenience and cost efficiencies.

In terms of the actual product, Tesco says it is 'committed to removing price as a reason to shop elsewhere', which is why it has matched Aldi on hundreds of items as well as bringing in 'Low Everyday Prices' on 1,600 other items and extending Clubcard discounts to over 2,700 stores.

Promotions, which were once looked down on, will be 'sustained at lower levels' while product freshness and innovation will become key.

Clubcard, which is now physically in 20 million households and has 6.6 million app users compared with 2.5 million a year ago, is arguably the reason Tesco has been able to maintain such a big lead over arch-rival **Sainsbury (SBRY)** for so many years.

Management realised early on the value of customer data and the importance of making consumers 'sticky' via its loyalty programme. Now the trick is to increase the number of people who use Clubcard frequently, turning them into 'highly valuable' customers through more personalised offers and increased rewards, rather like frequent flyer bonuses.

Using the might of Dunhumby, the global leader in customer data science, which Tesco owns, customers will be offered a richer experience allowing them to choose how they earn and use their rewards, making Tesco more useful to them and creating a virtuous circle.

That creates the possibility of generating new revenue streams from suppliers, who would doubtless be willing to pay for preferential access to such a high-value customer base in order to tailor their product offering direct to consumer.

This has already happened in the US, where grocery chain Kroger revealed in its second quarter earnings it was on track to make between $100 million and $150 million of incremental operating profits this financial year from alternative sources including media and 'brand engagement'.

FLEXIBLE AND EFFICIENT

Instead of having to get in the car and make the weekly trip to the supermarket, customers can now shop whenever, wherever and however they want.

Tesco's online business, which already tops £6 billion in annual turnover, is well served from the existing large store network through in-store picking, but the group is rolling out urban fulfilment centres to increase delivery options.

The convenience market, which has seen rapid growth in the last few years, is also well served through almost 2,000 Express stores, close to 950 owned and franchised One-Stop stores and through Booker's wholesale relationship with 90,000 retail outlets up and down the country.

Yet this is where the bulk of store investment will go, in finding new sites and adding new franchisees, as the firm aims to become more 'capital light'. That means no more expensive, out-of-town megastores.

Tesco is also piloting on-demand services with its Whoosh platform and an agreement between One Stop and Deliveroo for deliveries within 60 minutes, while urban fulfilment centres have the potential to allow customers to order a full weekly shop and collect it minutes later.

The final leg of the strategy is finding efficiencies to at least offset input cost inflation, through making the business simpler and more productive. Lowering costs will increase cash flow, which can either be reinvested in the business or given to shareholders.

Having carried out a detailed review, the firm has identified around £1 billion of gross savings across areas such as goods not for resale, better productivity, optimising its delivery network and central overheads.

The £1 billion figure is gross, i.e. before any costs incurred, and will be achieved through incremental changes over the course of three years, although opportunities may arise which allow it to accelerate that schedule.

SHARES SAYS: ↗

This strategy sounds very impressive and would suggest Tesco is placed to prosper in the years ahead and not struggle in a very competitive market. The shares are well worth buying.

By **Ian Conway**
Senior Reporter

NETFLIX

TUNE IN OR SWITCH OFF?

We consider if the shares are worth buying today

Some share prices can seem immune from market turbulence, as has been the case for Netflix recently. While major indices like the FTSE 100, S&P 500, Nasdaq, Eurostoxx 50 and Hang Seng have struggled since the start of September, the streaming TV and movies giant has defied gravity.

Over the past month the stock has outstripped the Nasdaq Composite's (the US tech market where it is listed) single-digit declines and appreciated substantially, pushing the share price to all-time peaks of around $640.

Shares seldom dedicates an entire lead feature to a single company but there are some stocks that so captivate investors that they command the lone spotlight. We believe Netflix is one of them, as Tesla and Amazon have in the past in *Shares*.

By **Steven Frazer** News Editor

A record share price at a time when overall stock markets are out of sorts will have many investors slamming the door shut. On the other hand, Netflix has its shareholder zealots that will see opportunity where others see irrational exuberance.

In this feature *Shares* will try to fairly weigh the pros and cons, explain how the company addresses key questions about its future, and provide an answer to the key investment question – should you buy Netflix ahead of its third quarter earnings on 19 October?

Impressive share price gains

Source: Refinitiv • Created with Datawrapper

NETFLIX DEBATE

The bear argument is easy to grasp. Subscriber growth is slowing, competition is intensifying, huge piles of cash are needed to keep content fresh, while the company already has enormous debts to service, forecast to approach $10 billion by the end of this year.

For many, this leaves the firm's $280 billion market value looking hugely stretched, implying as it does a 2021 enterprise value (EV for short, which includes net debt) to revenue and EV/EBITDA (earnings before interest, tax, depreciation and amortisation) of 9.5-times and close on 42. High-teens EV/EBITDA is typically considered racy.

The price to earnings multiple is pitched above 61 on this year's forecast $10.44 earnings per share.

The bull case is also easy to understand. Competition is over-egged, cash burn is set to dramatically reverse over the next few years, most of its $10 billion net debt is long-dated and balance sheet efficient while the company has only scratched the surface of its global growth opportunity.

Analysts have identified 1.4 billion potential homes for the company to target worldwide, leaving its global penetration rate below 15%.

CORD-CUTTING PIONEER

Netflix has come far since its origins as a DVD rental by mail service, morphing into a pioneer in subscription video-on-demand and the largest online TV and film service in North America, where it had just shy of 74 million subscribers as of 30 June 2021.

These days it has more overseas customers with about 135 million worldwide (excluding US/Canada) across more than 190 countries, including approximately 31 million in the UK, according to Ofcom stats.

Streaming video adoption continues to happen at a fast pace across the world, which should boost Netflix's subscriber base and revenues over time, but the transition was given a huge push by the Covid pandemic.

DM Martins Research data anticipates more than 10% compound annual growth rate for the streaming sector over the next three years.

New streaming services have been coming thick and fast, with the likes of Disney+, HBO Max, Apple TV, Amazon Prime Video, Hulu, Britbox and many others stepping up the competitive threat.

We believe the debate has moved beyond which streaming service to choose, with increasing numbers of people happy to subscribe to two, three or more services.

But the wider reality is that Netflix is fighting for your attention against much more than other streaming services, with linear TV, DVDs, reading a book, surfing YouTube, playing video games, socialising on Facebook, going out to dinner or to a bar with friends all recognised by the company as competition for our time.

BUSINESS IS IMPROVING

Netflix earns just a fraction of consumers' time and money, but it believes in the opportunity to win a bigger share of consumers' leisure time if it can keep improving.

Part of that improvement strategy is a future increasingly dominated by original and exclusive content, which is where most of the firm's programming investment has been going in recent years.

It has scored critical and popular success, and this year racked up nominations and wins for both film and television awards for its original content, including 44 Emmy Awards and seven Oscars, the most awards of any studio at the 93rd Academy Awards.

Netflix is responsible for popular series like *Stranger Things*, *The Crown* and *Bridgerton*, and more recently hitting gold with *The Queen's Gambit* and *Squid Game*, while astute rights-based acquisitions will help, such as its recent deal for the rights to all the Roald Dahl books. The latter provides an opportunity to extend its reach into merchandise, theatre and more using a rich library of beloved characters.

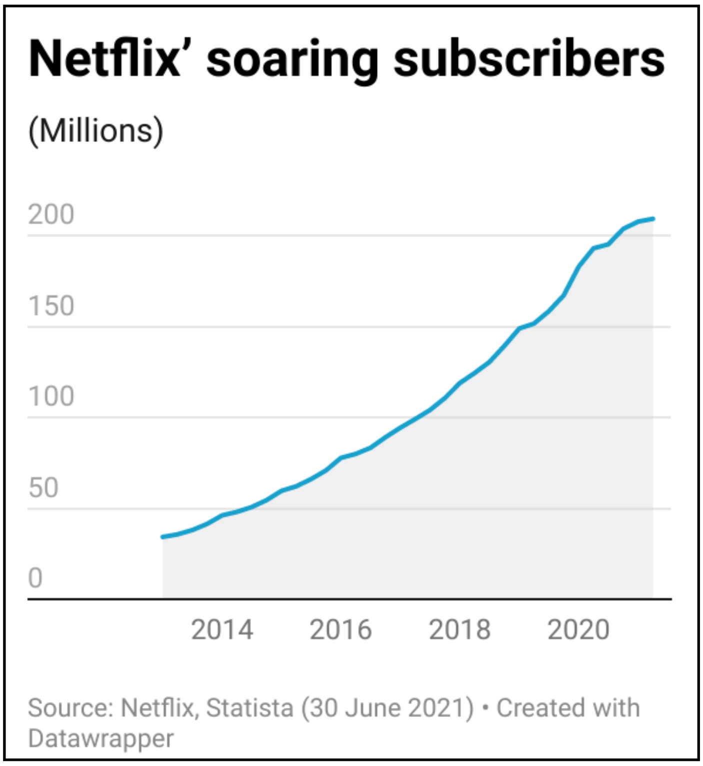
Tiered subscriptions, sponsored content and even advertising are all options to pursue, although Netflix firmly believes that now is not the time to mess with a model that works. However, expansion into streamed gaming looks like the next big step.

