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SHARES

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Where to find quality stocks on sale

BRITISH AMERICAN TOBACCO exclusive interview with finance chief


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Contents

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The new trusts planning to shake up the infrastructure space

These vehicles look different and are chasing higher returns

Infrastructure has been a popular area to invest in recent years but it is known for its reliable long-term income streams rather than being particularly dynamic or growth focused.

However, two new vehicles could shake up infrastructure's rather staid reputation assuming they join the market as planned.

First up is **Pantheon Infrastructure**. People might be familiar with the Pantheon name. Pantheon Ventures is a large private equity firm which already runs the **Pantheon International (PIN)** trust.

What makes its new infrastructure proposition stand out from the crowd, according to the head of Europe in Pantheon's global infrastructure and real assets investment team Richard Sem is it is truly diversified across different types of infrastructure asset and is targeting a higher level of return at 8% to 10%.

Sem observes that most infrastructure trusts listed in London either specialise in areas like renewables or government-backed projects.

Since 2015, the investment manager (Pantheon) has committed $2.7 billion to 34 co-investment transactions, delivering risk-adjusted returns of 16.7%.

The trust will co-invest alongside Pantheon's unquoted funds and third parties which should help keep costs lower for investors – an immediate £1 billion pipeline is lined up, with hopes to invest in eight to 12 assets within nine to 12 months of listing.

Sem tells *Shares* the trust will also have a shorter investment horizon than traditional infrastructure funds of around five to eight years. With a strategy of looking to improve the performance of assets through initiatives such as restructuring debt, achieving savings on operating expenditure and targeted investment and then potentially exiting.

FLEXIBILE INVESTMENT MANDATE

He adds: 'The valuation environment in infrastructure is certainly high at the moment but we have great ways to navigate that. We are highly selective in the deals we convert on and we benefit from not being tied to any particular sector.'

This means, as Sem explains, that if a lot of money is chasing digital infrastructure assets, for example, then it can look elsewhere.

The fund hopes to raise £300 million and the offer on the listing is open to 9 November with plans for shares to begin trading on 16 November.

The other new infrastructure play **Alinda Capital Infrastructure** is again taking a slightly different approach. It is investing in medium-sized infrastructure businesses (rather than underlying assets) with the aim, like the Pantheon trust, of earning returns in the order of 10%.

Like Pantheon, the investment manager, US private equity firm Alinda, also invests in infrastructure through the private markets.

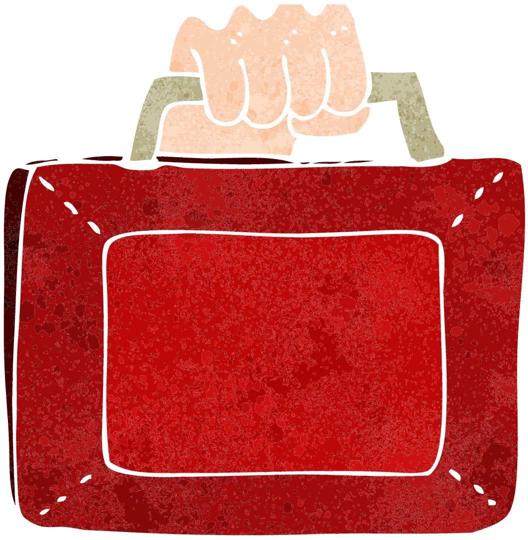
The new trust will be a material investor in Alinda Infrastructure Parallel Fund IV as well as making direct investments itself and with partners.

Alinda is looking to raise £350 million and the offer is expected to close in mid-November. The Alinda fund is set to trade initially in the specialist fund segment of the London Stock Exchange which means it will only be available to sophisticated retail investors, though the plan is for it to opened up to a wider retail audience in time.

By **Tom Sieber** Deputy Editor

Pubs raise a glass to rates and duty cuts in Budget

Hard pressed hospitality sector offered a helping hand as Sunak offers rate rise hint



Hard-pressed pubs and the wider hospitality sector were among the main winners from chancellor Rishi Sunak's third budget as they were served up some notable giveaways.

The wider market had a pretty muted reaction to the statement which contained relatively few surprises after several key items were trailed in advance. The FTSE 100 was broadly unchanged, although there were gains for the more domestic-facing FTSE 250.

An improvement in the OBR's (Office for Budget Responsibility) economic forecasts also helped give the pound a modest lift against the dollar. The OBR has lifted its GDP forecast for 2021 from 4% in March to 6.5% and the estimate for long-term scarring on the economy was revised down from 3% to 2%.

Sunak also offered the latest hint that a rate increase could be coming soon as he confirmed he'd written to the Bank of England to give them a nudge on their remit of 'achieving low and stable inflation'.

However James Antwis, analyst at HSBC Asset Management, said: 'The combination of higher rates and premature fiscal tightening could jeopardise the recovery and this means that today's budget should provide food for thought for the MPC ahead of next week's policy meeting, and throws doubt on whether the Bank can raise rates as quickly as markets are currently pricing.'

Pubs benefited from a new 'draught relief', a 5% cut on duty on draught beer and cider, and were one of several industries to get a boost from a 50% cut on business rates (up to a maximum of £100,000) for retail, hospitality and leisure companies.

Shares in pubs groups **JD Wetherspoon (JDW)** gained 5.5% to £10.41, **Mitchells & Butlers (MAB)** to 3.2% to 254.6p and **Marston's (MARS)** were up 3.9% to more than 80p. Gym operator **Gym Group (GYM)** ticked 0.6% higher to 265p on the news.

The obvious losers were in the banking sector where despite the expected cut in the corporation tax surcharge from 8% to 3% in 2023 the industry still faced an increase in corporation tax from 27% to 28% that year – ahead of the rates paid by other companies. **Barclays (BARC)** fell 1.5% to 199.7p.

UK-listed airlines largely shrugged off a cut to passenger duty on domestic flights, reflecting their greater focus on international travel.

Buried in the small print was news that the still quite generous ISA allowance will remain frozen through the 2022/2023 tax year at £20,000 along with the £9,000 limit on Junior ISAs and the £5,000 starting rate at which you start to pay tax on the interest earned on savings.

Watch out for companies carrying a lot of debt

Financially weak companies have benefited from the low interest rate environment but that could be about to change

The UK's most heavily indebted companies have underperformed the FTSE All-share index over the last six months perhaps reflecting increased fears of rising interest rates which could lead to higher borrowing costs and consequently lower earnings.

Balance sheets haven't been a focus for investors in a long time because central banks have been flooding the financial system with very cheap money.

However, all that could be changing as the 'inflation is temporary' narrative loses credibility amid rising inflation expectations.

Investors may find it increasingly rewarding to pay attention to company's financial leverage which could act like a lead weight on share performance over coming months.

One direct effect of a less accommodative central bank is that commercial banks might look to tighten their lending criteria. The most heavily indebted companies will feel the pinch first, as they tend to be in worse shape financially and therefore pose the highest risk to banks' balance sheets.

In addition, banks lend to financially weak firms over shorter durations to account for the extra risk which means that higher interest rates and borrowing costs come into effect sooner as older debts expire.

We have run a screen using Stockopedia to identify stocks with a market capitalisation greater than £100 million, excluding financials, where net debt to assets is greater than 60%. This is a measure of leverage and calculated by comparing net debt to total assets.

We excluded financials because it is difficult to reliably calculate net debt for them. Net debt is total debt minus cash. Levels above 60% are considered risky and less sustainable.

We narrowed the field further by insisting on an Altman Z-score of less than 1.2 times. The Z-score is designed to identify companies which have a higher risk of bankruptcy, with readings below the 1.2 threshold considered riskier than average.

UK's most indebted companies

Name	Rel Strength 6m (%)	Net Debt / Assets Latest (%)
Cineworld	-34.9	81.1
Iwg	-18.1	80.4
Ten Entertainment	15.8	79.0
Ssp	-31.2	75.0
J D Wetherspoon	-32.3	68.1
Contourglobal	-6.0	66.7
Wh Smith	-19.0	64.1
Marston's	-24.8	63.9
Tullow Oil	3.7	60.5
Severn Trent	4.9	60.1

Relative to FTSE All-share

Source: Stockopedia, Refinitv • Created with Datawrapper

The worst performer in the basket over the last six months is cinema operator **Cineworld (CINE)** whose debts prior to the pandemic left the group exposed when its cinemas were forced to shut.

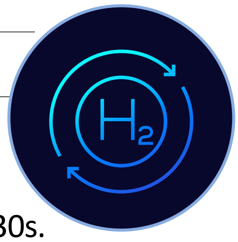
While the group seems well positioned to benefit from pent-up demand and a promising roster of film releases it has had to borrow further to stay alive which means higher future borrowing costs that eat into profits, leaving less on the table for shareholders.

At the other end of the share price performance spectrum is water utility **Severn Trent (SVT)**. Its revenues are relatively dependable which justifies higher than average levels of debt financing.

That said, during lockdown utility companies discovered that extra home consumption didn't completely offset the loss of business usage, denting revenue, and hurting profit. [MGam]

Hydrogen to return to the spotlight at climate summit

New London listing promises unique 'green' hydrogen exposure



With the world's focus turning to climate matters at the COP26 summit in Glasgow next week, the topic of hydrogen is likely to resurface after a period of relative quiet.

Hydrogen's potential to replace natural gas as a low-carbon fuel has long been touted as part of the race to net zero emissions by 2050. According to Bloomberg New Energy Finance, the global market for hydrogen could be worth $700 billion per year by 2050.

Last weekend Saudi Arabia, one of the world's largest oil and natural gas producers, pledged to hit net zero emissions by 2060 through carbon capture and the use of hydrogen.

The Saudi government said it would use a large portion of the production from its Jafurah development, one of the world's largest natural gas reserves, to make 'blue' hydrogen for export by the 2030s.

Meanwhile, UK investors have the opportunity to invest in one of the world's few 'green' hydrogen suppliers, which only uses renewable energy in the manufacturing process.

Leeds-based **Atome Energy**, 85% owned by **President Energy (PPC:AIM)**, intends to float on the junior market by the end of the year and to begin 'green' hydrogen production by the end of 2023.

The firm already has baseload agreements in place to tap renewable energy sources 24 hours a day at its sites in Iceland and Paraguay, with exports destined for markets throughout Europe and South America. [IC]

Missguided in trouble as retail sales slump

Fast fashion firm appeals to outside investors in emergency cash raise

THE LATEST RELEASE of the monthly UK retail sales data from the Office for National Statistics made for grim reading, with September registering the sixth straight month of falling sales as measured by volume, the longest period of successive monthly falls since the series began in February 1996.

On the bright side, sales volumes were still slightly above pre-pandemic levels, but this was only due to spending on food and fuel. Non-food receipts were down significantly year on year and even online sales were down for the first time.

The big casualties were household goods stores, where volume sales have fallen each month since their peak in May after the reopening of non-essential retail.

Clothing sales increased, but the sector is still suffering from labour and supply chain issues. One firm which has been particularly badly affected is fast fashion company Missguided, which according to press reports is urgently trying to raise £50 million in funding to keep trading.

Missguided's founder Nitin Passi is thought to be in talks with restructuring experts to look at options for the business, according to trade journal the *Retail Gazette*.

As well as suffering from supply chain issues, industry sources reported some of its larger wholesale customers had delayed payments, deepening the cash crisis at the firm. No doubt online rivals **ASOS (ASC:AIM)** and **Boohoo (BOO:AIM)** will be watching developments with interest. [IC]

How to tap into rising rates and valuations in the shipping market

Newly-listed trust offers real asset backing, an attractive yield and aligned management

With almost every company announcement these days making a reference to higher shipping costs, it's high time we took a look at the trillion-pound ocean freight market for a stock idea.

One name which jumps out straight away and is differentiated from the crowd is investment trust **Taylor Maritime (TMI)**, which came to the market in May.

Taylor Maritime is only the second listed closed-end vehicle investing in shipping after **Tufton Oceanic (SHIP)**, and has a smaller market capitalization ($330 million versus $390 million) even though by the end of this year it will have a similar-sized fleet (25 vessels versus 26).

The big difference between them is Tufton has a very diversified fleet made up of container ships and bulk carriers on one hand and tankers on the other.

FOCUSED APPROACH

Taylor Maritime instead has a very focused fleet, owning 23 'handysize' dry bulk carriers, which are typically 130 to 150 metres long with a deadweight of between 24,000 tonnes and 35,000 tonnes, and 2 'supramax' bulk carriers which is the next size up, between 150 and 200 meters long, with a deadweight of between 50,000 and 60,000 tonnes.

TAYLOR MARITIME
BUY
(TMI) $1.31
Market cap: $335 million

Dry bulk carriers are used for loose goods which can't be transported in a container, for example rice or cement or iron ore, and they often carry a mixture of cargoes in their separate holds. Deadweight tonnage refers to the total weight the ship can carry in terms of load, fuel and ballast water.

With their shallow draft of just 10 metres, handysize carriers can deliver a wide range of cargoes to almost any port in the world, making them one of the most popular types of dry bulk carriers for shippers.

Supramax carriers have become increasingly in demand in recent years due to their ability to take larger cargoes and their on-board loading equipment which makes it quicker to transfer loads to and from the quayside.

Both types of ship can unload part of their cargo at one port and load the empty hold with another cargo, repeating the process several times before they reach their final destination.

POSITIVE OUTLOOK

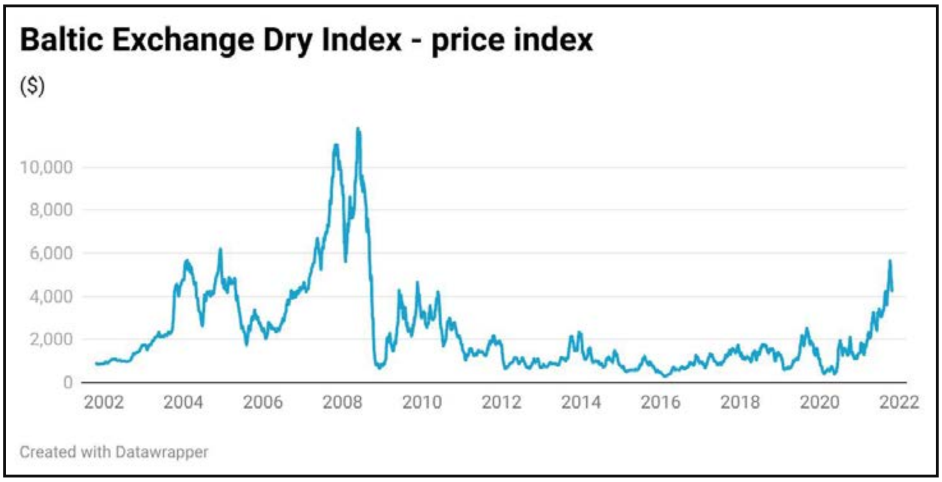
Taylor Maritime charters its fleet out to shipping companies, and the outlook for the dry bulk sector is particularly good at the moment with spot rates increasing and the value of ships also rising due to lack of supply.

Historically, the shipping market has been highly cyclical, but chief executive Ed Buttery puts a lot of this down to the nature of the capital which previously backed the sector.

'In the past, a lot of hedge funds and private equity investors would pile into the market when rates were low looking for a 40% IRR (internal rate of return) and move on when something else caught their eye', says Buttery.

These investors would typically load the shipping firms up with debt, suck out as much cash as possible and exit leaving management struggling with interest payments. 'They were basically agnostic about business, it was a trade for them', he adds.

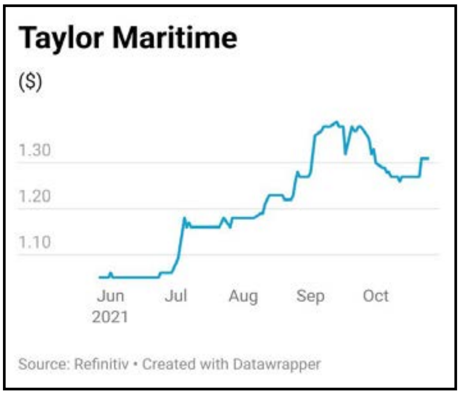
One of the main reasons for floating Taylor Maritime as a closed-end fund was to raise permanent capital from long-term shareholders, with no debt financing, while at the same time appealing to UK investors looking for income with a target yield of 7% or $0.07 per share on the $1.00 issue price.



YIELD ATTRACTIONS

As well as an attractive yield (currently 5.5%), the trust offers exposure to real assets which are appreciating due the lack of new capacity and is run by a strongly-aligned management team which has over $30 million of its own money invested alongside shareholders.

The latest net asset value of $1.398 represents an uplift of 24% during the third quarter and 43% since IPO, helped by a $68 million increase in the valuation of its current fleet. It also means the trust is trading at a discount of over 6% to NAV, making this a good entry point.