Last month it agreed its first acquisition in the gaming space to buy video games maker Night School Studio, as well as releasing plans to roll out five mobile gaming titles in select European markets, including Spain and Italy.

PROFITABLE GROWTH

Netflix is increasingly balancing new subscribers with profits.

It sees operating margins moving higher for 'years to come', having expanded from 7% in 2017 to 18% last year. The company is targeting 20% in 2021.



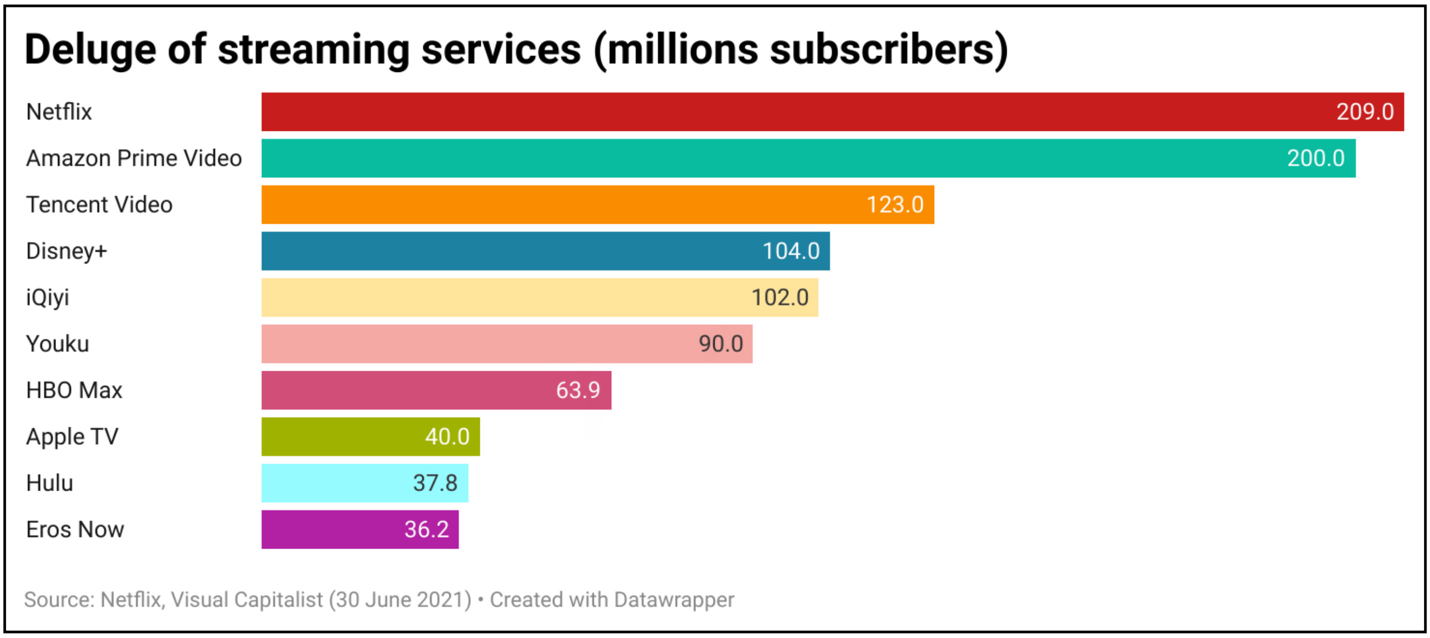
Beyond that, it is aiming for average 300 basis point annual margin gains, although this will have to be judged over a multi-year period because of the inherent bumps of largely upfront production costs.

The move into making more of its own shows is a big deal for Netflix, one that has put huge pressure on cash flows. This is not surprising, it's obvious that making TV shows requires spending large sums to get production in motion before getting payback down the line as costs are amortised.

Content amortisation represents the vast majority of Netflix's cost of revenues but that also covers other production costs, such as content personnel, physical production, post-production, music rights and overall deals. This can all be monitored by investors by watching the firm's accounts – cost of revenues sits on the profit and loss account, or P&L for short.

Similarly, investors can see how much Netflix is spending on new and bought content by looking through the cash flow statement in the company accounts, where the sum of 'Additions to Streaming Content Assets' and the 'Change in Streaming Content Liabilities' equates to its cash spending on streaming content.

Netflix believes that cash flow pressures will ease in time and that investors will see the gap between net income and free cash flow narrow over the next few years. Importantly, management says they see no need for external financing to fund day-to-day operations, making net debt more consistent



and manageable and relieving the threat of selling new shares to investors to raise fresh capital.

NAVIGATING GUIDANCE

For the time being updates to the number of net new subscribers seems likely to dominate how investors react to the stock.

Stay-at-home orders during the Covid-19 pandemic drove business for Netflix as consumers watched more television because cinemas, live music and sports were shut down.

Netflix guided for 3.5 million net new subscribers in the third quarter. This would be better than 2020's 2.2 million third quarter increase but down sharply on the 6.8 million subscribers the company added in the pre-pandemic third quarter 2019. But it would also mark a steep acceleration over the approximately 1.5 million net new members added in the second quarter of 2021.

Netflix worldwide subscribers (millions)

US/Canada	73.95
EMEA	68.70
Latin America	38.66
Asia Pacific	27.88

Source: Netflix (30 June 2021) • Created with Datawrapper

The quarterly guidance Netflix gives the market is the company's actual internal forecast at the time it reports and is primed for accuracy, not conservatism, which leaves it more exposed to surprises, both good and bad.

But it makes sense since giving a more cautious steer could mean under-investing in content and marketing. This does make for a more volatile share price in the run-up and in response to trading updates and financial results.

Netflix posted $2.97 earnings per share on sales of $7.34 billion in the second quarter, lower than analysts had expected, with consensus pitched then at $3.18 earnings a share on $7.32 billion sales. On a year-on-year basis, Netflix earnings jumped 87% while sales rose 19%.

For the third quarter, Netflix expects to earn $2.55 a share on sales of $7.48 billion. In the same period a year earlier, Netflix earned $1.74 a share on sales of $6.44 billion.

TUNE IN, OR SWITCH OFF?

So, are the shares worth buying or not? We definitely see scope for more earnings growth over the coming years as overseas markets open up with faster broadband connections and mobile networks, while Netflix has put to bed any doubts that it will struggle to be a maker of top drawer TV and films.

A brief to become self-sustaining and improve both cash flows and margins could make for

Netflix' biggest streaming hits

TV series	(million accounts watched)
Bridgerton (Season 1)	82
Lupin (Part 1)	76
The Witcher (Season 1)	76
Sex/Life (Season 1)	67
Stranger Things (Season 3)	67
La Casa de Papel (Part 4)	65
Tiger King	64
Queen's Gambit	62
Sweet Tooth (Season 1)	60
Emily in Paris (Season 1)	58

Source: Netflix • Created with Datawrapper

exciting share price returns in the years ahead, and there are many fund managers who would argue that by not focusing very much on quarterly subscriber gains and earnings is precisely its appeal for longer-term investors.

Yet *Shares* is still left with nagging doubts about how much investors are being asked to pay for this potential, especially in the wake of the stock's recent surge.

WAIT FOR A BETTER ENTRY PRICE

In conclusion, investors should not rush to buy Netflix stock ahead of next week's update. There are too many unpredictable moving parts that could upset the share price short-term and leave new buyers dissappointed.