Tharisa is a chrome-plated buy for cash flow growth

Platinum group metals and chrome producer is set for an excellent 2022

THARISA
BUY
(THS) 132p

Market cap: **£367.1 million**

An imminent uplift in production and improvement in margins at chrome and PGM (platinum group metals) miner **Tharisa (THS)** should act as a catalyst for the shares with full year results on 2 December crystallising this positive trend in the market's mind.

The company has entered cold commissioning on its Vulcan chrome processing plant which is expected to boost chrome output by 20% and lead to lower unit operating costs. It should also lower the company's carbon footprint.

The latest production guidance for the year to 30 September 2022 is for 165-175,000 ounces of PGMs and 1.75-1.85 million tonnes of chrome, putting Tharisa well on the way to medium-term targets of 200,000 ounces and two million tonnes respectively.

Investment bank BMO estimates that with the impact from Vulcan, guidance for greater recoveries of PGM and the capital costs of setting up the new plant in the rear-view mirror the company will be able to generate free cash flow of $197 million which translates into a free cash flow yield in the region of 30%.

The company is already sitting on net cash of nearly $50 million and the strong cash generation could underpin better than expected dividends with the group offering a near-5% yield based on BMO's forecasts.

INTEGRATED OPERATOR

Tharisa is an integrated operator meaning it is active in mining and processing as well as marketing, sales and logistics.

The company produces its metals from the open pit, mechanised Tharisa mine, located some 90 kilometres from Johannesburg. The mine is 74%-owned by Tharisa with the remainder owned by the local community, in line with South African legislation.

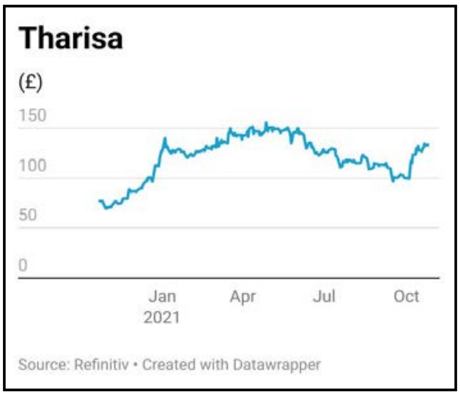
PGMs are used across a wide range of metal-contained products, ranging from platinum in jewellery to fuel cells and catalytic convertors.

Chrome is used the production of stainless steel. South Africa supplies 80% of China's chrome requirements. On an annual basis Tharisa accounts for 10% to 12% of this demand.

Inevitably the business is exposed to volatility in the price of PGMs and chrome which have fallen after a strong start to 2021. This largely reflects the global supply chain issues which have hit areas like car production.

However, CEO Phoevos Pouroulis tells *Shares* he expects strong fundamentals for PGMs and chrome to support prices once these short-term issues have abated and notes that as a low-cost producer Tharisa is able to generate strong margins at current pricing levels. This should also help the company absorb higher freight costs.

Elsewhere the company has development projects in Zimbabwe to which the market is currently ascribing little or no value. [TS]



THE MERCANTILE INVESTMENT TRUST
(MRC) 261.5P

Gain to date: 44.4%
Original entry point:
Buy at 181.1p, 17 September 2020

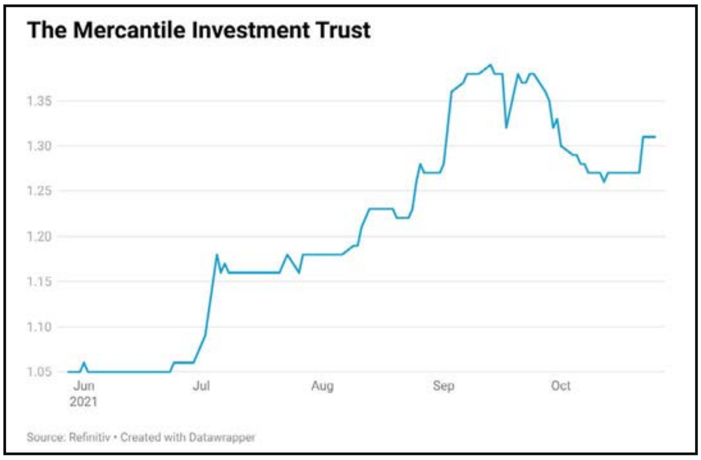
OUR BUY CALL on investment trust **Mercantile (MRC)** is 44.4% in the money and we are pleased to note a benchmark-beating first half performance (15 Oct) from the small and mid cap-focused fund.

Focused on finding 'tomorrow's UK market leaders', Mercantile's tried-and-tested strategy paid off in the six months to July 2021, with the trust generating a net asset value total return of 25.3%.

That was comfortably ahead of the 18.1% produced by the benchmark FTSE All-Share (ex FTSE 100, ex Inv Companies) index, thanks to stellar share price performances from the likes of luxury watch retailer **Watches of Switzerland (WOSG)** and media group **Future (FUTR)**.

The positive outlook of fund managers Guy Anderson and Anthony Lynch is reflected in the trust's 10% gearing, with portfolio companies for the most part either continuing to perform strongly or recovering well from the Covid crisis.

Mercantile also said it plans to at least maintain the full year dividend at 6.7p by dipping into its revenue reserves, 'but to a lesser extent than required for 2021', with investee companies beginning to increase and restore pay-outs.



SHARES SAYS:
Keep buying at 261.5p. [JC]

ACCROL
(ACRL:AIM) 37.8p

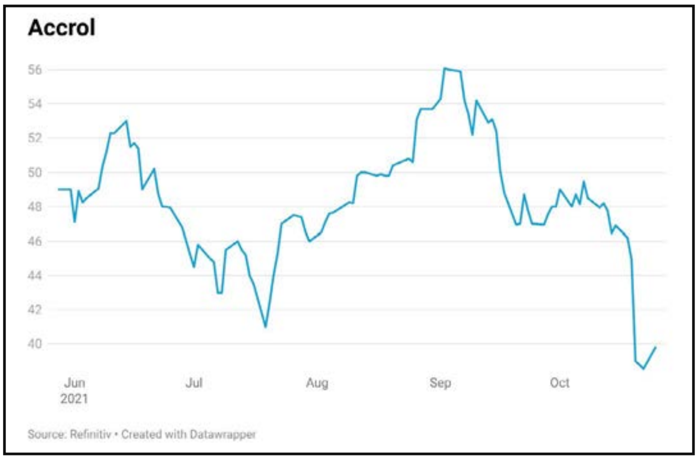
Loss to date: 25.6%
Original entry point:
Buy at 50.8p, 26 August 2021

OUR BUY CALL on **Accrol (ACRL:AIM)** is 25.6% underwater following a profit warning (20 Oct 2021) from the toilet roll, tissue and kitchen roll maker.

Yet we're minded to stay positive on the private label manufacturer, since the business is being buffeted by external factors rather than internal issues. Accrol has been transformed by chief executive Gareth Jenkins and has exciting longer-term growth potential, supported by the expansion of the major discounters.

Earnings for the year to next April will be lower than previously expected due to a time lag in passing on increased supply chain costs to customers. The HGV driver shortage, rising raw material prices and a slower than expected recovery in footfall for discounters have conspired to constrain Accrol's sales and profit growth.

While forecasts have been downgraded, Accrol still expects to deliver revenue growth of 25% and a 20% improvement in adjusted EBITDA this year. And the company, which sells non-discretionary products, remains well placed to benefit from a recovery in tissue volumes as the effects of the pandemic unwind.



SHARES SAYS:
Accrol's profit warning is unfortunate, but we think the shares are oversold. Still a buy. [JC]

CARETECH
(CTH:AIM) 623.5p

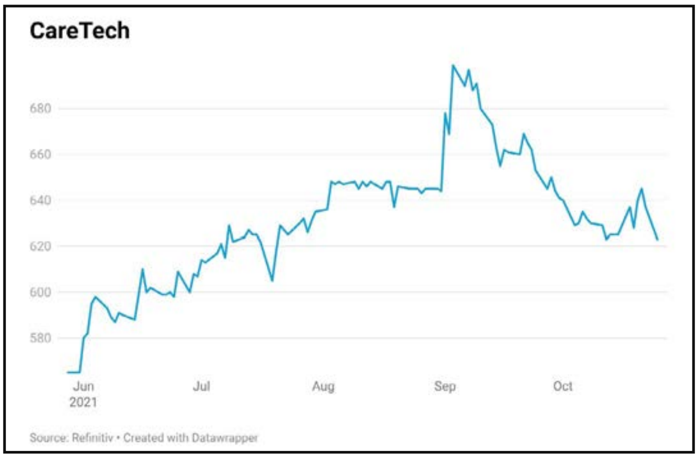
Gain to date: 0.7%
Original entry point:
Buy at 619p, 21 July 2021

SOCIAL CARE AND education services provider, **CareTech (CTH:AIM)** reported a resilient trading update for the year to 30 September, in line with market expectations.

Consensus expectations are looking for double-digit increase in revenues and EBITDA (earnings before interest, taxes, depreciation, and amortisation).

Strong cash generation supported the continued deleveraging of the group with a reduction in net debt to £259 million bringing the ratio of net debt to unaudited EBITDA to 2.7 times implying EBITDA of around £96 million.

The group's property portfolio which comprises 407 freehold and long leasehold sites was revalued upwards by 20% to £930 million compared with the last assessment in 2018.



The company highlighted continued organic growth initiatives opening seven new developments and purchasing eight properties in the second half, while the bolt-on acquisition pipeline remained strong.

Short-term recruitment issues aside CareTech appears well positioned to continue its growth path.

SHARES SAYS: ↗
Remains a buy. [MGam]

HOUSEHOLD NAMES GOING CHEAP:

Where to find quality stocks on sale

By **Ian Conway** Senior Reporter

With the FTSE touching post-pandemic highs and US markets pushing towards record levels, it's reasonable to ask if there is any value left in stocks.

The problem for investors looking for income and capital gains is, with rock-bottom returns on bonds and constant central bank support, there are few alternatives to stocks and shares.

However, despite the recent surge in one or two cyclical sectors like energy and banks we don't think it makes sense to switch wholesale into 'value' stocks.

Instead, we have found half a dozen big shares, all household names with resilient business models, where in our view growth over the next 12 months isn't being priced in properly and which now offer great relative value, both against their past valuations and the broader market.

FALLING BY THE WAYSIDE

As we recently observed, after a choppy September with the FTSE selling off sharply into mid-month before rebounding, a lot of what we consider sensible companies have seen their shares fall by the wayside.

Rather than try to catch a short-term bounce in the most downtrodden names though, we're interested in stocks which were already being sold off before September and where prices now look completely out of line with their prospects. The table overleaf shows names from London's Main Market which have sold off recently, but where this doesn't represent profit taking after an exceptionally strong run.

Not all of these companies represent attractive investments but the *Shares* team has looked through them to identify those where recent share price weakness looks unwarranted – these are highlighted in green in the table.

We've also extended our search a little further to the largest AIM companies and found a diamond in the rough there too.

CONSUMER STOCKS UNDER PRESSURE

One of the areas of the market which has seen the biggest de-rating is the consumer discretionary sector, including companies which did well during the pandemic but which the market has since decided will struggle to keep up that growth momentum.

While the way we spend our money has changed a lot in the last year and a half – more of us are using the internet to shop and we're using credit and debit cards instead of cash, for instance – we're generally still buying the same things we were before the pandemic.

Therefore, it seems odd that the market has de-rated these well-known, high-quality consumer-facing companies – three of which are in the FTSE 100 no less – with visibly improving earnings, especially when the broader market is being re-rated.

SOLD OFF STOCKS

Company	Change since 6 Sep '21	Forecast PE
Fisher (James) & Sons	−25.0%	17.5
QinetiQ	−17.0%	13.0
Homeserve	−15.9%	17.1
Micro Focus	−15.7%	3.6
Melrose Industries	−15.4%	47.7
Go-Ahead	−15.4%	8.3
IG Design	−15.3%	16.4
Vesuvius	−14.8%	13.9
Lancashire	−14.3%	15.4
Moneysupermarket.com	−14.1%	18.6
Essentra	−13.8%	14.1
Wetherspoon (JD)	−13.4%	20.3
Sabre Insurance	−12.1%	15.7
Berkeley	−11.7%	11.2
Hiscox	−11.1%	20.9
Associated British Foods	−9.8%	24.4
Direct Line Insurance	−9.5%	11.1
Speedy Hire	−9.1%	14.4
Smith & Nephew	−7.7%	20.8
Intertek	−7.7%	26.8
Jupiter Fund Management	−7.5%	8.3
Wood Group	−5.5%	12.6
Reckitt Benckiser	−4.8%	18.5
Unilever	−4.5%	17.9

Source: SharePad, 21 October 2021 • Created with Datawrapper

HOUSEHOLD NAMES ON SALE

AB FOODS (ABF)

Price: £17.60 – Market Cap: 14 billion
Index: FTSE 100

Unlike the some of the other names discussed here, AB Foods – and specifically its biggest profit centre, Primark – was a lockdown loser, only coming into its own when vaccinations began to be rolled out late last year.

Despite a strong rally into the early summer, the shares swiftly turned down and have lost virtually all their gains of the last 12 months. Moreover, they are just half their peak of late 2017 when it seemed the company could do no wrong.

Regardless of its lack of an online capability, Primark remains a 'category killer' in the fast fashion market with prices and an appeal to its core customer base few can match.

In its pre-close trading update last month, the firm said despite lower than expected sales at Primark operating profits would be ahead of expectations and ahead of last year.

At the same time, the sugar business is seen delivering a bigger increase in operating profits than expected thanks to a very strong performance in its African business Illovo.

The firm also owns market-leading food brands, among them Twinings, Jordans, Dorset Cereals and Ryvita which generate dependable if unspectacular cash flows.

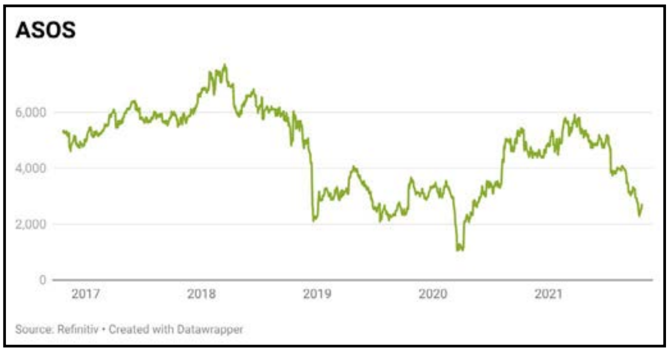
While it is common for conglomerates to trade at a discount to the sum of their parts, investors are being asked to pay just 13 times next year's 'recovery earnings' and 12 times normalised earnings the year after which seems uncommonly cheap. (JC)

ASOS (ASC:AIM)

Price: £25.40 – Market cap: £2.5 billion
Index: AIM 50

If we ignore the pandemic low then ASOS shares are trading at levels they haven't seen since 2019, despite the fact the firm generated £344 million of EBITDA in the year to August or more than three times 2019's figure.

There's no doubt ASOS was another pandemic winner, with customers flocking to buy comfy leisurewear during lockdown, and sales growth will moderate from 20% last year, but it is still expected to be between 10% and 15% this year and next year.



Short-term headwinds such as supply chain pressures, delivery and labour costs will dissipate, while investment in technology is reducing overheads and improving the customer experience with the use of artificial intelligence and data mining.

At the same time, new categories are being added, like Face + Body where sales were up nearly 50% last year to £150 million, and the firm is targeting £7 billion of annual sales from less than £4 billion last year in an addressable market which it estimates to be worth £430 billion.

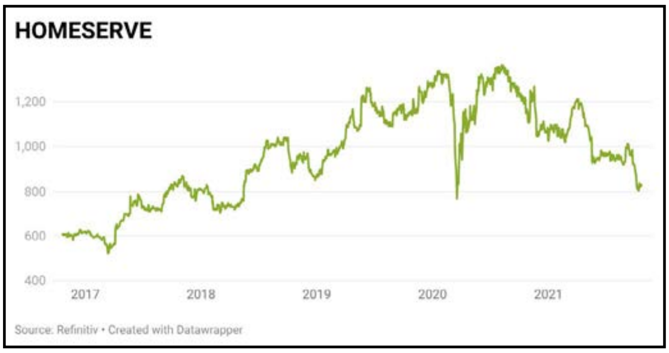
Based on consensus forecasts, the shares are now trading on 22 times this year's earnings and 17 times next year, compared with 55 times earnings a few years ago. That seems cheap for a business with a potential market 100 times bigger than its current sales. (IC)

HOMESERVE (HSV)

Price: 832p – Market cap: £2.8 billion
Index: FTSE 250

Homeserve sells homeowners insurance against unexpected plumbing, heating or electrical emergencies, and provides qualified tradespeople to sort things out if there's a problem.

It operates in the UK and the US, where it already has almost five million 'members'. It also runs the Checkatrade platform, charging tradespeople to advertise, so it has two steady income streams.



The issue is the firm needs to spend to grow, and a big splurge on HVAC (heating, ventilation and air-conditioning) suppliers and installers in the last year has seen its debt pile up.

It also took an £85 million provision to write off its customer relationship management platform, which was no longer fit for purpose, hammering earnings.

Given that both these issues are temporary, and the firm is by nature highly cash-generative with regular income from insurance and advertising, we don't see there being any lasting damage, but the company's general lack of communication doesn't really help.

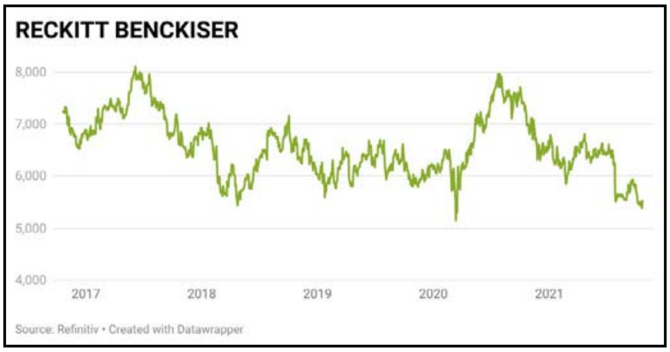
The last update in July talked about strong growth in the US and a return to profitability at Home Experts this year, but since then it's been radio silence and the half-year results aren't until mid-November.

Given expectations are low, good news could see the market reappraise Homeserve's growth potential leading to a proper re-rating of the shares, which are trading on just over 20 times this year's earnings against more than 30 times in previous years. (IC)

RECKITT BENCKISER (RKT)

Price: £54.58 – Market cap: £39 billion
Index: FTSE 100

Like Unilever, shares in Reckitt have recently been trading at their lowest price since the pandemic. What's more, excluding the March 2020 low, the shares haven't been this price since early 2018.



There is no question Reckitt was another pandemic winner, as global sales of hygiene and health products like Dettol and Lysol soared last year, and as with other winners, investors are questioning whether growth is sustainable.

What they have missed is that sales of these two key products have continued to grow this year. The weakness has been the Chinese infant formula business, which thankfully the firm has now sold, and in over-the-counter cold and flu treatments after cases dropped 90% following repeated global lockdowns and the roll-out of vaccinations.

Third quarter results were well ahead of expectations, with like for like sales up 3.3% against estimates of -0.7% and 15% growth last year. The increase was evenly split between higher volumes and higher prices, with sales up in all areas including cold and flu products.

On a two-year basis group sales were up 18% which tells us this is a structural uplift in demand not just a pandemic boost.

Thanks to this strong performance the firm raised its 2021 and 2022 growth guidance and kept its margin target. We think less than 20 times forward earnings is a bargain for a world-class business like Reckitt. (IC)

WETHERSPOON (JD)

Price: 950p – Market cap: £1.2 billion
Index: FTSE 250

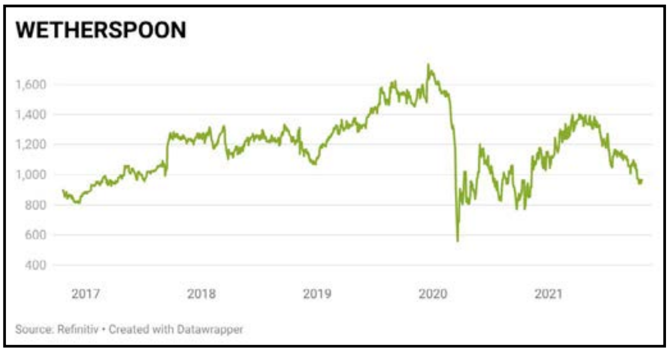
Rather like Primark, 'Spoons' as it is affectionately known has a large and highly loyal fan base, but unlike Primark its customers span the entire age range from students to the retired who all appreciate its value-for-money proposition.

Like every hospitality business it suffered disproportionately during the pandemic, and although the shares had a good run post-reopening they have now handed back the bulk of their gains.

Yet, thanks to a capital raise at the beginning of the year the firm has the firepower to expand its estate and garner further market share while others are still in self-preservation mode.

Meanwhile, trading has been better than expected with like for like revenues down just 6.4% in September against expectations of a 15% drop, and the company expects turnover to return to 2019 levels next year.

Consensus earnings expectations have been steadily revised up since mid-year and the shares are trading on just over 20 times current year forecasts and less than 17 times the year after.

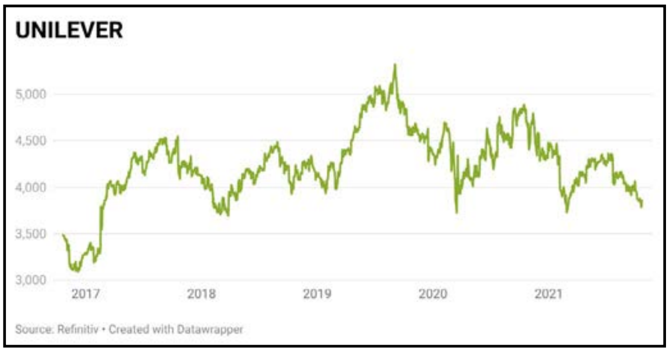


Earlier this month analysts at Peel Hunt and Stifel raised their recommendations to buy and Panmure Gordon initiated coverage, also with a buy, indicating the broking community thinks the sell-off is overdone. (MGam)

UNILEVER (ULVR)

Share price: £38.22 – Market Cap: £98.5 billion
Index: FTSE 100

Shares in Unilever were recently trading at the same level they were 18 months ago during the pandemic even though, as its third quarter results demonstrated, the company is continuing to grow sales and earnings.



Investors who may have been wary about the firm's ability to push through price increases to offset slowing volume sales and rising input costs have realized the group's brands have enough appeal with consumers for it to be able to pull it off.

Moreover, it's not alone. Swiss rival Nestle increased prices last quarter to deliver forecast-beating sales and other leading FMCG firms such as Danone and Procter & Gamble have warned consumers can expect higher bills at the check-out in coming quarters.

Estimates for the full year imply fourth-quarter sales growth of just 3.3% against 4.6% last quarter, which looks easily achievable, while sales are expected to increase just over 4% next year and underlying operating margins are seen flat at 18.4%.

At the current share price, that means investors are paying just over 18 times next year's earnings and just over 17 times 2023 earnings compared with historic multiples in the mid to high 20s. On a relative value basis, we think that kind of discount is too good to pass up for a quality stock. (IC)

New leader Kishida could herald new dawn for Japan

Kishida's leadership could boost Japanese shares

Japan's stock market enjoyed a recent surge following the resignation of increasingly unpopular prime minister Yoshihide Suga.

The Nikkei 225 index reaching a 31-year high in September as the whole Tokyo stock exchange cheered Suga's departure.

Japan bulls are hoping the arrival of new PM Fumio Kishida can provide the impetus for a fresh rally, though markets are trying to work out just how his leadership could influence areas like fiscal stimulus, foreign policy, and taxation.

Kishida has emphasised continuity and is unlikely to deviate significantly from the long term economic policy established by Shinzo Abe (Abenomics) or the renewable energy goals and digitalisation strategies introduced by Suga, the outgoing leader.

Kishida is expected to roll out redistribution of household income. Structural reforms may be less of a priority, given that deregulation has been widely blamed for increasing inequality in the world's third biggest economy.

Japan's ruling Liberal Democratic Party (LDP), expected to win the general election that will be held at the end of October, has chosen its new leader in the form of Kishida, regarded as something of a continuity candidate.

Masaki Taketsume, manager of **Schroder Japan Growth Fund (SJG)**, says Kishida inherits a much brighter situation than his predecessor as the pandemic-induced state of emergency is lifted.

While the change of PM has raised concerns in some quarters that Japan may be heading back into an era of political instability and short prime ministerial terms, Taketsume isn't especially worried.

'After all, Shinzo Abe was Japan's longest-serving PM (with his second term lasting from 2012 until 2020), so any subsequent incumbent was always likely to serve a shorter term in office', he explains.

Public dissatisfaction with Japan's slow vaccine rollout was one of the main reasons that Suga stepped down. However, Taketsume says the vaccination campaign 'has accelerated substantially in recent months', so much so that Japan has now 'fully vaccinated a larger share of its population than the US, despite a much slower start' and lifted its state of emergency at the end of September.

'While Japan has benefited from the broader global economic recovery this year, we should now start to see the domestic economy re-open and recover', insists Taketsume, who has identified Japanese small caps as particular beneficiaries.

The Schroders stock picker also points out earnings momentum is still accelerating in the Japanese market, in contrast to other regions where upward revisions may have peaked, which corresponds 'to the path of Japan's slower vaccine roll-out and longer-lasting restrictions'.

GREEN IS GOOD

Taketsume largely anticipates a continuation of government policy under new broom Kishida. 'A new supplementary budget and further stimulus is already under discussion,' he explains.

He does sees environmental issues rising up the agenda under Kishida with COP26 on the horizon and Japan among those countries that have pledged to reach net zero carbon emissions by 2050. Suga also declared the more ambitious goal of cutting emissions in 2030 by 46% relative to 2013 levels.

JAPAN TRUSTS & FUNDS - TOP PERFORMERS

Funds	Five year total return
Goldman Sachs Japan Equity Partners Portfolio	114.2
FSSA Japan Focus	99.5
Comgest Growth Japan	76.6

Trusts	Five year total return
Fidelity Japan Trust	129.6
JPMorgan Japanese	87.1
Baillie Gifford Japan	72.6
Aberdeen Japan	45.2

Source: Source: FE Fundinfo, 13 Oct 2021 • Created with Datawrapper

'In my view, it will be Abenomics 2.0', chips in Richard Kaye, one of the trio of managers guiding **Comgest Growth Japan (BYYLQ08)**. Kishida has been vocal on stimulus measures for the economy, so 'we'll have the reopening dividend' according to Kaye, who adds Kishida is 'clear on the need to push the digitalisation trend that Suga talked about but never really implemented'.

Also weighing in is Richard Aston, manager of **CC Japan Income & Growth (CCJI)**, the trust scouting for strong dividend growth in a nation of cash-rich corporates that have shown admirable dividend-paying resilience during the pandemic.

One area Aston believes will remain outside of Kishida's influence is corporate governance reform.

'There's no question that government intervention was critical in initially getting corporate governance reform off the ground. However, it has enough momentum behind it to continue growing beyond the influence of the political sphere,' he says.

By far the biggest reason for this, says Aston, is the Tokyo Stock Exchange, 'which is currently finalising its biggest ever reorganisation'.

'This includes everything from high levels of liquidity and standards of shareholder treatment to minimum thresholds for tradable market capitalisation. And it is this wave of effort to conform with the market's new standards alone that suggests improving corporate governance standards will continue to be a major focus for Kishida and Japan's corporates long into the future.'

SHARES' PICKS

Baillie Gifford Japan Trust (BGFD) 986p

Recent share price weakness at **Baillie Gifford Japan (BGFD)** presents an attractive entry point for an actively-managed, quality-growth oriented trust with a fantastic long-run record of outperforming the TOPIX and a competitive ongoing charge of 0.68%. The Matt Brett-managed trust invests in medium to smaller-sized companies with above average prospects for growth, which may come from innovative business models, the disruption of traditional Japanese practices or overseas opportunities.

Comgest Growth Japan (BYYLQ08) £14.65

Quality-growth investors with a long-term horizon might also consider **Comgest Growth Japan (BYYLQ08)**. Managed by Richard Kaye, Chantana Ward and Makoto Egami, the fund is 'trying to find the very best companies in Japan' according to Kaye and offers a play on themes including Japan's improving corporate governance and digital transformation.

Schroder Japan Growth (SJG) 222p

According to FE Fundinfo, **Schroder Japan Growth (SJG)** has lagged sector peers with a 10-year total return of 155.07%, reflected in a 7.28% discount to net asset value. Yet this suggests there's underlying value to be unlocked here for capital growth-focused investors. And the trust offers exposure to selective Japanese small caps exposed to the domestic service sectors where Taketsume anticipates a strong recovery.

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

Why there's renewed life in the non-life insurance sector

These companies offer a mix of generous yields and exposure to exciting areas like cyber insurance

It would be easy to dismiss the general or non-life insurance sector as an obscure and rather boring segment of the market. But this collection of companies are involved in exciting themes like cyber and offer some generous dividend yields to boot.

THE SECTOR AT A GLANCE

The UK FTSE 350 non-life insurance sector is comprised of five stocks whose market capitalisations range from relative sector minnow **Lancashire (LRE)** at £1.3 billion, up to **Admiral (ADM)** at £8.9 billion.

The sector has a combined valuation of £19.2 billion and covers a diverse array of insurance categories including motor, travel, property, home, pet and marine insurance. The sector also provides exposure to the reinsurance sector, and the rapidly growing market for cyber insurance.

The relatively high yield offered by stocks in the sector has resulted in considerable interest from income investors. We recommend **Direct Line (DLG)**, as one of the few UK personal line focused insurers to have successfully diversified away from motor insurance. We also believe Lloyds of London insurer **Beazley (BEZ)** could be a high reward investment, albeit with commensurate levels of risk.

General insurance is predominantly a short-term business. The insurer collects a premium (the payment a customer makes to an insurance company in exchange for their insurance policy), and for the following 12 months is at risk of paying out.

DID YOU KNOW?

Insurance companies insure their own potential liabilities through the **reinsurance market**.

The FTSE 350 non-life insurance sector: Constituents by market cap

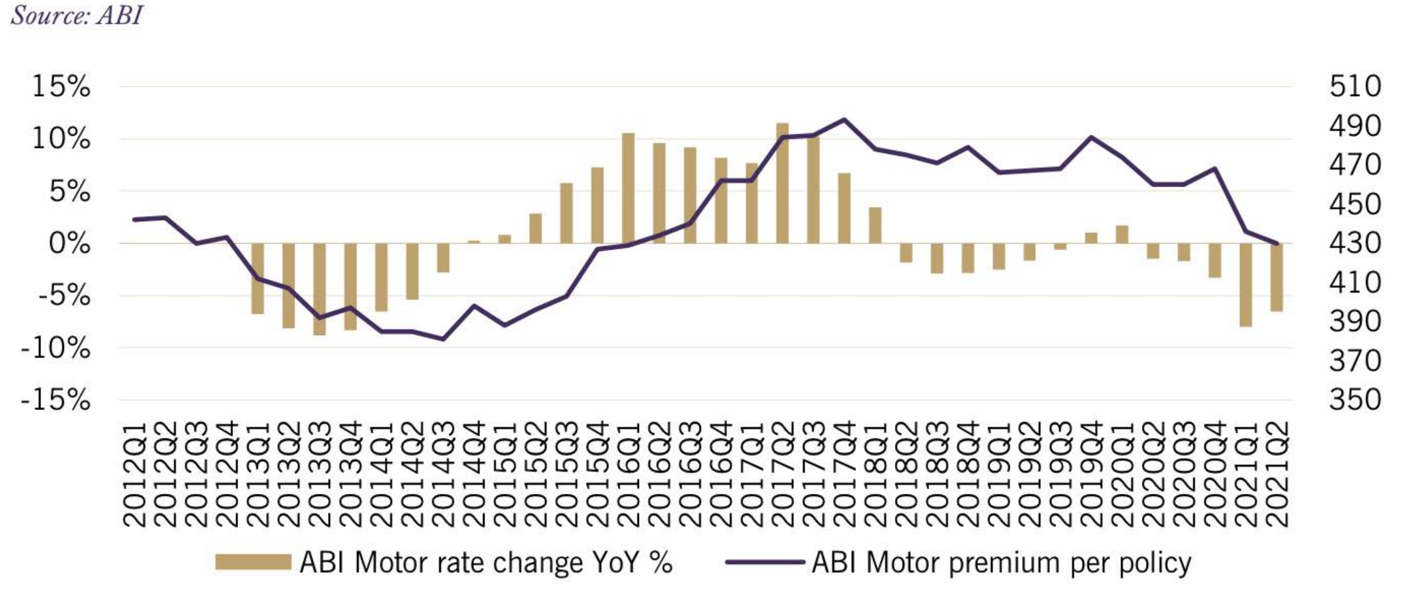
Company	Market cap	Dividend yield %
Admiral	£8.9 billion	9.5
Direct Line	£3.8 billion	8.7
Hiscox	£2.9 billion	3.1
Beazley	£2.3 billion	3.1
Lancashire	£1.3 billion	2.2

Source: Refinitiv, SharePad. Yield based on forecast dividends. • Created with Datawrapper

Four key factors drive returns:
- Premiums earned;
- Claims paid out;
- Operating expenses;
- Investment returns from premiums paid in advance.