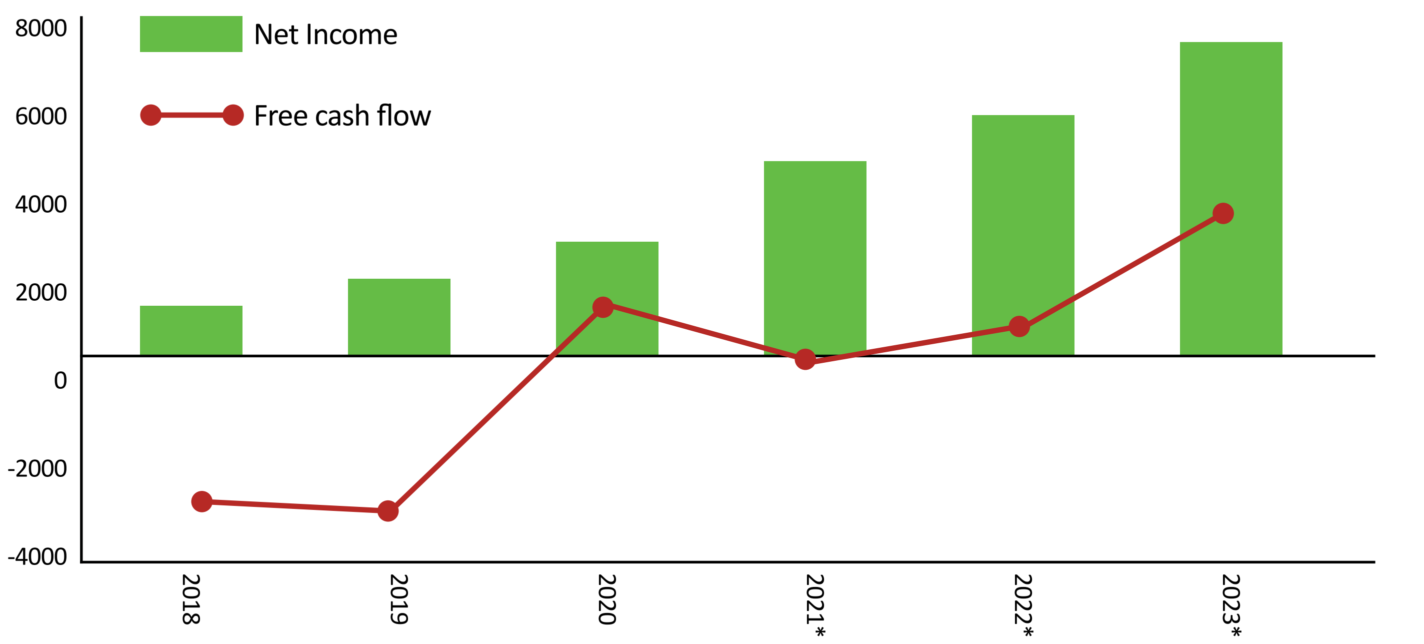
Longer-term, we would want to see more evidence that the company can keep growing while pushing profit margins up. We think there is scope for the business to raise its prices a lot more than current levels. After all, Netflix is seen as a must-have in so many households that people treat it like a utility bill, paying it whatever the cost.

To be frank, we're frustrated that the shares are not a straightforward 'buy now' situation.

After all, this is a business which provides a service that a lot of people around the world crave. Strategically it is making good progress with improving the quality of its content and expanding into new areas. It is ticking a lot of the right boxes from an investment perspective.

Investors prepared to take a long-term view might be happy to pay the premium price to own the shares today. But we have a feeling there could be a better entry point soon, so sit tight and wait for a pullback before pressing the 'buy' button.

Net income vs free cash flow ($ millions)



Source: Refinitive. *Consensus forecast

KNOW THE SCORE

If you thought ESG scores simplify ESG investing, you would be right, but not in a good way.

The value of an investment in the fund, and any income from it, can fall as well as rise and investors may not get back the amount invested.

We believe that, in many cases, passive high-yield investing underperforms its active equivalent. By contrast, owning handpicked, resilient companies allows us to capitalise on the market's imperfections. But what of passive environmental, social and governance (ESG) investing? Is this one area where a simple, rules-driven approach does pay?

The assessment of issuers is often based on an external ESG rating, but the scoring criteria don't always include some of the most important dimensions of a company's value, such as culture, customer loyalty and capacity to innovate.

Even assuming external scores are perfect, if clients want to direct capital towards a sustainable future, why limit that support to companies already considered 'sustainable'? If 'controversy is only dreaded by the advocates of error', should capital not support businesses that seek to rectify and compensate for any ESG weaknesses?

Digi Communications is the leading provider of internet, pay TV and mobile services in Romania and a significant investor in the country's infrastructure, driving socioeconomic empowerment and enabling people in disadvantaged areas to connect. Despite some historic governance risks relating to business ethics, which we felt had been addressed by new policies in 2020, we took a small holding as we couldn't identify any financially material penalties via stress testing. Instead, we are being rewarded with a yield premium versus European incumbent peers.

We engaged with Digi Communications to challenge management on internal policies and to monitor its planned improvements – adjusting our holding depending on progress. While Digi didn't warrant a perfect score, this company-specific and nuanced approach to ESG does matter.

When it comes to ESG investing, we look beyond numbers and engage with companies. This is how to create actual change.

ANNUAL DISCRETE PERFORMANCE HIGH YIELD BOND FUND					
	30/06/16-30/06/17	30/06/17-30/06/18	30/06/18-30/06/19	30/06/19-30/06/20	30/06/20-30/06/21
Class B-Inc (%)	12.6	1.7	6.7	-0.6	9.6
IA £ High Yield Sector (%)	10.4	1.0	5.2	-2.3	13.5

Performance source: FE, total return in sterling.

Past performance is not a guide to future returns.

The manager believes this is an appropriate comparison for this fund given the investment policy of the fund and the approach taken by the manager when investing.

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All data as at 31 July 2021 and source Baillie Gifford & Co Limited unless otherwise stated.

Changes in the rate of exchange will cause the value of any investment, and income from it, to fall as well as rise and you may not get back the amount invested. The Fund's share price can be volatile due to exposure to a single market, a single currency, movements in the prices of the underlying holdings and the basis on which the Fund is priced.

This article does not constitute, and is not subject to the protections afforded to, independent research. Baillie Gifford and its staff may have dealt in the investments concerned. The views expressed are not statements of fact and should not be considered as advice or a recommendation to buy, sell or hold a particular investment.

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Automatic enrolment: the key facts

Who is included, what does it involve and does it ever make sense to opt out?

At the start of the century, the government of the time asked Dr Adair Turner to investigate poor pension saving rates.

Turner's Pension Commission suggested adopting automatic enrolment into a pension scheme. Since 2012, a new employee will automatically join the employer's pension scheme, and both the employee and the employer pay a minimum amount into the retirement pot.

The individual doesn't have to make an active choice or request membership or sign application forms. It all happens automatically. If the individual decides they don't want to join, then they can opt out and their membership is cancelled as if it never existed.

DOES EVERYONE GET AUTOMATICALLY ENROLLED INTO A PENSION?

Not quite – there are some parameters. Only the employed are automatically enrolled, and not the self-employed. You have to be 22 or over and under state pension age, which, at the moment, is 66 for both men and women.

You also have to be earning at least £10,000 a year – that figure isn't just basic salary, it includes any overtime and bonuses. But even if you don't fit into these parameters, you can still ask to join the pension scheme; your employer cannot refuse if you do. And if you earn over £6,240 a year your employer has to pay into the pension scheme.

CAN I DECIDE WHICH PROVIDER TO SAVE WITH?

No. Your employer will have chosen a provider to run their pension scheme. However, you could choose to save extra in a different pension scheme at the same time you save in your employer's pension scheme.

WHAT ARE AUTOMATIC ENROLMENT MINIMUM CONTRIBUTIONS AND CAN I PAY MORE?

If you remain automatically enrolled, then you probably have to pay into your pension scheme. The standard minimum contribution you will have to pay is 4% of a band of earnings – called qualifying earnings, between £6,240 and £50,270 (in 2021/22).

Your employer will pay 3% of this band of earnings, and the government will add another 1% as tax relief, making a total of 8%. This effectively doubles your contribution.

However, your employer might choose to pay in more than this amount and/or might pay a contribution based on your whole salary rather than just a band. It will depend upon their pension rules.

WHERE WILL MY PENSION BE INVESTED?

The whole idea behind automatic enrolment is the employee joins the pension scheme without having to make any decisions. Therefore, when you are automatically enrolled in your pension scheme, contributions will be invested in a default investment fund which will be managed for you right up to when you take the benefits.

Default funds come under a high level of scrutiny. The employer and scheme trustees have a duty to ensure their default fund remains appropriate for their employees.

But you don't have to stay invested in the default fund. The downside of a default fund is that it is designed for a wide range of people, so it won't be tailored for your individual needs.

You might have different views on where you want your money invested and the level of risk you are prepared to take. You may also want to choose funds specifically to match your outlook on environmental or social concerns.

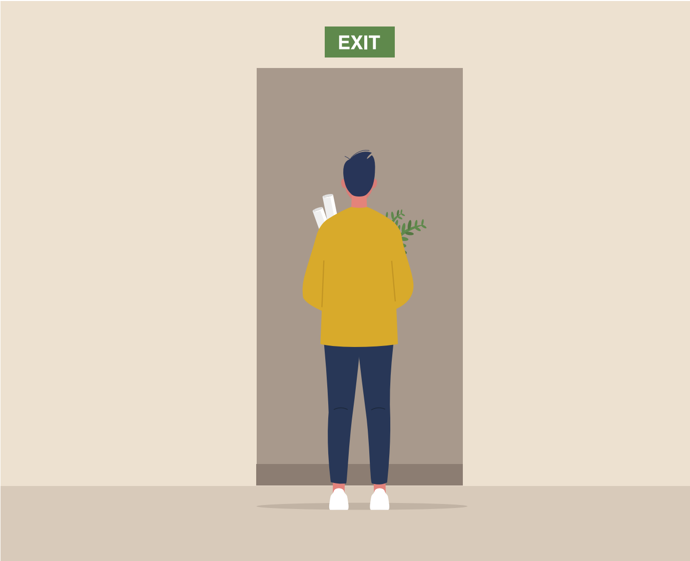
Instead, you can choose different investments for your contributions, and/or the money you have already built up in your pension. The different investment funds on offer will depend upon the scheme your employer has chosen.