General insurance companies have a significant exposure to the bond markets. In order to preserve the value of the premiums they receive, continue to pay for claims when required and offset inflation, insurers invest the premiums they receive

MOTOR INSURANCE RATES UNDER PRESSURE



from customers. Bonds are a lower risk place for them to put this money.

In the case of Beazley, for example, bonds account for a considerable 81% of its portfolio. The low interest rate environment has negatively impacted returns from bonds.

This makes it increasingly important for insurers to focus on segments of the market where rates are improving.

RATES SET TO MOTOR

Claims inflation running at 7% to 8% coupled with a 15% reduction in motor insurance premiums has created a toxic backdrop for the motor insurance segment. However new research by Peel Hunt suggests rates for motor insurance could be set to rise.

Lower levels of traffic on the roads as a result of Covid-19 have resulted in premium deflation for motor insurance. UK motor insurance premiums have declined by 15% since March 2020 according to CPI data provided by the Office for National Statistics (ONS).

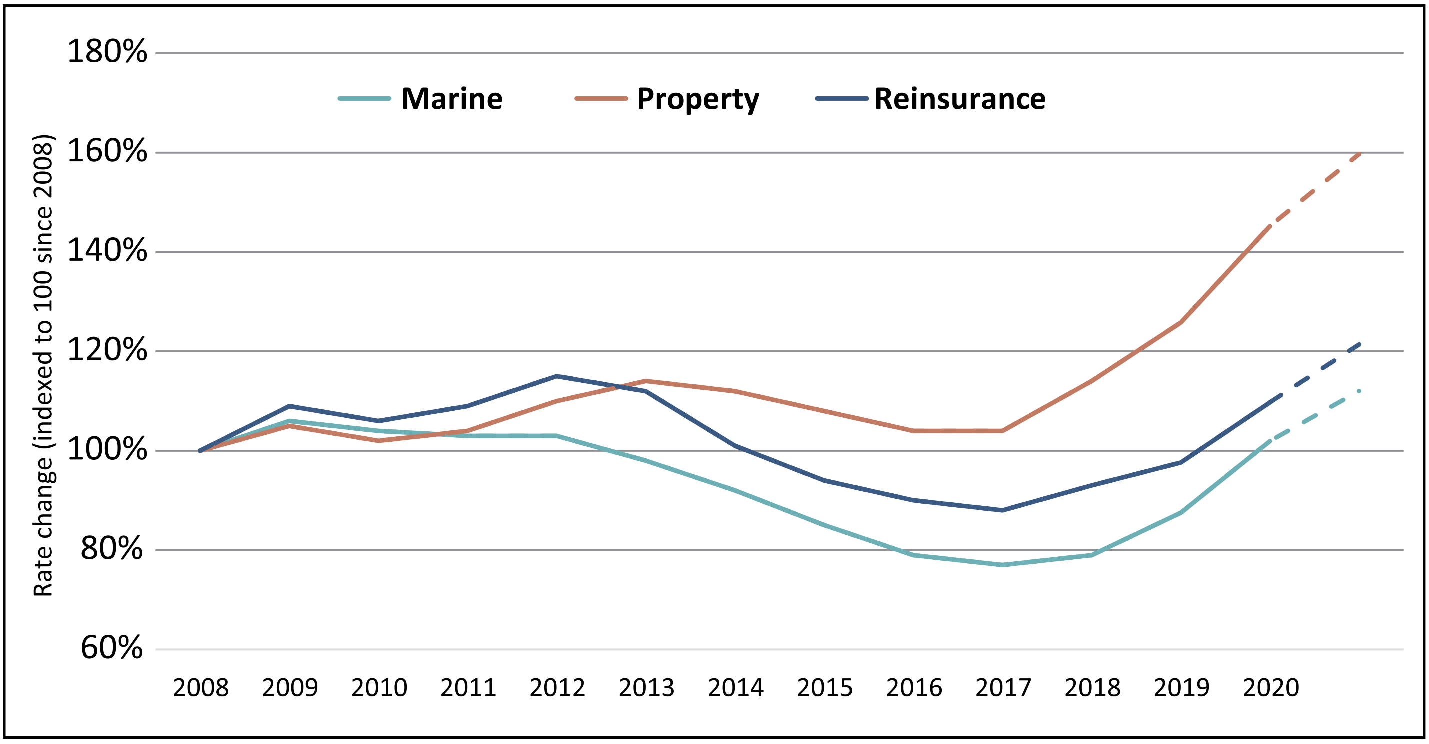
According to Peel Hunt analyst Andreas von Embden ‘the motor pricing cycle is bound to turn after a number of soft years in which insurers underfunded claims inflation’. Embden believes that claims frequencies will jump back, which combined with new FCA pricing rules due to be implemented next year should force underwriters to increase new business rates.

KEY METRICS

- The **claims ratio** is the percentage of claim costs incurred in relation to the premiums earned.
- The **expenses ratio** is calculated by dividing the expenses associated with acquiring, underwriting and serving premiums by the net premiums earned by the insurance company
- The **combined ratio** is the total of claims paid plus operating expenses, divided by premium income.

If the combined ratio is below 100% then the insurer is earning in premiums more than it is paying out in claims and costs, and so is making an operating profit. But it can still be profitable if the combined ratio is over 100%, as investment income makes a further contribution to the bottom line.

PROPERTY, MARINE AND REINSURANCE



PROPERTY, MARINE AND REINSURANCE

The strength of the reinsurance market has been reflected in recent comments made by the CEO of the historic insurance market Lloyd's of London John Neal. He noted that the Lloyd's market has 'achieved rate increases for five years, something I haven't seen during my time in the market'.

Global catastrophe losses have been unusually high since the second half of 2017, linked to everything from Asian typhoons to US hurricanes and widespread wildfires. These losses have been compounded by the impact of Covid 19.

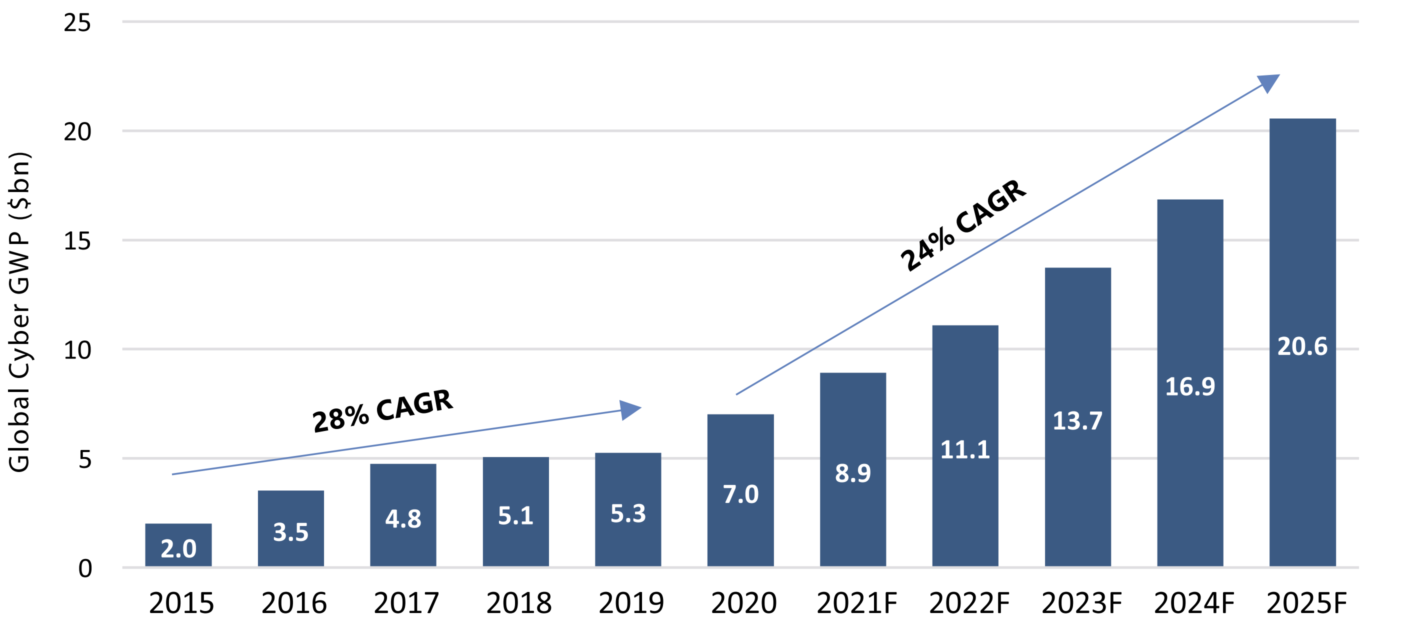
This environment of sustained losses has provided a conducive environment for a rise in rates. Property, marine and reinsurance lines are experiencing the most favourable pricing conditions since 2008.

CYBER GROWTH OPPORTUNITY

The cyber insurance market present an exciting new growth market. Between 2015 and 2019 gross written premiums (the general insurance premium underwritten before any deductions for reinsurance), increased at a compound annual growth rate of 28%.

This growth is likely to continue driven by regulatory change coupled with an increasing awareness of cyber risks amongst management.

CYBER INSURANCE MARKET OVER TIME



Source: Jefferies, GlobalData

A surge in ransomware claims in recent years has resulted in a hardening in the cyber insurance rate environment.

Rate increases of 44% in the first half of 2021 have been recorded, and this positive trend is expected to continue into the second half.

STOCK PICKS

DIRECT LINE (DLG) 281P

The company offers motor, home, rescue, travel, credit and pet insurance under a number of brands most notably, Direct Line, Churchill, Green Flag and NIG.

Direct Line's repair garage network (DLG Auto Services) gives it a truly differentiated competitive advantage. This division has enabled it to maintain underlying claims inflation at approximately 3% to 5% in recent years.

This is considerably lower than that of its peer group. Owning its own network allows it to offer very quick repair times due to its large and bespoke repair centres. Its operation in Birmingham is a good example of this. Currently 55% of claims go through DLG Auto Services. The longer term ambition is for 70% to go through these centres.

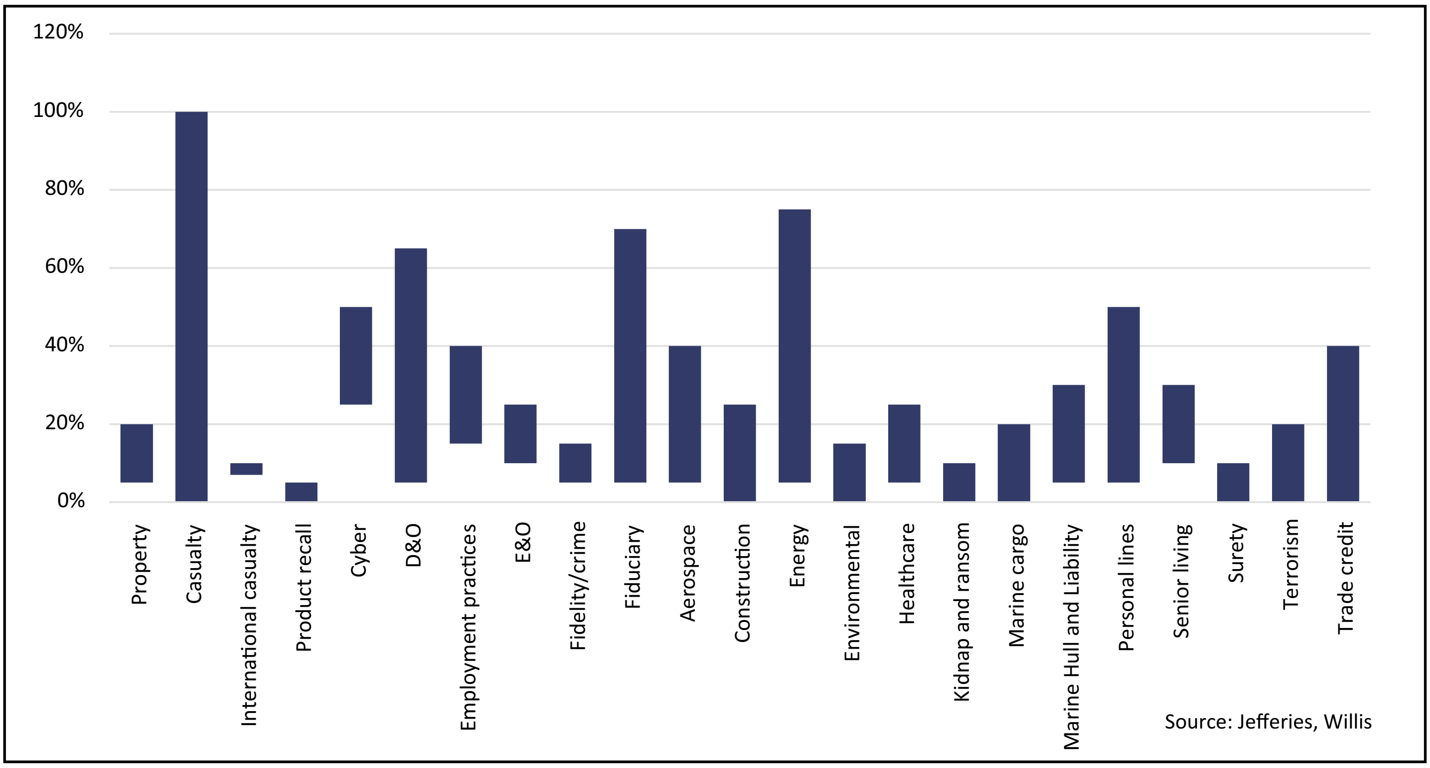
Direct Line is reaping the benefits from investment in technology. A new underwriting platform is facilitating cost reductions, Jefferies expect the business to beat its 20% expense ratio target by 2023. Jefferies forecast operating expenses of £697 million in 2021 (equivalent to a 23.6% operating expense ratio), with further reductions by 2023 resulting in a 19.5% expense ratio.

It will also enable the company to be more agile with its pricing. This is critical given that the motor industry is characterised by a high degree of price elasticity.

According to research by Nordic insurance company Sampo Group, new business volumes change by 5% for every 1% change in price. Historically Direct Line has been slower than competitors to respond to price changes in the market, which has constrained growth. It now has the capability to implement more rapid price changes for a specific cohort of drivers, which is likely to result in market share gains.

Recent high levels of capital expenditure due to investment in technology have resulted in cash earnings being below IFRS earnings. As the technology transformation nears completion this situation will be reversed, and higher cash earnings will support an 8% dividend yield, and £100 million of potential share buy-backs between 2021 and 2023.

LLOYD'S INSURANCE LINES SEE RATES INCREASE IN 2021



BEAZLEY (BEZ) 372P

This Lloyd's of London insurer writes traditional property, marine, and reinsurance lines through its Lloyd's syndicate. The group recently merged its Political Risk and Accident & Health lines into Political Risk, Accident and Contingency (PAC). The most valuable components are the group's Specialty (Casualty) lines and Cyber & Executive Risk (CyEx) businesses.

According to research from advisory firm Willis Towers Watson all but one major line of business in the London Market are expected to benefit from rate increases (see chart).

Beazley's exposure means that it is particularly well positioned to benefit from an improving pricing environment. Research by Jefferies, estimates that from 2015 to the end of 2021 Beazley has benefited from over 44% compound rate increases.

However the nature of insurance accounting means that the benefits of rate increases can take several years to be recognised. Consensus earnings estimates may significantly underestimate the impact of the earnings accretive impact of these rises. This view underpins Jefferies 2022-2023 earnings forecast which is 20% ahead of consensus.

Another appealing facet of Beazley's business model is its exposure to the most exciting growth opportunity in global insurance cyber. Cyber attacks are becoming an increasing concern amongst corporates with management becoming increasingly cognisant that insurance cover is inadequate. Beazley has the greatest exposure to cyber insurance amongst global listed insurers accounting for 15% of gross written premiums.

Beazley Breach Response which is the group's signature product and protects clients from malware, ransomware and other cyber threats. It has provided Beazley with a first mover advantage in the sector which has been strengthened by its ability to also offer risk management services.

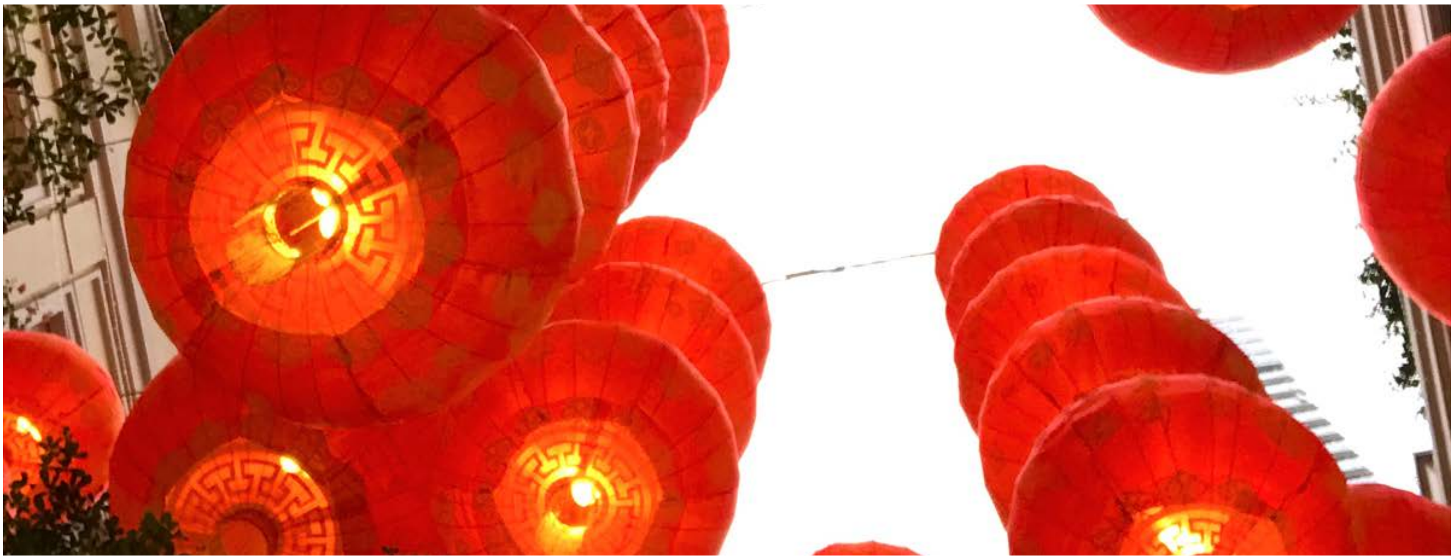
The growth dynamics for the cyber insurance market are encouraging. According to Aon approximately 65% of organisations in 2020 expect cyber exposure to increase from 58% in 2015.

The same survey shows 32% of organisations now believe their cyber insurance cover is insufficient, compared to 19% in 2015. This shift in attitudes surrounding the need for greater cyber insurance is likely to drive future demand and earnings growth for Beazley.

By **Mark Gardner,** Senior Reporter

abrdn

WHY CHINA, WHY NOW?



By Nicholas Yeo, Investment Manager, abrdn China Investment Company Limited

China's equity and bond markets have grown into the second largest financial market in the world, after the US. This is a US$18 trillion market that is both deep and liquid. There are more than 5,000 Chinese companies listed onshore in mainland China and offshore, mostly in Hong Kong and the US, presenting vast opportunity.

Chinese markets are also becoming large and growing components of major global indices. For instance, Chinese equities now make up 33% of the MSCI Emerging Markets Index. If China A-shares (the shares of mainland China-based companies that trade on the two Chinese stock exchanges) were included fully (from the current 20%), this would push the overall weighting of Chinese equities to 53%.

A big driver of growth has been the Stock Connect programme, which was launched in 2014. This opened direct trading links connecting Shanghai and Shenzhen with Hong Kong, making A-shares more accessible to institutional investors outside the mainland. These days, any investor with a brokerage account in Hong Kong can invest in the top 1,500 companies listed in Shenzhen and Shanghai. Two-way investor flows between mainland China and Hong Kong have flourished as a result.

Another draw is the low correlation of Chinese equities with other asset classes. In other words, A-shares provide a great opportunity to diversify portfolio risk and potentially enhance returns. In addition, the onshore market is highly volatile and inefficient. It is dominated by retail investors and vulnerable to rumours and speculation, and hence more momentum driven. This presents huge opportunities for active stock pickers such as abrdn to exploit.

Investing in both the onshore and offshore markets makes sense because of the extensive range of opportunities across these markets. With the onshore market, the investor gains greater exposure to unique sectors such as baijiu liquor, as well as the faster growing new economy ones like electric vehicles and batteries, specialist technology and niche industrial areas. As for offshore, the investor gains more access to the internet and e-commerce companies, along with gaming and telecom plays.

More broadly, China's financial reforms continue to improve the accessibility and liquidity of the domestic market. With more international investors' participation in the A-share market, it could shine a light on global best practice and help to raise governance standards of local companies over time.

Why now?
abrdn sees tremendous opportunity in China, and the portfolio is well positioned to capitalise on key areas of structural growth.

- **Aspiration:** As incomes increase and living standards improve in China, rising affluence is leading to fast growth in premium, or higher value, goods and services in areas including cosmetics, travel and food and beverage. The consumer story is attractive because boosting domestic spending forms a central component of China's reform agenda.

- **Digital:** Growing integration amid the widespread adoption of technology means a bright future for plays on e-commerce, gaming, cybersecurity and data centres supporting cloud services.

- **Green:** Policy makers globally are committing to a greener and lower carbon world and China is in the driver's seat. Investments in renewable energy, batteries, electric vehicles, related infrastructure, and environmental management all have a bright future. Grid parity will be game-changing.

- **Health:** Rising disposable incomes are driving demand for healthcare products and services. The opportunity set is diverse. The proposed holdings include a leading hospital, contract research providers and an internet healthcare platform.

- **Wealth:** Growing prosperity means structural growth for consumer finance, such as wealth management and insurance protection, as well as increasing investor participation on stock exchanges.

At this point, abrdn is seeing reasonable valuations, with the MSCI China All Shares Index's price earnings multiples at 20% cheaper than the levels in February this year. The index is also trading at a 50% discount to the Standard & Poor's 500 Index on a price to book basis. Fundamentals remain supportive, with a consensus estimate of at least 20% earnings growth for Chinese companies in 2021. In terms of fund flows, northbound and southbound flows on Stock Connect continue to grow.

In China, standards of disclosure, reporting and access to management are increasingly moving towards international norms. Many Chinese companies are also moving up the quality curve steadily. China is already the leading global manufacturer of solar panels and wind turbines.

This quality aspect extends to the environment, social and governance (ESG) front as well. abrdn is finding that more and more Chinese companies are beginning to understand and appreciate the importance of, and the value that can be created by, engaging with long-term investors and becoming more cognisant of ESG issues. Increasingly investors are aware of their carbon footprint. They are realising that implementing sustainable practices can improve brand perception, customer loyalty and, ultimately, the share price. It can also help to guard against catastrophes that can have legal ramifications. abrdn is engaging companies on social factors, such as how they interact with employees, vendors and society, explaining how supporting employee well-being can lead to a more productive workforce and help them to recruit and retain talent.

In all this, abrdn remains positive about the long-term prospects for Chinese equities and the private sector retains a critical role in ensuring that the Chinese economy continues to innovate and prosper and that China reaches its goal of being a moderately prosperous nation by 2035. China still needs well-functioning capital markets to help propel growth. Companies that can adapt to the emerging regulatory frameworks and align with policy objectives such as digital innovation, green technology, access to affordable healthcare and improved livelihoods will continue to have a bright outlook.

Important Information
Risk factors you should consider prior to investing:

- The value of investments and the income from them can go down as well as up and you may get back less than the amount invested.
- Past performance is not a guide to future results.
- Investment trusts are specialised investments and may not be appropriate for all investors.
- There is no guarantee that the market price of a Trust's shares will fully reflect its underlying Net Asset Value.
- As with all stock exchange investments the value of the Trust shares purchased will immediately fall by the difference between the buying and selling prices, the bidoffer spread. If trading volumes fall, the bid-offer spread can widen.
- Investment trusts can borrow money in order to enhance investment returns. This is known as 'gearing' or 'leverage'. However, the use of gearing can result in share prices being more volatile and subject to sudden or large falls in value. Where permitted an investment trust may invest in other investment trusts that utilise gearing which will exaggerate market movements, both up and down.
- Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. This may mean your money is at greater risk.
- Investing globally can bring additional returns and diversify risk. However, currency exchange rate fluctuations may have a positive or negative impact on the value of your investment.
- Specialist funds which invest in small markets or sectors of industry are likely to be more volatile than more diversified trusts.

Other important information:
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The case for a rebound at unloved British American Tobacco

In an exclusive interview with *Shares* the finance chief of the tobacco giant makes a compelling argument

The fund manager of the **City of London Investment Trust (CTY)**, Job Curtis, recently said that 'tobacco stocks have gone back to having the pariah status that I witnessed at the beginning of my career'.

This untouchable status is reflected in **British American Tobacco's (BATS)** recent share price performance. After peaking at just over £52 in June 2017, the shares have marked a steady decline and now trade in a £25 to £29 range and are currently at the lower end of this at £26.

There are two principal reasons for the stock's current malaise. First the market has concerns regarding the rate of structural decline within the combustibles (cigarette) business.

Second, analysts have expressed reservations over how long it will take for the considerable investments in NGP (next generation products) to become profitable.

COMPELLING ARGUMENT

In an exclusive interview with *Shares*, Tadeu Marroco BAT's finance and transformation director provides a compelling argument for why these

concerns have been overdone. In addition he outlines several new and exciting initiatives that the group is pursuing, and which the market appears to have overlooked.

At the current price we think Marroco's reasoning stands up and investors who are comfortable with the obvious ESG (environmental, social and governance) risks should buy the shares.

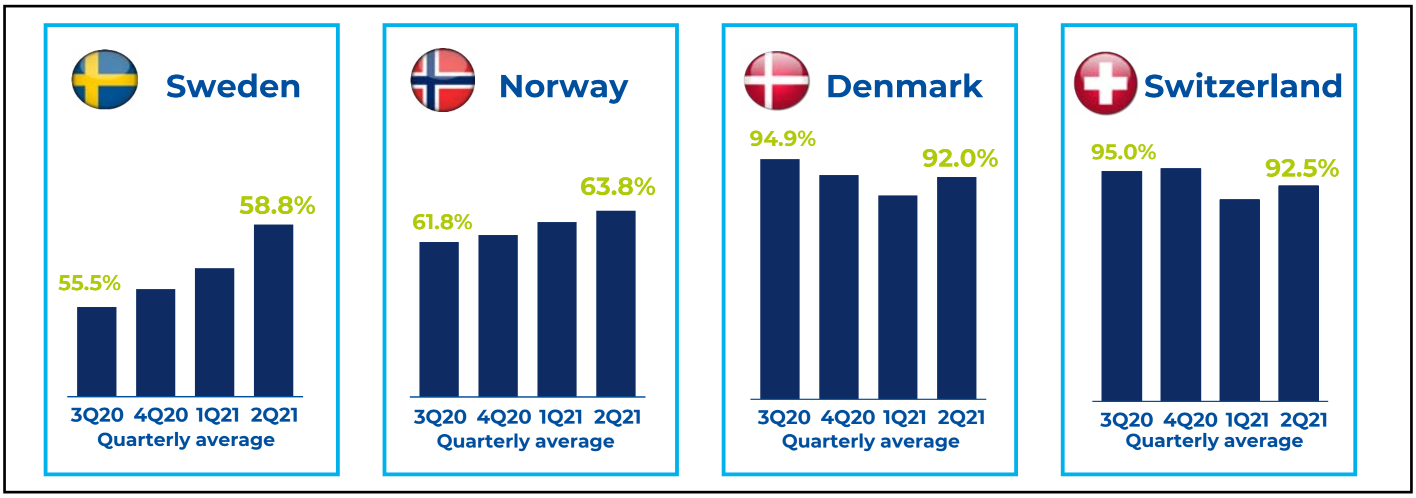
The market has naturally been concerned about the rate of structural decline in BAT's core cigarette business. There has been a marginal increase in the annual rate of volume decline from 1-2% to 3%. However there are several mitigating factors which offset this.

Given the strong position of its global brands the group has been able to continually improve the price mix. Marroco suggests 'the elasticity of cigarettes across the world is still very benign at 0.4 to 0.6'. Or in other words a 10% increase in price would lead to a 4% to 6% drop off in consumption

A newly installed revenue growth management digital tool is also helping to extract value from the cigarette business. This enables the group to manage on a very precise and granular basis all elements of price elasticity in any given geography. In addition Marroco highlights that 'it can also help optimize promotions and the total cost of investments'.

The strength of the cigarette business is built on the group having strong global brands at every price point. Around 70% of the group's combustibles portfolio are what it calls global

VELO: MAINTAINS INTERNATIONAL MARKET LEADERSHIP



Source: British American Tobacco

drive brands. These include Lucky Strike, Dunhill, Pall Mall and Kent. In America the premium American Spirits and Newport brands have been particularly successful.

TRANSFORMATION STRATEGY

The group's transformation strategy has been focused on three categories: vapour, tobacco heating and modern oral. It has been successful in developing three leading brands. These are Vuse in vapour, glo in tobacco heating and Velo in modern oral (nicotine pouches).

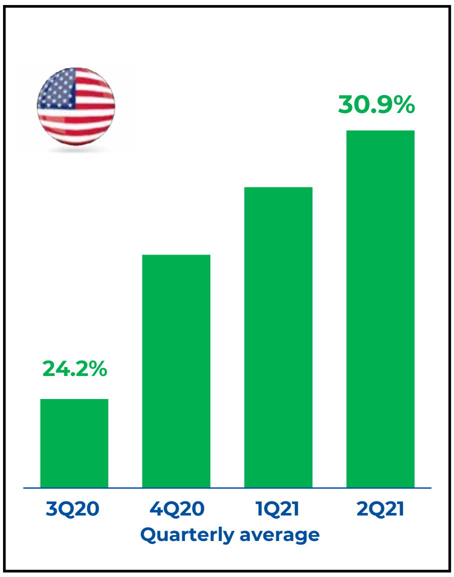
There has been a degree of scepticism regarding the group's ability to make vapour as profitable as cigarettes given the fragmented nature of the category.

Marroco provides an interesting counterpoint to this, noting that 'recently BATS has been taking global value leadership share of the vapour category, under Vuse which is now the number one brand globally'.

Another factor which will further boost the profitability of vapour is the transition from a manual to an automated production process. Marroco reveals that 'we have recently renegotiated with our major supplier to move from the manual assembly of the cartridge to an automated process'.

British American has pursued a strategy of discounting the price of devices to get its vaping product in the hands of the consumer. However it is now in a position to increase price.

VUSE US VALUE SHARE



Source: British American Tobacco

Marroco is optimistic about the prospects for the group in the tobacco heating products and modern oral categories. Glo is the group's flagship THP product and comprises a battery powered device that heats specifically designed tobacco sticks to 240 degrees celsius. This process produces a nicotine containing aerosol with a tobacco taste which the user inhales.

The device is a single unit, with one button making it simple and intuitive to use. As tobacco sticks aren't burned no ash is generated. 2020 marked the launch of glo Hyper. The pivotal breakthrough was in harnessing an advanced inducting heating technology to deliver record heating times.

'In tobacco heated products glo Hyper continues to be BAT's most successful launch yet, driving a very positive category performance, across all markets and is the fastest growing offer in the market today,' says Marroco.

In the Modern Oral Category (nicotine pouches) the American market is benefiting from the broader range of products picked up through the acquisition of Drfyt Science in November 2020. The acquisition expands BAT's portfolio from four to 28 product variants, providing a wide range of nicotine strengths and flavours.

Marroco says: 'Consumers are increasingly health focused, they want to reduce their intake of sugar and salt, and alcohol consumption.

'This has created opportunities to try new ways of enjoying nicotine. The problem is that nicotine is perceived as being the cause of numerous diseases.

'This is not the case. This is where new science has come in and clarified the situation for many regulators across the world'.

The key markets for the group's modern oral products include Scandinavia, Switzerland and Czechoslovakia. In addition BATS is currently running pilots in Kenya, Pakistan and Indonesia.

CANNABIS POTENTIAL

According to Marroco 'cannabis is a very interesting market with a lot of potential'. This view prompted BATS to recently acquire a stake of close to 20% in the Canada-based cannabis producer Organigram for approximately £126 million.

Founded in 2013, Organigram first began as a medical cannabis provider. Today, the company is focused on producing high quality, indoor-grown cannabis for patients and adult recreational consumers in Canada.

BATS finance director Tadeu Marroco

Marroco explains: 'Organigram is an attempt to collaborate and have access to cutting edge research and development technology, product innovation and cannabis expertise, which complements BAT's extensive development capabilities. '

A centre of excellence will be established at OrganiGram's facility in New Brunswick to focus on developing next-generation cannabis products, with an initial focus on cannabidiol or CBD. Marroco believes 'there is considerable value in the Canadian market, which is pretty much open. The Canadian market alone represents £4 billion in value'.

America is the key potential cannabis market. Democratic lawmakers in the US have indicated their desire to decriminalise cannabis use at a national level. However the outlook remains uncertain.

DIGITISATION BENEFITS

The group is also benefiting from a move towards digitising the whole business. One example of how digitisation is adding value is e-commerce which has much higher margins than sales through other channels. An average e-commerce subscriber has a lifetime value of three times compared to the traditional retail customer. Around 10% of vaping revenue already comes from e-commerce and with increasing scale the group is able to negotiate better trade margins.