WHAT HAPPENS IF I WANT TO OPT OUT?

Your employer cannot ask you or force you to opt out of your pension scheme. But once you have been automatically enrolled, you can always choose to opt out.

To do this you need to ask the pension provider for an opt out form, complete it, and then return it to your employer (or your pension provider might allow you to opt out online).

If you opt out of the scheme within one month of being automatically enrolled, you'll be treated as if you had never joined the scheme, and any money that you've paid in will be refunded in full.



But you will only get back the money you paid in – not the tax relief awarded by the government or your employer's contributions.

If you decide to stop saving after the first month has passed any contributions you and your employer have made will usually be held within the pension scheme, together with the tax relief given to you by the government. You will then be able to access this money from the age of 55 (rising to 57 from 2028). At that point you can withdraw it either in full or in part, or use it to buy an annuity, or just leave it to continue to grow and access the funds later.

If you do decide to opt out, then after three years the employer has to automatically enrol you back into the pension scheme (if you still qualify). If you still don't want to pay contributions you can then opt out again, and the process will continue when the employer re-enrols you after another three years.

Remember though if you do opt out you lose the value of your employer contributions – they cannot give you the value of the lost pension contributions in any other way, such as a higher salary.

So, if you change your mind you can ask to re-join the scheme at any time. However, your employer only has to respond to all requests to re-join a scheme once every 12 months, so it may be some time before your request is actioned.

WHAT ABOUT THE SELF-EMPLOYED?

If you are self-employed then you won't have an employer and automatic enrolment does not affect you.

However, you may still want to think about how you can save tax-efficiently for your later life, either through a pension or a Lifetime ISA (if you are young enough to qualify for an account) or both. Both tax wrappers offer generous tax advantages. Read more here.

WHAT ABOUT DIRECTORS – ARE THERE ANY EXEMPTIONS?

In some cases, directors may be exempt from automatic enrolment.

A lot hinges on whether the director has a contract of employment with the organisation. The contract of employment does not have to be written down anywhere – it could be verbal or implied.

If a director *does not* have an employment contract, they are exempt from automatic enrolment. However, if the organisation has other staff, then it is counted as an employer and has to think about automatic enrolment for those other staff.

If a director does have an employment contract, they do not have to be automatically enrolled if they are the only person in the company with an employment contract. But if there are other people working in the company with an employment contract then both the director and the staff have to be considered for automatic enrolment. This is a complicated area and if it applies to you then the Pensions Regulator has helpful information.

I EMPLOY ONE PERSON – WHAT DO I HAVE TO DO?

If you employ anyone, even if it's just one person like a nanny or a gardener, then you need to think about whether automatic enrolment applies to you as an employer. The Pensions Regulator can give you lots of useful information about what you need to do.

DOES IT EVER MAKE SENSE TO OPT OUT OF AUTO-ENROLMENT?

For most people it makes sense to stay within the pension scheme once they have been automatically enrolled. This way they can benefit not only from tax relief and tax-free growth from the government, but they can also benefit from their employer's pension contribution, which they will lose if they opt out.

As the employer contribution makes up over 37% of the money being paid into the pension, the loss of these contributions is significant.

However, there are situations where it may make sense to opt out. For example, if you really cannot afford to pay your contributions.

If an individual has claimed Fixed Protection or Enhanced Protection to protect their lifetime allowance, then this protection may be broken if they pay into a pension scheme. If their employer has reasonable grounds to believe that the individual might have one of these protections then they do not have to automatically enrol them into the pension scheme.

However, the employer is not required to exempt the individual. So, any individual holding such protection should be aware that if they are automatically enrolled, they should opt out to retain their lifetime allowance protection.

By **Rachel Vahey**
AJ Bell Senior Technical Consultant

Schroders

Why has north Asia outperformed its south-east Asian peers?

By Richard Sennitt, Fund Manager, Asian Equities

This article is an excerpt from our 25th Anniversary booklet celebrating a quarter century of the Schroder AsiaPacific Fund plc. See the full booklet here.

The success of north Asian countries (China, South Korea, Taiwan) in containing the Covid-19 pandemic last year is well-known. Strict lockdowns and quarantine procedures helped all three countries return to relative economic normality last year while Western economies suffered protracted disruption. China and Taiwan even recorded positive GDP growth for 2020.

This success was, in part, why north Asian markets substantially outperformed their south-east Asian peers last year.

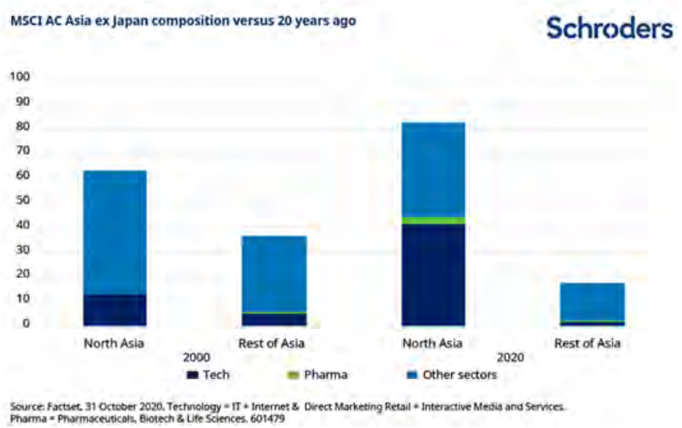
However, it's not just successful containment of the virus that explains north Asia's strong recent stock market performance; it's also that the kinds of companies that performed well during the pandemic were already well represented in north Asian stock markets.

North Asia a tech leader

Take the chart below. The first two columns show the composition of the MSCI AC Asia ex Japan index in 2000 and the second two its composition in 2020. As we can see, north Asia has grown to be a much larger part of the overall index.

Within north Asia, it is the technology related names that have grown, from c.13% of the index to over 40%. By contrast, the tech sector in the rest of Asia has remained small.

Internet platform companies have benefitted from the rapid adoption of new technologies by Asian consumers, who have been arguably less held back by legacy infrastructure compared to the rest of the world. For example, smartphones have facilitated swift growth in areas such as e-commerce and mobile payments.



Of course, technology products and services have been in high demand throughout the pandemic. There was a sharp spike in demand for smartphones, tablets and laptops as companies scrambled to supply their employees with devices to work from home. There was also growth in "play at home" demand for televisions and computer games consoles, as well rising levels of e-commerce and online gaming all driven by reduced mobility. All these trends have been driving strong demand for different types of technology over the past 18 months, contributing to north Asia's strong performance.

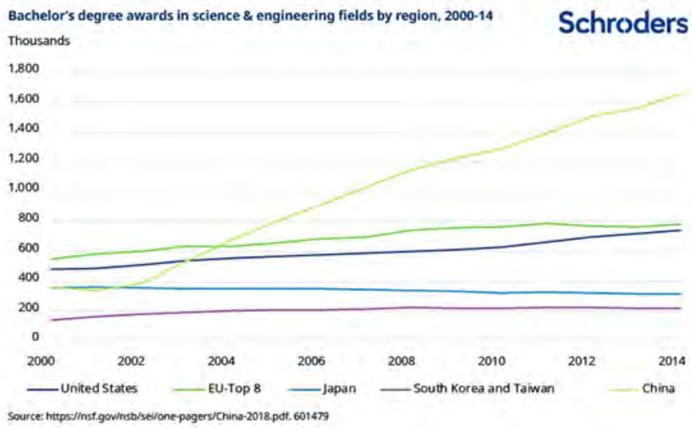
Two long-term reasons for north Asia's success

Part of the answer is investment in research & development (R&D). Korea and Taiwan have long been spending more on R&D than their south-east Asian peers. Meanwhile, China has increased its spending substantially.

Investment in knowledge industries, like technology, is crucial to helping companies develop and grow. This means north Asia has been better able to adapt to the rapid changes in technology in recent years.

For investment to be effective you need people who know how best to spend it. This brings us to another reason for north Asia's tech success: education. Graduates with a high quality education are needed to implement the elevated levels of R&D spending.

The chart below shows how China in particular has rapidly increased the number of science and engineering graduates it produces. South Korea and Taiwan produce a relatively high level of such graduates given their population size. These graduates will have careers lasting for 30-40 years, increasing their knowledge and experience over time and adding value to the companies they work for.



In our view, it is the combination of all these factors, that has contributed to north Asia's feat of developing successful technology companies that has been reflected in stock market outperformance. They also stand the region in good stead for the future.

These factors can potentially help north Asia's economies avoid the "middle income trap", which sees countries attain a certain level of income but then get stuck there. China especially is no longer the cheap source of labour it once was and it faces increased competition from regional neighbours where manufacturing wages are lower. Vietnam in particular has been a beneficiary of this.