In a recent presentation City of London manager Curtis indicated that he has warmed to the tobacco sector and British American Tobacco is the largest holding in his portfolio. His enthusiasm is predicated on their renewed focus on next generation products, and their ability to generate prodigious amounts of cash.

Curtis believes that British American Tobacco it is trading at an attractive valuation. "It is yielding 8%, and a free cash flow yield of 14%, it is rapidly deleveraging and will be down to three times net debt to EBITDA (earnings before interest tax, depreciation and amortization) this year'. This may prompt a share buyback, which according to Curtis could provide a catalyst for a re-rating of the shares.

By **Mark Gardner**
Senior Reporter

How to avoid falling foul of the lifetime allowance

The limit on how much you can put into a pension and benefit from tax relief is worth keeping in mind

The limit on how much you can put into a pension and benefit from tax relief is very much worth keeping in mind

HOW TO AVOID FALLING FOUL OF THE LIFETIME ALLOWANCE

Squirreling away over £1 million might feel like a far-flung dream for many retirement savers.

However, recently published HMRC figures show that in 2019/20 pension schemes reported over 8,500 instances where the lifetime allowance had been breached. The total value of the related charges was £342 million – a 21% increase from £283 million in 2018/19.

What's more, the Government's decision to freeze the lifetime allowance at just over £1 million (£1,073,100 to be exact) until 2025/26 means that more people are likely to be pulled into its orbit in the coming years.

As a result, understanding how the lifetime allowance works – and when it might make sense to breach it – will become increasingly important.

THE LIFETIME ALLOWANCE IN BRIEF

The lifetime allowance caps the total amount you can save in a pension without having to pay an additional tax charge.

While the current level is just over £1 million, over the years successive governments have whittled the figure down in a bid to raise revenue for the Exchequer (in fact back in 2011/12 the figure was as high as £1.8 million).

Each reduction in the lifetime allowance has resulted in the creation of a new set of 'protections', allowing some people to keep a higher personal lifetime allowance.

You can read more about these protections and the conditions that come with them here.

Your pension savings will be tested against the lifetime allowance when a 'benefit crystallisation event' occurs. These events include taking tax-free cash, buying an annuity, entering drawdown, starting a scheme pension (if you have a defined benefit pension) or taking an ad-hoc lump sum (sometimes referred to as 'UFPLS').

A test will also be carried out on your 75th birthday if you have funds that haven't been used to buy an annuity or provide a scheme pension – including any growth your fund has enjoyed if you have chosen to remain invested in retirement in drawdown.

HOW THE LIFETIME ALLOWANCE CHARGE WORKS

If you breach the lifetime allowance, a charge will be applied to the excess. This charge will be 25% if the money is left in the pension or 55% if taken out of the pension.

Take, for example, someone who breaches the lifetime allowance by £1,000. If the excess is left in the pension, a 25% charge will be applied, reducing the fund to £750. When these funds are later withdrawn, if income tax is paid at 40%, the amount the person will receive after tax will be £450.

If the person instead takes the £1,000 out as a lump sum, they will pay a 55% lifetime allowance charge (and no income tax), meaning they also end up receiving £450.

For this reason, if you expect to pay less than 40% tax on your withdrawals it can make sense to keep your excess in the pension and pay the 25% charge.

WHERE IT MIGHT MAKE SENSE TO BREACH THE ALLOWANCE

For example, take a higher-rate taxpayer who pays £2,000 into their pension via salary sacrifice, matched by a £2,000 employer contribution.

If this resulted in them exceeding the lifetime allowance by £4,000, it will be subject to a maximum lifetime allowance charge of 55%, meaning they would receive £1,800 if they take the excess as a lump sum.

This might be less than they'd have received if they hadn't breached the lifetime allowance, but as the £2,000 salary sacrifice only 'costs' £1,200 – due to the saver receiving higher-rate tax relief on the money paid in – this still effectively represents a 50% return on their contribution.

BREACHING THE LIFETIME ALLOWANCE

Writing my weekly *Shares* column, I'm often asked by those close to the lifetime allowance how a lifetime allowance charge can be avoided. However, in certain circumstances it can make sense to take the lifetime allowance charge on the chin.

If you receive matched employer contributions in your workplace pension scheme, for example, these could be worth more than any lifetime allowance charge you might pay.

Those approaching the lifetime allowance could, of course, reduce the risk in their portfolio in order to ensure investment growth doesn't push them over the allowance – or indeed place their entire fund in cash. However, this could also have a negative impact on your overall retirement outcome.

Take someone who has just hit the lifetime allowance of £1,073,100. If they removed all risk from their investments, they could avoid paying a lifetime allowance charge.

But if they stuck with their investment strategy and the fund grew to £1,200,000 when they came to access it, the maximum charge on the excess they could pay would be £69,795 (55% x £126,900), leaving £57,105 to take as income.

So investment growth has still ultimately benefited the saver (although by less than it would have done before taking the lifetime allowance charge).

OTHER OPTIONS

Given the lifetime allowance charge aims to remove the upfront tax advantage of saving in a pension (although investment growth within the pension is still tax-free), personal contributions that don't attract an employer match might be better invested elsewhere.

ISAs, for example, benefit from both tax-free investment growth and tax-free withdrawals. If you have already used up your £20,000 annual ISA allowance, you can invest in a general investment account (GIA) and use your annual dividend allowance of £2,000.

By **Tom Selby**
AJ Bell Head of Retirement Policy

Bucking the benchmark

*Benchmarks are vital in the world of investing. However, investors who slavishly follow the benchmark restrict the future potential returns of their portfolios, effectively leaving money on the table. In this article, we discuss how, **Laura Foll and James Henderson, Co-Portfolio Managers of Henderson Opportunities Trust (HOT)**, utilise the Trust's flexible 'go anywhere' mandate and 'bucket' approach to differentiate it from the benchmark and its peers.*

Benchmarks fulfil a vital role in the world of investing. Firstly, they serve as a standard against which the performance of an investment can be measured relative others within the same peer group or category. Secondly, they guide investors regarding the broad investment strategy being pursued by the portfolio manager. They are essentially a guide for investors, therefore, rather than a shackle for managers on the basis that the primary objective for the manager is to outperform the benchmark rather than mirror it.

Consider HOT, part of the investment trusts range managed by Janus Henderson Investors. Its objective – and hence its benchmark – is capital growth in excess of the FTSE All-Share Index (All-Share) from a portfolio of UK holdings. The All-Share is made up of the FTSE 100, FTSE 250, and FTSE SmallCap indices, encompassing 600 or so companies listed on the main market – reserved for larger, more established businesses - of the London Stock Exchange (LSE). Meanwhile, 800 or so businesses are found within the Alternative Investment Market, or AIM, a sub-market of the London Stock Exchange launched in 1995. AIM has developed into the world's most successful and established market for younger, dynamic, high-growth companies. While the average market capitalisation (market-cap) of AIM businesses is circa £80 million, for those businesses within the All-Share Index, the average market cap is much higher, at almost £4bn. The All-Share Index also represents around 98% of the market capitalisation of all UK listed equities[1].

Despite the prominence of larger-cap stocks, the broader universe of all UK quoted stocks has consistently proven to be a happy hunting ground full of exciting opportunities for Laura Foll and James Henderson, co-managers of HOT. The Trust's flexible, 'go anywhere' mandate ensures that the managers are not constrained by the benchmark in terms of sector or market capitalisation. In addition, the ability to invest in larger companies found on the FTSE 100 down to those smaller companies listed on AIM, allows the managers to expand their investible universe substantially. Unsurprisingly, therefore, the portfolio differs materially from its index, with sector weightings showing a marked divergence from the All-Share benchmark in several key areas, as illustrated by the table on the next page[2].

[1]Source: FTSE Russell, FTSE All-Share Index factsheet, as at 30.07.21
[2]Source: Janus Henderson and Factset, as at 31.08.21

SECTOR WEIGHTINGS

	All Share (%)	HOT (%)
Financials	22.5	19.3
Consumer staples	15.0	0.9
Industrials	13.3	22.9
Consumer discretionary	12.4	16.8
Basic materials	9.3	6.5
Health care	9.7	4.4
Energy	7.2	10.5
Real Estate	3.3	1.1
Utilities	3.0	1.1
Telecommunications	2.2	2.1
Technology	2.0	14.5

Source: Janus Henderson and Factset, as at 31.08.21

Amongst the reasons for this divergence are to take advantage of the UK's positive economic backdrop and rapidly changing investment landscape, whilst exposing investors to a diverse range of exciting opportunities across a broad range of sectors. In recent months, the managers have increased their exposure to financials which should benefit from the UK's better-than-expected economic recovery. This has primarily been driven by the reopening of the economy following the successful rollout of Covid-19 vaccines and the release of pent-up consumer demand. Meanwhile, the exposure to industrials is to take advantage of the UK's cyclical recovery and the rich seam of smaller companies within the sector.

Longer term, the managers are also considering the UK's rapidly changing investment landscape, with the move towards decarbonisation a prime example. The transition to a low-carbon economy presents a significant opportunity to invest in a multi-year structural growth trend, while also helping to tackle an existential crisis. As a result, the Trust is overweight to the alternative energy sector, holding companies including AFC Energy, Ceres Power and ITM Power, which in James and Laura's view, have the potential to be among the future market leaders in areas such as fuel cells and electrolysers.

In addition to the substantial sector divergence, the portfolio has significant exposure to small-cap stocks, particularly within the AIM market, as shown in the table on the next page[3]. This differentiation from both the All-Share benchmark and the Trust's peers has been one of the main drivers behind the Trust's performance, with UK small-cap stocks outperforming their domestic large-cap peers over the last 12-months. This has largely been driven by the recovery in cyclical stocks - from last year's covid-induced slump - as the UK economy has continued to reopen. Smaller companies tend to be more domestic in their exposure and more cyclical. Therefore, by investing across all sizes within the small-cap space, James and Laura are not only giving themselves greater choice in their stock selection, but they are also gaining diversification from exposure to a broader range of industries.

[3]Source: Janus Henderson and Factset, as at 31.08.21

Janus Henderson INVESTORS

PORTFOLIO EXPOSURE BY MARKET-CAP

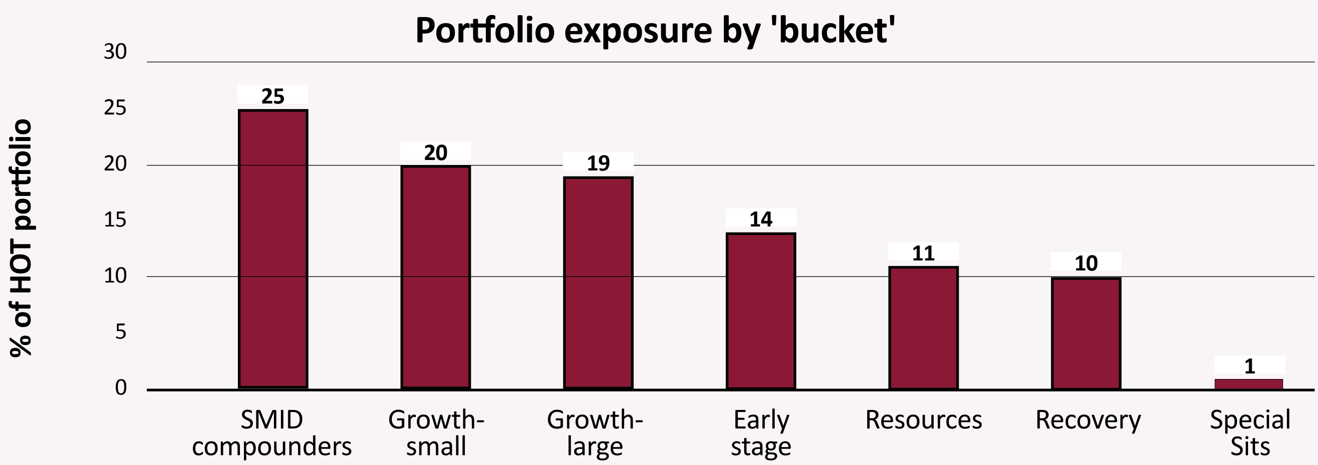
	Portfolio weight (%) *	Benchmark weight (%)	Active weight vs. benchmark
Large cap	25.6	78.8	53.2
Mid cap	12.6	17.8	5.2
Small cap	7.9	3.4	4.5
Fledgling	0.0	0.0	0.0
AIM	62.2	0.0	62.2
Other listed	3.6	0.0	3.7

Source: Janus Henderson and Factset, as at 31.08.21 *excluding cash

To ensure that the Trust is exposed to a diverse range of growth and value drivers across the different market caps and sectors mentioned above; the managers utilise a 'bucket' or 'sleeve' approach to managing the portfolio – another key differentiator for the Trust. The portfolio is divided into seven classifications, each with an indicative exposure range (nonbeing larger than 40% of the total). The buckets are constructed as follows:

- **Small and mid-cap compounders (20–40% of the portfolio):** good quality, usually well-established companies with strong management teams, offering the potential for long-term compounding of returns as they grow earnings.
- **Growth small cap (20–40%):** earlier-stage than the 'compounders', these are companies that are at an earlier stage of their life cycle with the potential for higher sales and earnings growth.
- **Large cap (10–30%):** familiar names that nevertheless offer operational quality and long-term growth potential; these can increase the liquidity of the overall portfolio and also pay, on average, a higher dividend yield.
- **Early stage/university spinouts (0–20%):** although these may be unproven and can be risky, their prospects are largely uncorrelated to market moves and they may offer significant commercial potential as assets are commercialised.
- **Natural resources (5–15%):** positioning will depend on the commodity, but these cyclical stocks can add portfolio diversification.
- Recovery (0–20%): contrarian value opportunities.
- **Special situations (0–10%):** distinct from recovery stocks in that they offer a specific catalyst for change, such as a restructuring, rather than simply being out of favour.

The current portfolio exposure by 'bucket' is shown in the chart below[3]:



[3]Source: Janus Henderson and Factset, as at 31.08.21

The managers believe this approach provides 'true' diversification; in that different 'buckets' may perform well in different market environments. This was evident last year as the managers rotated away from some early-stage companies that did well in 2020, to more recovery and natural resources names that could benefit from the reopening. While almost 60% of the portfolio is currently represented by early-stage AIM companies, the managers also take full advantage of the opportunities present within other buckets, which might mean a move up the market cap scale. The **'Recovery'** bucket, for example, consists predominantly of more established older and/or larger businesses that are having to reinvent themselves due to the trends exacerbated by Covid-19. Marks & Spencer constitutes a good example; last year's Ocado deal was instrumental in boosting its online presence in food.

While the Trust's flexible investment mandate and 'bucket' approach differentiate it from the benchmark and its peers from an allocation perspective, they have also set it apart from a performance standpoint. The Trust's unconstrained mandate helped it ride out the pandemic-related market volatility and post strong returns both prior and subsequent to the positive news on vaccines that emerged in late 2020. On a total return basis, the Trust's net asset value (NAV) and share price are both well ahead of the benchmark over one, three, five and ten years. Performance has been particularly strong over the last 12 months: the NAV and share price have both increased by 64% and 57%, respectively, compared to the

benchmark return of 27%. Relative to its peer group: the Trust is the top performer within the UK All Companies sector over both one and two years[4]. The Trust also offers a 2% dividend yield and can boast a 10-year unbroken record of dividend growth[5].

The speed of change within the UK's investment landscape means that some industries will continue to face disruption, while in other areas, large new companies will emerge. Some of the companies that are major constituents of the index today will be replaced by new generation companies. The speed of this change could be more rapid than in the past. Such an environment provides Laura and James – who are unconstrained by the benchmark – with significant opportunities to substantially add value over an index-oriented approach to portfolio management.

ANNUAL PERFORMANCE (CUM INCOME) (%)

Discrete year performance % change (updated quarterly)	Share Price	Nav
30/06/2020 to 30/06/2021	73.2	63.7
28/06/2019 to 30/06/2020	-16.8	-16.2
29/06/2018 to 28/06/2019	-7.1	-7.4
30/06/2017 to 29/06/2018	22.3	21.9
30/06/2016 to 30/06/2017	27.3	27.8

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

[4]Source: Janus Henderson, as at 21.09.21
[5]Source: Henderson Opportunities Trust factsheet, as at 31.08.21

Janus Henderson INVESTORS

GLOSSARY TERMS

Cyclical
Companies that sell discretionary consumer items, such as cars, or industries highly sensitive to changes in the economy, such as miners. The prices of equities and bonds issued by cyclical companies tend to be strongly affected by ups and downs in the overall economy, when compared to non-cyclical companies.