However, cheap labour isn't necessarily the advantage it once was. While some companies may choose to switch their production to these lower wage countries, that will generally be lower value-added production. In addition, companies in similar industries draw cluster benefits from being located close to each other. This is particularly the case for industries operating amidst complex supply chains.

Rest of Asia down but not out

Does that mean it's all doom and gloom for the rest of Asia then? Certainly not.

Taking short-term factors first, many south-east Asian countries also managed the pandemic well but the composition of their economies meant they were unable to draw benefit from this.

For example, Thailand was successful in containing Covid last year, but travel restrictions meant its tourism sector – c.20% of the economy – was very badly affected. There is scope for a sharp rebound in travel and tourism once vaccines are distributed and restrictions lift, giving a near-term uplift to the economy. However, with vaccination rates still relatively low in much of Asia the timing of this rebound remains uncertain given the potential for further outbreaks.

Looking longer term, there are several trends working in favour of the rest of Asia. Demographics is one, with populations much younger on average than their north Asian peers. Urbanisation is another; countries in much of the rest of Asia still have greater scope for urbanisation and the collaboration and innovation benefits that come with it.

As we can see, there are multiple factors, both long- and short-term, to explain north Asia's stock market outperformance over the past 18 months. These factors also leave it well placed as we look ahead. Equally, there are reasons why the rest of Asia can play catch up.

If you'd like to hear more from the Schroder Investment Trust team, subscribe to our newsletter.

Should my wife have all her income paid into a SIPP?

AJ Bell's pensions expert Tom Selby considers the details around employer pension contributions

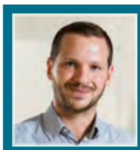
My wife is nearly 64 and will retire in the next two years. Together with a business partner she manages two nursery schools.

This is a limited company (50% each) and for the last couple of years she has paid herself a minimal amount in salary, with the rest taken in the form of dividends totalling around of £30,000.

She has a SIPP with a very small amount in it and virtually no other pension rights.

She will not be short of money on which to live. Would it be sensible (tax efficient) for the school to pay all her income into the SIPP?

David



Tom Selby
AJ Bell Senior Analyst says:

While tax relief on personal pension contributions is restricted by your UK earnings, there is no such earnings limit for employer pension contributions.

Employer pension contributions can benefit from corporation tax relief as a deductible business expense, provided they are made 'wholly and exclusively for the purposes of trade'. In HMRC's eyes the contributions should be made at a reasonable level for the individual concerned and their role in the company.

Extracting profit from a business as an employer pension contribution rather than as a dividend will also save on any tax that would have otherwise been paid on the dividend itself.

Someone who is a company owner has the option of paying some or all of the firm's profits directly into their pension.

By taking a small salary from the business means your wife is likely to be obtaining National Insurance credits each year, boosting her entitlement to certain benefits, such as the state pension.

Choosing not to declare a dividend could have an impact on her business partner, so it is important that they speak to their tax adviser or accountant.

Your wife needs to consider the annual allowance. This is the total amount that can be paid by you, or on your behalf, to pensions each year before a tax charge will apply on the excess. For most people the annual allowance in 2021/22 is £40,000. If you have very high earnings or have flexibly accessed taxable income from your retirement pot your annual allowance may be lower.

Once in the pension, the money benefits from tax-free investment growth on the contributions. When a saver comes to access their cash, usually a quarter (25%) will be available tax-free, with the rest taxed in the same way as income.

It may be possible for your wife to pay more than £40,000 into her pension via an employer contribution.

Pensions 'carry forward' allows savers to use annual allowances from the three previous tax years in the current tax year. This means that someone could make a contribution worth up to £160,000 without breaching the annual allowance.

To use carry forward the person needs to have been a member of a registered UK pension scheme during the years in question. You don't need to have paid into a scheme. Where personal contributions are used the 100% of relevant earnings rule also applies, although this is not an issue when it comes to employer contributions.

Carry forward is not available where someone has accessed taxable income from their pension and triggered the money purchase annual allowance.

Very high earners who trigger the annual allowance taper can only carry forward the tapered amount (which will be somewhere between £40,000 and £4,000).

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

Rethinking the role of bonds

With bond yields close to all-time lows and credit spreads quite tight, what role can bonds play within an equity/bond portfolio going forward? In this article, we discuss the approach adopted by ***David Smith, Portfolio Manager of Henderson High Income Trust****, his underlying rationale, and the impressive results the Trust has delivered.*

Understandably impacted by the coronavirus, investors sought safety throughout much of 2020 in fixed income, with bond yields falling to historic lows. As we entered 2021, bond yields rose, and prices fell as investors' confidence increased on optimism that the global rollout of highly effective vaccines would lead to a relaxation of government restrictions and a sharp recovery in economies. More recently, inflationary pressures have also not helped, with inflation data in the UK, US and Europe rising above central bank targets, further pushing bond yields higher. The debate over whether current high inflation will prove transitory - due to supply bottlenecks caused by the pandemic - won't be resolved for some time, which means the current outlook for bonds is particularly uncertain. With the asset class providing stable returns historically, one can begin to question the role it plays for equity/bond portfolios going forward.

Henderson High Income Trust, part of the Janus Henderson investment trust range, is one such trust that invests in both equities and fixed income securities to deliver a combination of high income and the potential for capital growth. The bond portfolio has always been a unique feature of the Trust; it dampens the overall volatility of the NAV and offers a predictable revenue stream. While portfolio manager, David Smith, has reduced the allocation to bonds over the last 18 months, recognising the strong performance they have delivered, the uncertain outlook given inflationary pressures, and the limited potential for further capital appreciation - he still believes there is a place for bonds in the Trust.

Bonds provide a diversified source of income for the Trust, something that proved incredibly valuable in 2020, given the significant dividend suspensions and cuts witnessed in the UK equity market. The bond portfolio maintained its level of revenue generated for the Trust and there were no defaults. In addition, bonds also help dampen the overall volatility of the Trust, as they are relatively more resilient than equities at times of economic stress. Once again this proved valuable last year, with the fixed income portfolio returning 7.7% against the FTSE All-Share decline of 9.8% on a total return basis.[1] Finally, the bond portfolio, funded by the Trust's borrowings, helps to boost the headline dividend yield of Henderson High Income.

[1]Source: Janus Henderson, Annual Report 2020

Janus Henderson INVESTORS

This aids the portfolio construction of the equity portfolio, meaning David does not have to chase the highest yielding areas of the market where dividends have historically proven to be unsustainable. With this structure, the equity portfolio can focus more on higher-quality companies that offer the potential for long-term capital growth and sustainable dividends that can grow.

Two holdings that bring this strategy sharply into focus are Coca-Cola Hellenic Bottling Company and luxury brand Burberry. Coca-Cola HBC is one of the largest bottlers in the Coca-Cola system, producing, selling, and distributing a wide range of non-alcoholic beverages across developed and emerging markets. The company's diversified brand portfolio and new products are well positioned to take market share in its growing categories which should underpin robust profit growth going forward. British Heritage brand Burberry has undergone a strategic transformation over the past four years which is starting to gather momentum and should lead to higher growth and margins. Despite both companies having below market dividend yields of 2.3%, they offer potential for capital growth and superior dividend growth.

Owning these types of companies has helped the Trust to recover strongly. The share price and net asset value have grown by 41% and over 29%, respectively, on a total return basis over the last 12 months[2]– both well ahead of

the benchmark. The Trust has also outperformed over 3, 5 and 10-years. Furthermore, the Trust has delivered on income, with the dividend payout raised again in 2020, as it has been in every consecutive year since 2012, evidencing the robustness of the Trust's revenue reserves.[1] The dividend yield currently stands at an attractive 5.6%[2], with the Board committed to at least maintaining the current level of payment in 2021.[3]

Annual performance (cum income) (%)		
Discrete year performance % change (updated quarterly)	Share price	Nav
30/06/2020 to 30/06/2021	28.8	21.4
28/06/2019 to 30/06/2020	-13.0	-11.0
29/06/2018 to 28/06/2019	3.7	1.1
30/06/2017 to 29/06/2018	-1.3	5.6
30/06/2016 to 30/06/2017	20.4	15.7

All performance, cumulative growth and annual growth data is sourced from Morningstar

[2]Source: Henderson High Income Trust factsheet, 31.08.21
[1]Source: Henderson High Income Trust PLC, Annual Report 2020
[3]Source: Henderson High Income Trust PLC, Half Year Report 2021

THIS IS AN ADVERTISING PROMOTION

Janus Henderson INVESTORS

2020 was a very challenging environment for income seekers, and 2021 has brought about a different set of challenges for investors. The Trust's ability to invest a small portion of its portfolio in bonds helps dampen overall volatility, especially during equity market drawdowns, diversifies the income stream and aids the equity portfolio positioning towards companies that offer the potential for capital growth. Henderson High Income has a unique structure but one that it plays to its advantages.