Contrarian
An investment style that goes against market consensus or a conventional approach. Contrarian investors believe that crowd behaviour can lead to mispricing opportunities in financial markets.

Diversification
A way of spreading risk by mixing different types of assets/asset classes in a portfolio. It is based on the assumption that the prices of the different assets will behave differently in a given scenario. Assets with low correlation should provide the most diversification.

Market capitalisation
The total market value of a company's issued shares. It is calculated by multiplying the number of shares in issue by the current price of the shares. The figure is used to determine a company's size and is often abbreviated to 'market cap**'.**

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

Large cap stocks
Larger companies as defined by market capitalisation total market value of a company calculated by multiplying the number of shares in issue by the current price of the shares) tend to be easily bought or sold in the market (highly liquid).

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.

Should I keep overpaying on my mortgage?

Our expert looks at where spare cash might go as you start to consider retirement

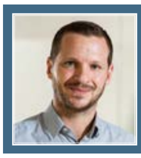
I'm 50 years old and would like to retire as close to 55 as possible. I have a joint mortgage for which we make overpayments of £250 per month. The mortgage is a five-year fixed rate at 1.49% which runs until April 2026.

Should we continue to make the overpayments and pay down the mortgage quicker, or would it be better to slow off with repaying the mortgage while we use the excess for investment purposes?

On retirement, is it considered a good use of the money to pay off what is left on the mortgage?

Or is it better to retain more of the pot to live off day to day, while continuing to pay the mortgage down – and perhaps use some of the pot of money for investments to fund us later in life?

Jonathan



Tom Selby
AJ Bell Senior Analyst says:

Firstly, if you're overpaying your mortgage make sure you check the terms and conditions to ensure you aren't at risk of paying a penalty for doing so.

Generally speaking, it makes sense to pay off any high-cost debts you might have before making extra mortgage payments or investing your money.

If you don't have any high-cost debts then building up a rainy-day fund in case of emergency (e.g. broken boiler, car repair) should be your next priority. This should ideally be enough money to cover three to six months of fixed expenses.

Once you've done this you can start to think about saving for the longer term and, potentially, overpaying your mortgage.

From a purely financial perspective, the key will be whether your investments can deliver returns that beat your mortgage interest rate of 1.49%.

If you are employed then your workplace pension should almost certainly take priority, as not only will you get tax relief on the amount you pay in, but your employer must pay into your pension too. For a basic rate taxpayer making the minimum contributions it costs £400 to get £800 into their pension – effectively a 100% return upfront.

If you're considering saving in an ISA or cash account then you'll need to achieve returns of higher than 1.49% to be financially better off versus overpaying your mortgage.

However, decisions such as this are personal, based on

a variety of factors including your financial circumstances, priorities, and attitude to risk. For many people there will be a psychological benefit from paying off their mortgage early, for example.

The most important thing is to think carefully about what's important to you and understand the implications of whatever decision you take. If you're unsure, it might be worth speaking to a regulated financial adviser to talk through your options.

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.

DANNI HEWSON
AJ Bell Financial Analyst

Market impact of company updates more obvious than economic data

Looking at how economic set-pieces and corporate releases influence stocks

You don't need a degree in finance to understand that both company earnings reports and major economic indicators and events both influence the investing landscape.

However, looking at how London markets have performed over the last, complicated, 12 months it's interesting to dig into those peaks and troughs and explore trends. Just weeks ago, at the start of the latest round of company earnings, the FTSE 100 surged to a pandemic high despite ongoing concerns about supply snarl ups and rising prices.

US banks in particular exceeded expectations, but it wasn't just banks and it wasn't just US companies reporting forecast busting figures. It's not surprising that stellar results whet investor appetites.

They're straightforward and immediate. If profits and earnings are up there's an instant catalyst to buy and vice versa when the numbers disappoint.

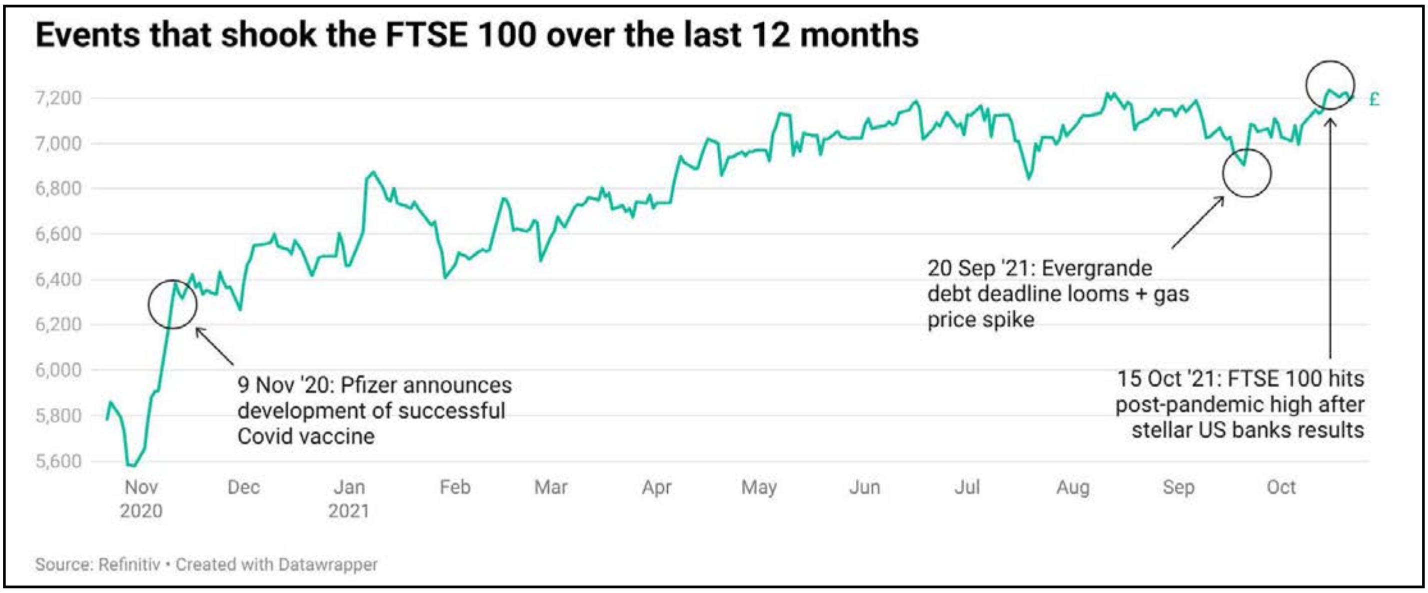
The X-factor is surprise. Investors are pretty good at picking up cues and pricing them in, so often its more about how a company does relative to expectations rather than how it makes out in absolute terms. Sometimes just meeting expectations will disappoint investors.

Updates from individual firms may have a significant impact on their own share price but a limited one on the wider market in isolation. However, in combination a results season can set the tone for the markets.

MARKETS DON'T LIKE SURPRISES

Economic data typically acts more like a drip, drip of incremental news which gradually shifts investor sentiment in different directions. Often individual releases like GDP figures don't tend to make big ripples unless there's a major upset.

For example, China's latest growth numbers unsettled many people but that's because any



DANNI HEWSON
AJ Bell Financial Analyst

slowdown seems unusual, and they came off the back of events which have already impacted sentiment towards China, from the tech crackdown in May to the Evergrande debacle which came to a head in September.

Both of those events in singularity took time to permeate through to big market movements, primarily because it was hard to know immediately what the situations might mean, it can take days or even weeks for the ramifications to really permeate. It buys investors time, gives them breathing space to make adjustments in their portfolios and get comfortable with the winds of change.

It's why the anticipated interest rate hike from the Bank of England which has received so many column inches has seemingly had a modest influence on markets so far.

Even when it comes it's unlikely to merit much of a move, unless the MPC (Monetary Policy Committee) go bonkers and shoot for a whole 1% all in one go, but that's about as likely as the UK experiencing a white Christmas in June.

The more UK-facing FTSE 250 index has endured a year of uncertainty. Covid hasn't run in a smooth line, lockdowns have had to be re-implemented, 'Freedom Days' have had to be shifted and sometimes the expected benefits are undone by crises like the 'pingdemic' which saw many businesses scrabbling to find the staff they needed just to keep operations going.

When the economy has enjoyed a smooth run, when the recovery juggernaut ploughed through, the FTSE 250 soared; its domestic companies expected to benefit from a return to something like business as usual.

RISING PRICES NOT THE ONLY TROUBLE AHEAD

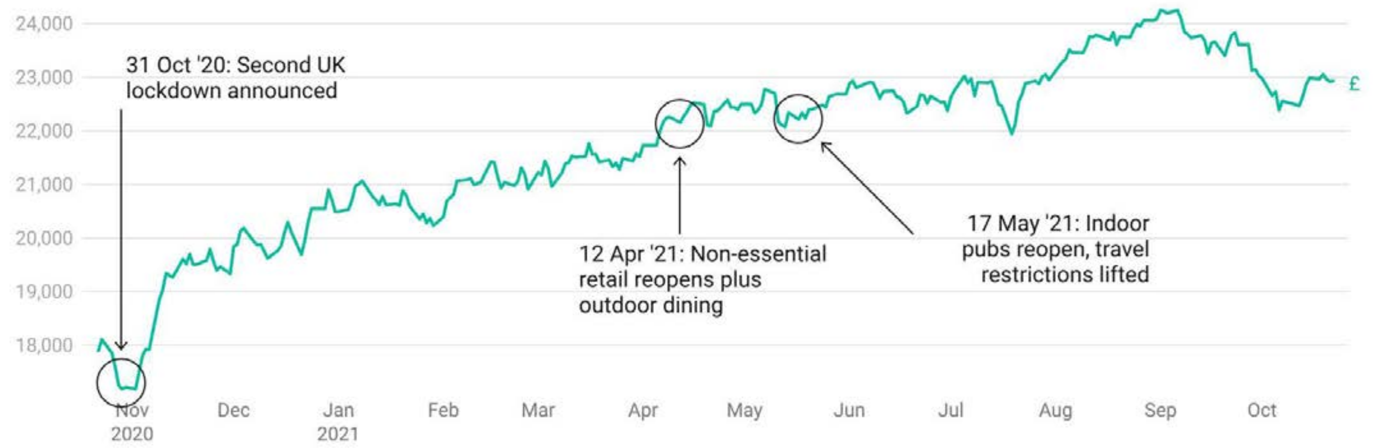
Gas prices on the other hand, they nestle between the two extremes. On the one hand rising prices and the impact they were having on energy providers could be clearly seen for some time. The energy cap was going up, small providers were dropping like flies.

But this impact was crystallised in a single day, a day of extremes, that made waves. After a 37% jump in 24 hours the gas price cooled as the Russian president stepped forward and seemed to imply more supply would be forthcoming to Europe.

Forget the next 12 months, the next six months is shaping up to bring more of those heart stopping, unexpected moments that markets hate to love and many more of those priced in economic set pieces.

And the next quarterly results, the judgement is still out on that one… even among companies which have beaten analysts' estimates, there have been warnings that margins are set to be eroded, that supply issues and inflation will take their toll. Investors love certainty, but in the unexpected there are opportunities as well as potholes.

Events that shook the FTSE 250 over the last 12 months



Source: Refinitiv • Created with Datawrapper

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Jay LeCoque, Executive Chairman

SourceBio International is an international provider of integrated state of the art Laboratory Services and Products. Headquartered in the UK, with offices in UK, Europe and the USA.

Frenkel Topping Group (FEN)
Mark Holt, COO

Frenkel Topping Group is engaged in the financial services sector. Its activities include specialist independent financial advice and wealth management with the objective of growing the assets under management.

Yü Group (YU)
Bobby Kalar, CEO & Paul Rawson, CFO

YU Group is an independent supplier of gas and electricity servicing SME businesses throughout the United Kingdom. In addition to the supply of gas and electricity, the company offers certain ancillary services and has obtained the necessary Ofgem licenses to supply gas and electricity in the United Kingdom market.

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Don’t get carried away by bitcoin’s ETF-inspired surge

The cryptocurrency has reached new record highs on the launch of a new tracker

Bitcoin has hit a new record high, prompted in part by the launch of the ProShares Bitcoin Strategy ETF, the first ETF tracking the cryptocurrency to be launched in the US. Other ETF launches are said to be waiting in the wings.

This raises the question of whether bitcoin is now in the middle of a new bull phase, prompted by exchange traded funds offering easy, tradable access to the cryptocurrency. Such a phenomenon has been observed in the gold market since Gold Bullion Securities listed the first gold-backed ETF in 2003.

SHINING LIKE GOLD

The World Gold Council calculates the gold-backed ETF market is now worth $201 billion, and these funds are used by institutional and retail investors alike, because it’s much easier to hold an ETF in your portfolio, pension or ISA, than it is a gold bar or coin.

The prospect of new ETFs offering access to bitcoin is potentially more powerful in terms of driving the bitcoin price than it is gold, as the latter is also held by central banks and used in jewellery and industry, as well as for investment.

However that is offset by the fact that it’s already relatively easy for retail investors to buy and hold crypto without the ETF wrapper. Plus the ProShares Bitcoin Strategy ETF doesn’t actually invest directly in bitcoin, but rather in bitcoin derivatives, namely futures contracts. That makes the link with the bitcoin price less reliable, and opens investors up to the cost of rolling over these contracts when they expire, which can be substantial.

ENVIRONMENTAL CONCERNS

If the ProShares launch sparks a flood of other providers to enter the ETF market, that should be positive for bitcoin demand. But the cryptocurrency’s price will be determined by a host of other factors too.

The huge carbon footprint of

Bitcoin cryptocurrency mining farm

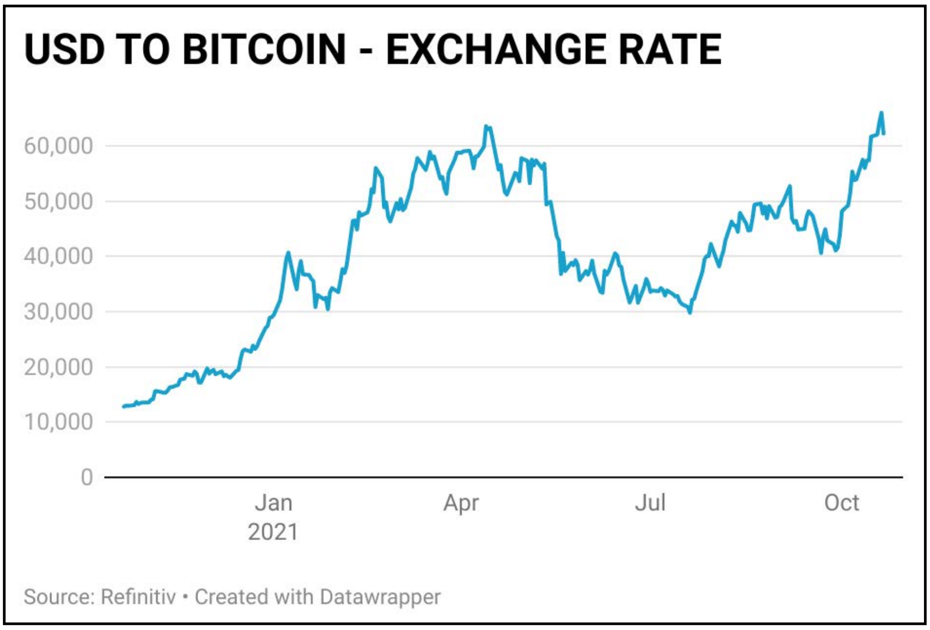
cryptocurrency mining prompted a big sell off earlier in the year. While that seems to have been forgotten in the recent price surge, it won't have been missed by companies and investment funds who are under increasing pressure to become greener, and facing more stringent reporting requirements surrounding their carbon emissions.

Environmental concerns prompted Tesla to back off from plans to allow customers to pay for cars with bitcoin, and other companies won't want to facilitate crypto payments if it impinges on their green credentials, particularly when transactions can already be quite easily fulfilled using dollars, euros or pounds. Like other industries, crypto mining can become cleaner, but it will take time and investment.

REGULATORY PRESSURE

The interventions of regulators can also be significant in the movements of cryptocurrencies, as we saw when Chinese authorities ramped up their clampdown on crypto over the summer.

Indeed, the latest bitcoin price surge may actually be down to the fact the US regulator has allowed the ProShares ETF to launch, which potentially paves the way for further funds to get the nod, opening up a new wave of liquidity for the crypto market.



However, the regulator was probably swayed by the fact the ProShares fund trades in futures contracts on a regulated exchange, rather than directly in bitcoin on less regulated crypto exchanges, and that will still be a sticking point for investors who want pure bitcoin exposure.

Here in the UK, the FCA (Financial Conduct Authority) has banned the sale of crypto derivatives and exchange traded notes to retail investors. Given the complexity of these instruments, the extreme volatility of the underlying asset, and the high potential for consumer harm, this looks a proportionate regulatory response.