For more information about the Henderson High Income Trust, visit www.hendersonhighincometrust.com

GLOSSARY TERMS

Credit spread – The difference in the yield of corporate bonds over equivalent government bonds.

Inflation – The rate at which the prices of goods and services are rising in an economy. The CPI and RPI are two common measures.

Net Asset Value (NAV) – The total value of a fund's assets less its liabilities.

Volatility – The rate and extent at which the price of a portfolio, security, or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

Yield – The level of income on a security, typically expressed as a percentage rate. For equities, a common measure is the dividend yield, which divides recent dividend payments for each share by the share price. For a bond, this is calculated as the coupon payment divided by the current bond price.

Three reasons the Chinese sell-off could be reversed

Fears over regulation, Evergrande contagion and slowing growth look overdone

The sell-off in China looks to have gone too far. The MSCI China index has declined by 20% over the last three months. Investor sentiment in the region has been undermined by a wave of policy tightening and stringent regulation targeting sectors from property to technology.

These fears have been compounded by concerns that Evergrande, the world's most indebted property firm will default, causing contagion in the Chinese bank sector. A series of recent downgrades to Chinese growth forecasts has provided further ammunition to sceptics of the Chinese economic miracle, who argue that investing in the region is an increasingly risky proposition.

Nonetheless, there is a compelling argument that we have reached a turning point for Chinese stocks, where valuations for the internet sector in particular are attractive. Regulatory intervention in China is not new, and the experience of 2018 would indicate that current fears have been overblown.

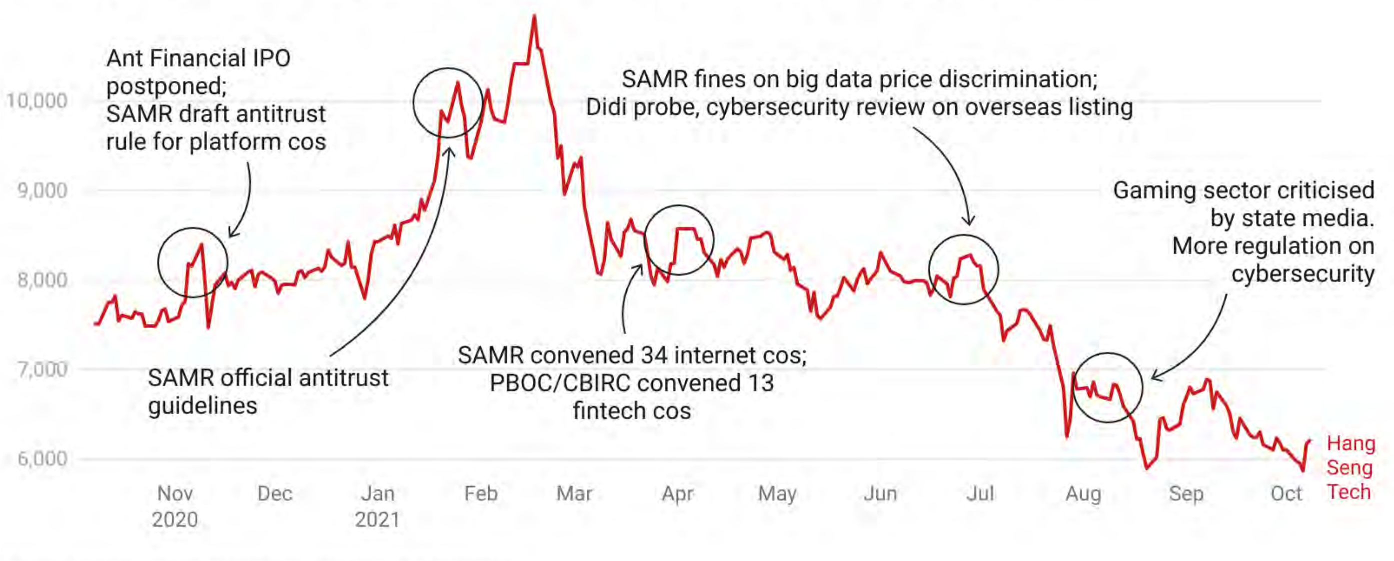
The property sector accounts for 25% of the Chinese economy, and is inextricably linked to both social stability and the financial system. This means the Chinese authorities are likely to contain the Evergrande situation, making contagion highly unlikely.

Fears of a sharp slowing of China's growth rate are also at odds with the continued expansion of the Chinese middle class, and the associated increase in disposable income.

A PERIOD OF INCREASING REGULATORY OVERSIGHT

The unexpected IPO cancellation in November last year of Ant Financial, a division of Alibaba, signalled the inception of

Examples of China getting tough on regulatory policy



Source: Fidelity, Shares magazine • Created with Datawrapper a government campaign to increase its control over the private sector. This increasingly draconian regulatory environment has encompassed private tutoring, e-commerce, social media, fintech, ride-sharing and video-streaming platforms.

Shares in Chinese Uber rival Didi fell 30% after the Chinese government announced a cyber-security review and insisted that the company remove a multitude of apps from its platform. The review came just after the company had listed on the US stock market.

Shares in both New Oriental Education and Technology and TAL Education lost over half their value following an unexpected crackdown by the Chinese authorities on public tutoring. The fundamental economics of after school tutoring have been undermined by the new policy measures. Not only will class sizes be significantly limited but they will also need to be non-profit. The overall aim of these reforms is to reduce the cost of education on children and families.

The Chinese internet sector was badly hit by new data protection legislation and new limits on the time children can spend online gaming. In response investors have aggressively sold shares in large cap companies including Baidu, Alibaba and Tencent.

CHINESE REGULATORY INTERVENTION IS NOT NEW

In a recent shareholder letter, Dale Nicholls, portfolio manager of **Fidelity China Special Situations (FCSS)**, argues that from a timing and historical perspective, it is not the first time that we have witnessed heightened regulation in China.

'We only need to cast our minds back to 2018 when the government felt the younger generation was spending too much of their time playing online games and as a result halted new gaming licenses. This was clearly a factor driving a near 50% correction in Tencent's stock market price before rebounding.

'Markets dislike uncertainty but we saw Tencent's shares rally 200% since the low in October 2020 to their high in January this year.'

According to Dale the Chinese internet sector is strategically critical, accounting for 40% of the economy and acts as an important conduit for innovation. He believes that current sector valuations are attractive, adding: 'Historically the sector has traded in a prospective price to earnings range of between 24 and 40. The sector is currently trading on a prospective PE multiple of 26 which is very close to the bottom of the range.'

On a stock level, Dale highlights Alibaba as an attractive investment. It has dominated recent headlines but if you 'factor out the cash and investments and the core business, you are looking at a low teens earnings multiple.

'This includes the cloud business which is loss-making but arguably still has long-term growth prospects. You can get to a single digit PE valuation for the core e-commerce business.

'There has been some competitive pressure, but for the dominant e-commerce player in China to be trading on that multiple, I think there is clear value emerging. If you are comparing Alibaba to Amazon which in some ways has similar businesses you can get to over a 70% discount.'

FEARS OF EVERGRANDE CONTANGION

For years market commentators have been anticipating the demise of Chinese property developer Evergrande. This is understandable given that it is the world's most indebted firm with $300 billion in liabilities. The company relies upon selling development properties years before completion to secure buyers' deposits.

Evergrande has become increasingly reliant on high cost, short-term financing. In an attempt to reduce leverage in the sector, authorities have constrained the developer's ability to sustain ever increasing levels of debt by limiting net debt to equity ratios to 100% and liability to asset ratios to less than 70%.

To generate cash Evergrande has been forced to significantly reduce the price at which it sells houses and to dispose of land at a marked discount. Last month it missed coupon payments on two dollar bond tranches and is scrambling to sell assets to pay creditors. An index of China yielding debt (MERACYC) which is predominantly composed of developer issuers has declined by 20% since May. This contrasts sharply with comparable American and European indices that have rallied.

An additional concern is that the deleveraging of the Chinese property sector may trigger contagion within the Chinese banking sector.

However recent research by Liberum's Chinese affiliate CGS CIMB suggests that this fear is largely unwarranted. Under its stress test analysis of the Chinese bank sector, which assumes a 9% corporate non-performing loan ratio, only Minsheng Bank would need to raise capital.

The research also indicated that falling prices are unlikely to have a material impact on the Chinese banking sector, because the low loan to value ratios provide a considerable buffer of approximately 30%.

Unlike America and Australia, Chinese mortgage credit underwriting has been relatively disciplined.

According to Michael Chang, director of financials at CGS CIMB: 'These factors as well as a lack of any material securitisation (where mortgages are packaged up in an instrument and sold to investors) market should help ensure that losses on mortgages are smaller than they otherwise would be.'

CHINESE GROWTH CONCERNS

The aforementioned difficulties at property giant Evergrande, coupled with the widespread regulatory squeeze prompted Bank of America to cut its China growth forecast. The economists lowered their 2021 and 2022 year on year growth forecasts to 8% and 5.3%, down from 8.3% and 6.2% respectively.

In a similar vein, investment bank Goldman Sachs expects 2021 Chinese GDP to grow by 7.8% compared with a previous forecast of 8.2%. Next year it expects GDP to grow by 5.5% compared with an earlier forecast of 5.6%.

'Considerable uncertainty remains with respect to the fourth quarter, with big upside and downside risks relating to the government's approach to managing the Evergrande stresses....and the degree of policy easing,' Goldman noted.

Fidelity Asia Pacific chief investment officer Paras Anand believes the mid to long-term Chinese growth outlook is robust given the expansion of the middle class. This has been facilitated by the increase in the urbanisation rate. In the most recent five-year plan a target of 65% was established, up from the current level of 61%.

Within a global context this is relatively low and the scope to further raise this level is a potential driver of long-term growth. Moreover within the urban population a significant cohort lack the Hukou (household registration rights and documentation).

Government plans to expand the Hukou system will confer increasing rights upon a significant number of urban workers. This will act as another catalyst for consumption and economic growth.

China funds performance

Fund	Five-year annualised return (%)
Baillie Gifford - China	14.3
FSSA - Greater China Growth	12.4
Fidelity - China Consumer	8.1
Invesco - China Equity	7.0
Threadneedle - China Opportunities	6.2
Liontrust - China	6.1

Source: FE Analytics, 8 October 2021 • Created with Datawrapper

China investment trusts performance

Trust	Five-year annualised return (%)
JPMorgan China Growth & Income	21.1
Fidelity China Special Situations	12.5
Baillie Gifford China Growth Trust	6.7

Source: FE Analytics, 8 October 2021 • Created with Datawrapper

By **Mark Gardner**
Senior Reporter

IS THE CHINESE EQUITY MARKET ATTRACTIVE ON VALUATION GROUNDS?

We are entering a new phase in the Chinese economic growth story, where we can expect more modest economic growth over the coming years.

However, this is very much in line with new government policy initiatives to engender a more balanced economy which is less dependent on fixed asset spending, but rather high quality manufacturing and consumption.

Victoria Mio, director of Asian equities at Fidelity, has highlighted the appeal of Chinese equities on valuation grounds. The MSCI China and CSI 300 index are both currently trading on a forward PE of 12 times, with consensus earnings for next year at 13%. She says: 'The market looks very cheap versus historical valuations.'

From a regulatory perspective Mio argues China has often instigated periods of regulatory change that 'usually last from six months to one year and the correction period is similar'. The correction started in March and we are currently seven months into this process.

According to Mio we are in the 'second half of the regulatory cycle and for long term investors China is definitely a place to be'.

China versus US market

Source: Fidelity, Refinitiv. 31 August 2021. RHS stands for right hand side

Quick out of the blocks

Following a change of management in April, Brown Advisory US Smaller Companies has recorded a strong start under its new leadership. Here, we profile some of the companies that have driven this momentum...

Earlier this year, **Brown Advisory US Smaller Companies (BASC)** transitioned to a new management company and team.

In a matter of days, the trust's newly appointed managers overhauled its portfolio almost entirely, retaining just two of the 37 stocks they inherited. As we outlined in a previous note, Brown Advisory is employing its tried and tested formula: their 'three G' approach to investing in US small-caps, which has proved successful in their long-established UCITS fund.

However, in a year which saw value perform very strongly - after a lengthy period of misery for value investors – the team's growth-oriented approach could have proved controversial.

A STRONG START

While it is always worth noting that past performance is not predictive of future outcomes, so far progress is promising. Since the new managers were officially appointed on 1 April 2021 to 31 August 2021, the trust posted NAV growth of 6.3% and a share price total return of 7.1%, while the Russell 2000 Index – the trust's benchmark – has been near flat over the same period. The trust also performed strongly relative to Morningstar IT North American Smaller Companies peer group, which has posted a share price total return of 2.9% over the same period.

At the same time, the trust currently sits on a discount of c. 10.8%, significantly wider than its investment trust peer group, giving investors access to this outperformance at a markdown.

So far, stock selection by the trust's Baltimore-based management has been a key aspect of this success, with four of its five largest holdings significantly outperforming the benchmark. Here, we thought we would take a deeper dive into those holdings.

VITAL INGREDIENTS

As a refresher, the trust's lead manager, Chris Berrier, and his team look for companies displaying '3G' characteristics. In practice, this means companies that have durable growth, sound governance and scalable go-to-market strategies.

Workiva is currently (as at 31 August 2021) the largest holding in the portfolio, with a 3.8% allocation. It is a SaaS (software-as-a-service) company, operating globally to provide cloud-based compliance and reporting functionality. In doing so it pulls data from across a disparate range of documents. As such, it has been an obvious beneficiary of the multi-year trend to migrate business systems online, with the pandemic rapidly accelerating this more recently.

The company boasts several high-profile clients, such as Google and Slack, reflecting its status as the leader in its sector. Since 1 April 2021, Workiva has seen its share price rise 51.99%.

BASC's second-largest holding, Charles River Laboratories, couldn't operate in a more different marketplace than Workiva, yet it reflects the manager's focus on innovative solutions created by specialists in their markets. The company provides research tools and support services for drug discovery and development.

Similarly to Workiva, it is benefitting from long-term trends – in this case, the falling cost of drug production, which is encouraging more development activity – that have been further boosted by the pandemic. Since 1 April 2021, Charles River Laboratories' share price has risen 50.89%.

Genpact is another digitally-focussed business services firm that has seen its growth accelerate under the changed work culture prompted by the pandemic. It provides digital solutions to improve client's processes across a broad range of applications, from supply chain through to community management. Since 1 April 2021, Genpact's share price has risen 20.38%, reflecting strong results in the first and second quarters.

A final meaningful position, which has also contributed to performance so far, is Waste Connections. While ostensibly waste management is not the most exciting opportunity discussed here, Waste Connections reflects the manager's desire to blend earlier stage, higher growth companies with more established names that are still generating growth.

Waste Connections is currently the third-largest waste management company in the US and has continued to gradually expand through strategic acquisitions in states where its coverage is lower. It has also been boosted by returning demand as states have unlocked from pandemic shutdowns. Since 1 April 2021, Waste Connections' share price has risen 18.52%.

Click here to read our detailed fund research on Brown Advisory US Smaller Companies here...

DANNI HEWSON
AJ Bell Financial Analyst

Insightful commentary on market issues

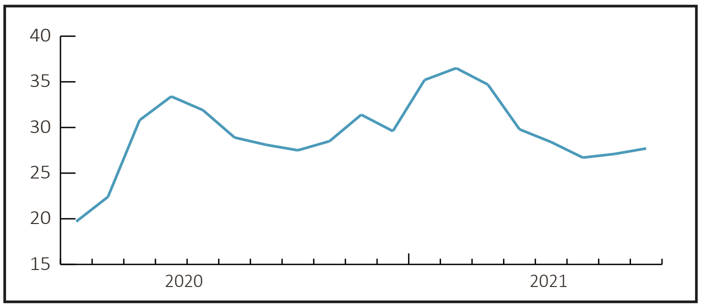
Retail: how a hybrid of online and physical stores is proving a success

It's no longer about having one or the other

Retail has been at war with itself for at least the past decade as old-style bricks and mortar businesses tried to keep up with the new kids on the online block. Big names like BHS and Toys R Us vanished from high streets and retail parks, others like New Look underwent brutal CVAs, which is a way for companies in distress to pay off their debts over a fixed period of time.

Established businesses launched their own websites but for many the rot had already set in. A lack of investment, a failure to understand how the new world worked created a vulnerability, and when the first Covid lockdown forced closures the shift from old to new simply sped up. For behemoths like Arcadia the nailed-on overheads were too great and the need to pivot quickly impossible for a business that size.

UK ONLINE SALES AS A PROPORTION OF RETAILING (%)



Source: ONS

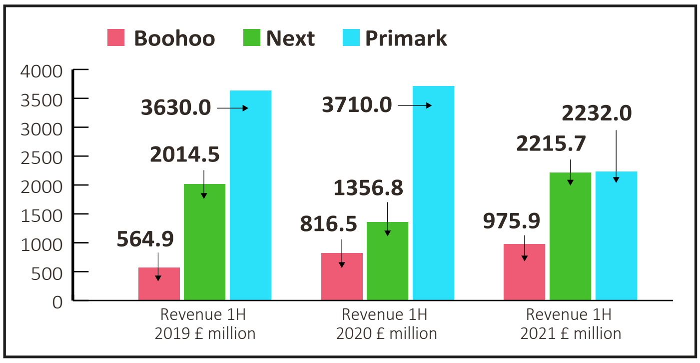
The proportion of online retail spend jumped by almost 15% while Covid-related restrictions were in place, but it did slip back when people were once again given the choice of where to spend their cash.

Shopping as an experience still has its place, particularly for big ticket items where people want the chance to touch the merchandise before they commit. And since May the numbers have remained stubbornly static, a trend that's certainly giving businesses like **Boohoo (BOO:AIM)** a growth headache.

Despite now resembling an online department store with many familiar names joining Boohoo's stable, the lack of a physical presence might be becoming an issue for the company and one that could get more acute as the months progress.

With the supply chain stretched to breaking point delivery costs have skyrocketed at the same time many traditional retailers have managed to pare down at least their rents. That's not to say bricks and mortar is enjoying a total renaissance. Primark is rethinking its stance on online, at least when it comes to attracting eyeballs as a transactional site is not yet on the cards.

MIXED FORTUNES FOR RETAILERS



Source: Company Accounts

DANNI HEWSON

AJ Bell Financial Analyst

The real winners seem to be retailers giving the customer what they want when they want it. That includes the choice of channel as well as the ability to buy online and collect or return the goods in-store.

Next (NXT) could be considered the swot of the retail world. After making what some might have considered a giant own goal by allowing rival brands to utilise its shops and delivery offer, Next has shot out of the changing room in the second half, making it a seriously superior competitor on a playing field that's rather changed from its pre-Covid formation.

Next's latest online sales growth would have been enough to make Boohoo weep and its stores have become a hybrid, both shop window and glorified warehouse.

Anyone thinking that Next's performance is unique just needs to consider how **Hotel Chocolat (HOTC:AIM)** has emerged from the past 18 months as a business which has found a way to succeed both offline and online.

Even Amazon, the bastion of online sales, has just opened its first non-food store in the UK offering customers an opportunity to indulge their senses with its four-star merchandise.

Whether the experiment will result in hundreds of Amazon hubs depends on the customer engagement but if the Next omni-channel story is any indication those yellow smiles could become a staple of our high streets and not just our letter boxes.

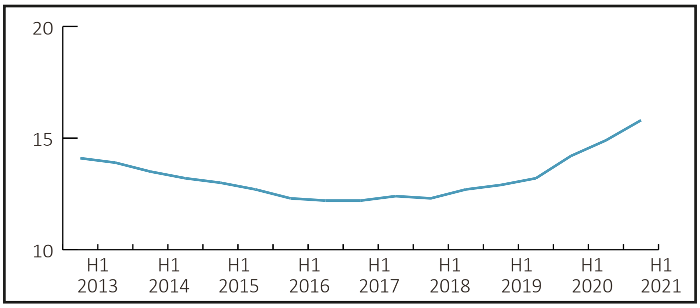
THE VALUE OF PHYSICAL SPACES

Before the pandemic online-only retailers had begun experimenting with stores in prime locations and there's nowhere quite as cool as London's West End. The CEO of property company **Shaftesbury (SHB)** Brian Bickell took me on a tour of the company's estate a couple of weeks ago and pointed out a couple of achingly hip stores that are otherwise 'online only'.

They'd grabbed the space initially as a glorified advert but had been pleasantly surprised by both the sales rung up in store and the uptick in the general area.

It's a phenomenon also experience by Yorkshire-based Joe Browns when it opened its physical store in Sheffield's Meadowhall shopping centre a few years ago.

RETAIL VACANCY RATES IN THE UK (%)



Source:: Local Data Company

As ever the key is location, location, location. No successful brand wants to be knocking up against empty spaces and post pandemic vacancy rates have hit an all-time high.

Shaftesbury's boss refers to the phenomena as a 'cancer' and he's pulling out all the stops to make sure it doesn't spread through his estate.

Big boxes (warehouses) are being resized and repurposed and bucket loads of data is being pored over to ensure it owns retail property located in places with the best footfall.

The idea of retail as entertainment and experience is nothing new; it's why shopping centre owners like **British Land (BLND)** have spent so much time and money reworking the leisure offer. Understanding retail is about more than just sales.

That's a lesson online names are beginning to learn; their core consumer might be happy but attracting new shoppers will take more than just a jazzy website. Margins are getting tighter and with that decreases the ability to use price as the key tactic to draw customers in.

Investors need to be as savvy as shoppers themselves. They need to probe a retailer's outlook and be sure they have appropriate plans in place to keep up with the changing landscape. It's no longer a case of bricks or clicks but of a smart, workable mix of the two.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Bonds show it's no time to buy

How inflation is affecting the fixed income market

While all eyes have been on the fuel crisis, little attention has so far been paid to the impact of higher oil and gas prices on government bond yields.

The yield on the benchmark UK government bond has been rising steadily, and now sits at over 1.1%. To those who remember gilt yields of 5% and higher prior to the financial crisis, 1.1% sounds very low. Historically, it is.

But only two months ago, the yield stood at just 0.5%, and if it rises further it could be extremely damaging for bond investors.

UNDERSTANDING GOVERNMENT BONDS

A gilt is simply a UK government bond; it's an IOU promised by the Treasury when they borrow money, something they've been doing a lot of recently.

The yield on these bonds rise when prices fall, so the recent increase from 0.5% to 1.1% shows investors have been selling out of gilts. That's because the spiralling price of oil and gas has heightened concerns that inflation may be more severe and long lasting than the Bank of England has suggested.

Inflation is very bad for bonds, because the value of the fixed income stream they pay is eroded by rising prices.

The 10-year gilt yield is still below the central bank's 2% CPI inflation target, however, so bond investors are clearly still willing to accept a return below the rate of inflation, even assuming the Bank of England has it under control.

That's because interest rates are still very low, and the Bank of England is still committed to its quantitative easing programme in which it holds £875 billion of government bonds.

However, a recovering economy and rising inflation heaps pressure on central banks to scale back QE, and raise interest rates. November looks like it could be a crunch

month as central banks on both sides of the Atlantic will meet to determine whether it's time to tighten monetary policy.

WHAT RATE RISES MEAN FOR FIXED INCOME

Conventional gilts would not fare well if interest rates rise. So far this year, UK gilt funds have on average fallen in value by 7%. While that's probably not enough to make most equity investors blush, investors choose bonds because they're seen as safe havens.

This may prove to be a false sense of security for gilt investors though, if we really are entering a new era of interest rate hikes. The last 12 years of ultra-loose monetary policy has driven gilt prices so high, they now carry an awful lot of valuation risk, and offer a pretty measly yield in return.

Other bonds take their lead from the government bond markets, but they won't all be affected to the same extent. Unlike gilts, corporate bonds (both high quality and riskier high yield) carry a higher interest rate, which cushions the impact of price falls emanating from tightening monetary policy.

They also tend to be shorter dated, which means they are less sensitive to interest rate rises. Being loans to companies rather than governments, they also experience some upward pressure on prices from an improving economy, because the accompanying earnings growth should make it easier for companies to service their debt.

In a rising interest rate scenario, 'riskier' bond funds should fare better than 'safer' conventional gilt funds, though they still might not make a positive return.

STRATEGIC BOND FUNDS: A USEFUL TOOL

Strategic bonds funds can be useful tools for fixed income investors. These have the flexibility to invest in global government bonds, high quality corporate bonds, and high yield bonds across the globe, giving the fund manager the scope to pick up a higher income where they can, and potentially protect investors from tightening monetary policy in certain countries.

Index-linked gilts also offer investors some protection from inflationary pressures because their capital and income rises with RPI. However, they also tend to be long-dated, which means interest rate rises will take some toll on that uplift.

Rising interest rates pose a challenge for all bonds. But of course, tighter monetary policy isn't a given. If the economy takes a dive, central banks may simply maintain low interest rates and QE, or even possibly loosen monetary policy. In that scenario, bonds will do quite nicely, and in a portfolio will provide a hedge against falling equity markets.

If the last 12 years have taught us anything, it's that we shouldn't rule out the possibility that interest rates can be cut further, as inconceivable as that has seemed at times. But rates are now so low, there's just not much more room for them to fall, while there's plenty of scope for them to rise.

The balance of potential gains and losses therefore suggests parts of the bond market are best avoided, and others should be bought selectively.

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

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

18 Oct: Tristel. **19 Oct**: Essensys, YouGov, Bellway. **21 Oct:** Renishaw, Renalytix. **22 Oct:** Virgin Wines.

Half-year results

19 Oct: BP Marsh.

Trading updates

15 Oct: Rio Tinto. **19 Oct:** 888, BHP. **20 Oct:** Antofagasta, Advanced Medical Solutions, Segro. **21 Oct:** Barclays, Spectris, St James's Place, Anglo American, Unilever, AJ Bell, PensionBee, Vivo Energy. **22 Oct:** InterContinental Hotels, National Express, Record.

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WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

SENIOR REPORTERS: Martin Gamble @Chilligg; Ian Conway @SharesMagIan; Mark Gardner

CONTRIBUTORS Danni Hewson, Laith Khalaf, Russ Mould, Tom Selby, Laura Suter, Rachel Vahey

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

PRODUCTION
Head of Design: Darren Rapley
Designer: Rebecca Bodi

CONTACT US:
support@sharesmagazine.co.uk

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