As the market develops, products may become simpler and the FCA's stance may change. But this serves to underline the crypto market is still in its infancy, and has a long way to crawl before it becomes mainstream.

LONGER TERM ADOPTION UNCERTAIN

The launch of the ProShares ETF is a positive development for bitcoin, but the longer term adoption of cryptocurrencies by businesses, consumers and regulators is much more important to long term returns, and all remain deeply uncertain. As such, consumers should only invest money in crytpo they are willing to lose in its entirety.

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

The DNA of the Indian market

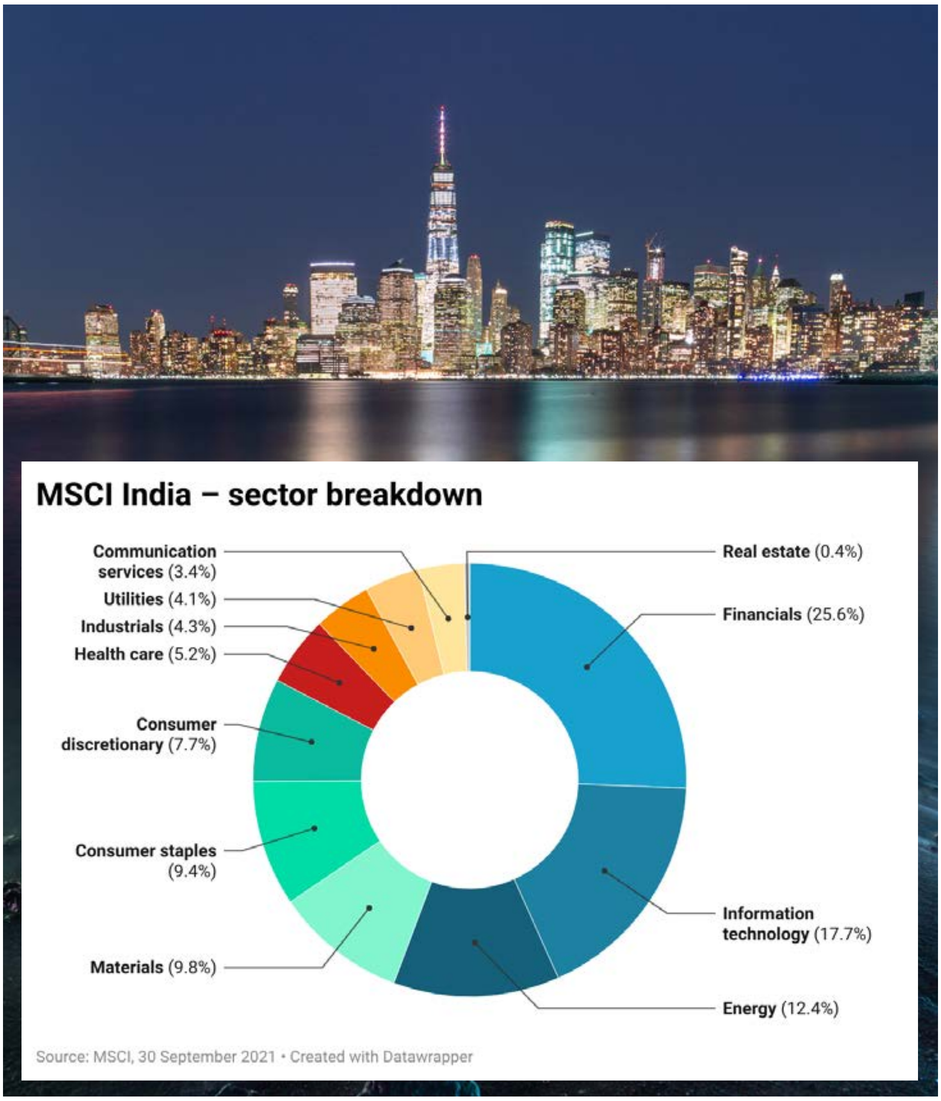
The value of shares in the world's largest democracy has grown rapidly this century

The Indian economy is one of the economic success stories of the last 50 years with its economy, despite a pandemic-led wobble, increasing in size 12-fold over the last five decades.

This is underpinned by favourable demographics with a study recently published in Lancet suggesting the country will have the world's largest working age population by 2100.

In the last two decades economic growth has been mirrored in the expansion of India's stock market with the market capitalisation of all Indian domestic companies going from $225 billion in 2000 to more than $2.5 trillion in 2020 according to data from the World Bank.

But what makes up the Indian market and how has it changed over time? Looking at the MSCI India index which is set up to capture the performance of India's largest companies, there is a reasonable amount of diversification.



The financials sector dominates but like any number of emerging markets, innovation plays an increasing role with information technology coming up on the rails.

India's largest companies tend to be older than those in other emerging markets like China suggesting there is scope for a wave of new innovative businesses to emerge in the world's largest democracy.

Reliance Industries, a conglomerate business of the type which is less common in the West but still a major factor in emerging markets, is the largest single company in the MSCI India index with business interests which span everything from energy to telecoms and retail.

Emerging markets: Views from the experts

Three things the Franklin Templeton Emerging Markets Equity team are thinking about today

1. The **Indian market** was a notable outperformer over the quarter, supported by a favorable earnings outlook relative to other parts of Asia, due to a strong domestic rebound post the second wave of Covid-19. Over the longer-term, we have increased confidence in Indian earnings growth due to positive demographics creating long runways for consumer penetration and upgrading, continued private sector penetration in segments like finance and health care, digitalisation from a low base, and supply-chain diversification supported by government policy. Our interactions with the management of Indian companies indicate confidence in the ability to grow their businesses based on industry consolidation leading to improved profitability, a fresh investment cycle, government initiatives seeding new investments in higher value-add areas, and the trend of global supply chain diversification.

2. China's government enacted new regulations in a number of industries in recent months, which has caused considerable investor concern. The **regulatory changes in China** were announced at a time when the country was seeing a slowdown in its economy and resurgence in Covid-19 cases, which has further weighed on equity performance. However, we believe China's government remains committed to fostering innovation as an economic growth engine. While the short-term volatility is painful for investors, these cycles have historically not unduly impeded the long-term structural growth of the broader economy.

3. The **Europe, Middle East and Africa (MENA)** region outperformed its regional peers in the third quarter of 2021, with all the markets in the benchmark, except for South Africa, recording positive performances. Leading the outperformers, the Czech Republic ended the quarter

with double digit returns, as the easing of Covid 19 restrictions drove an economic rebound. Equity markets in Russia, Kuwait and Saudi Arabia were supported by rising oil prices. Better than expected economic growth in Russia further buoyed its stock market. South Africa's market declined as riots in the country checked investor sentiment. A drop in metals prices also weighed on several materials stocks.

TEMPLETON EMERGING MARKETS INVESTMENT TRUST (TEMIT)

Porfolio Managers

Chetan Sehgal
Singapore

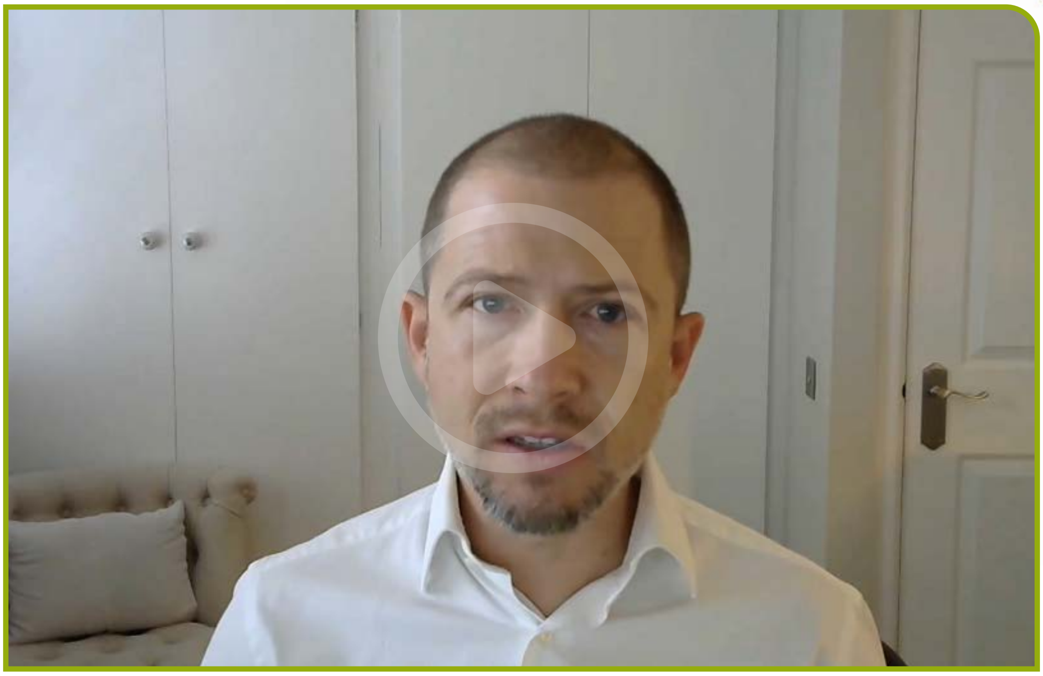
Andrew Ness
Edinburgh

TEMIT is the UK's largest and oldest emerging markets investment trust seeking long-term capital appreciation.

Invesco

INVESCO BOND INCOME PLUS LIMITED: HALF ONE 2021 HIGH YIELD REVIEW

21 July 2021



Rhys Davies
Portfolio Manager and Senior Credit Analyst
Invesco

- **Favourable economic backdrop for high yield bond markets continued**
- **High yield bond markets deliver positive returns in first half of 2021**
- **Inflation concerns unsettled government and investment grade bond markets**
- **Yields fall back slightly but compare favourably with government and investment grade bond markets**

Market background

2021 continues to be a solid year for high yield bond markets. This is reflected by the ICE BofA European Currency High Yield Index* delivering 3.33% in sterling terms to the end of June, with a positive return in each calendar month.

*This index comprises approximately 870 individual high yield rated bonds issued in euros and sterling.

An encouraging economic outlook, combined with the prospect of ongoing central bank support, has contributed to the steady performance. Indeed, this backdrop has led some commentators to revive the 'goldilocks' analogy for risk markets amid optimism that benign conditions might remain 'just right' for potential positive returns.

Despite the relative calm, markets have continued to see periods of volatility. Much of this has been caused by fears of a significant and protracted increase in inflation triggered by stimulus programmes launched in response to the Covid-19 pandemic. Fears of further lockdowns and the possibility of central banks removing support or raising interest rates have also weighed on markets.

Higher quality bonds tend to be the most sensitive to potential changes in interest rates and so it proved as, according to ICE, Sterling investment grade corporate bonds returned -2.80% and UK Gilts -5.82% for the six-month period.

Invesco

High yield markets did see a significant dispersion of returns with lower rated, and typically higher yielding, bonds significantly outperforming. ICE data showed that BB-rated bonds returned 2.52%, B-rated 4.0% and CCC & Lower returned 9.84% (all returns in sterling terms).

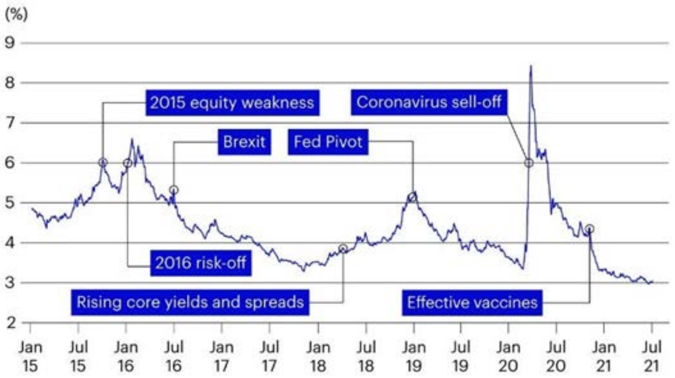
Figure 1

	% Return		Yield to Maturity %		Spread %	
Index	YTD 2021	2020	30/06/2021	31/12/2020	30/06/2021	31/12/2020
ICE BoA European Ccy HY Index (hedged to GBP)	3.33	3.16	3.04	3.34	3.04	3.65
ICE BoA European Ccy HY Index (hedged to GBP) BB	2.52	3.43	2.3	2.41	2.34	2.69
ICE BoA European Ccy HY Index (hedged to GBP) B	4	0.55	4.17	4.55	4.17	4.84
ICE BoA European Ccy HY Index (hedged to GBP) CCC & lower	9.84	8.44	7.61	9.26	719	985
ICE BoAML UK Gilts Index	-5.82	8.84	0.78	0.33	-	-
ICE BoAML Sterling Corporate Index	-2.8	9.3	9.3	1.44	106	113

Source: Bloomberg, ICE. Data to 30 June 2021.

The yield on the ICE BofA European Currency High Yield Index fell from 3.34% to 3.04% over the first half of the year and experienced an all-time low of 2.96% in early June. Spreads, the additional yield achieved when compared to government bonds, continued to narrow and fell from 3.65% to 3.04%. Although spreads in the high yield space have tightened, they still provide a strong premium over investment grade bonds which is shown by the spread on the ICE BofA Sterling Investment Grade Corporate Index falling from 1.13% to 1.06%.

Figure 2



Source: Macrobond, ICE. Data to 30 June 2021.

As yields now return to pre-COVID-19 levels, the demand for income generating assets remains high. This has led to record levels of high yield issuance as companies seek to build up cash surpluses, repair their balance sheets, or simply re-finance at a significantly lower cost. According to data from J.P.Morgan, European high yield issuance over the past six months was €93.1bn – already closing in on the record-breaking €103.3bn which was issued in the whole of 2020.

Figure 3

High yield supply

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD 2021
Issuance €bn	46	37.4	37.4	75.7	83.7	75.9	59.5	101.2	65.2	87	103.3	93.1
Redemptions €bn	18.6	13	15.6	26.6	45.3	48.6	57.8	81.6	49.7	69.6	45.3	36.4
Net €bn	27.4	24.4	21.8	49.1	38.4	27.3	1.7	19.6	15.5	17.4	58	56.7
# of bonds issued	115	107	110	216	219	176	145	233	163	182	206	188

Source: Bloomberg, ICE. Data to 30 June 2021.

Now most companies can access finance, and the global economy continues its recovery, default rates have fallen. According to Moody's, as at the end of June only 28 issuers have defaulted year to date which is less than a quarter of the 114 defaults in the same period last year. Moody's go on to forecast that their baseline trailing 12-month default rate will fall from the current 3.9% to 2.2% in June 2022.

Market outlook

Although yields are currently quite low and valuations are quite stretched in many cases, there are three reasons which suggests the backdrop for high yield bond markets is broadly positive.

1. Fiscal and monetary policy remains supportive
2. The improving trajectory of economies post-covid gives cause for optimism.
3. Defaults are low and forecast to drop further.

From my perspective, given the low level of yields, some increase in volatility would be welcome as the portfolio is well-positioned for such a backdrop.

Finally, inflation is an important risk factor to monitor. I've responded to that by keeping interest rate sensitivity low in the portfolio and being very disciplined in sticking to the types of higher yielding bonds that the trust normally holds.

Risk Warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange-rate fluctuations) and investors may not get back the full amount invested.

The portfolio has a significant proportion of high-yielding bonds, which are of lower credit quality and may result in large fluctuations in the NAV of the product.

The product uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

The product may invest in contingent convertible bonds which may result in significant risk of capital loss based on certain trigger events. As a result of COVID-19, markets have seen a noticeable increase in volatility as well as, in some cases, lower liquidity levels; this may continue and may increase these risks in the future.

When making an investment in an investment trust/company you are buying shares in a company that is listed on a stock exchange. The price of the shares will be determined by supply and demand. Consequently, the share price of an investment trust/company may be higher or lower than the underlying net asset value of the investments in its portfolio and there can be no certainty that there will be liquidity in the shares.

If investors are unsure if this product is suitable for them, they should seek advice from a financial adviser. For details of your nearest financial adviser, please contact IFA Promotion at **www.unbiased.co.uk**

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HOW I INVEST:

Taking baby steps to achieve a 250% return

David outlines how he manages his investments and his preference for the tech sector

Enthusiastic investor David has lived an active life over his 75 years having worked on four different continents as far afield as Africa and Australasia, and in the process, he has accumulated six different pensions.

David told *Shares* that when he was younger, he didn't appreciate the importance of pensions, partly because he was too busy working.

Today David enjoys spending most of his time researching stocks and managing his own investment pots. 'It is my job 24/7 and I love it,' he says.

It has been around four-and-a -half years since David took the decision to manage his own investments and he feels that the 250% return he has generated since has vindicated his decision.

He makes use of a myriad of investment resources including *Shares* while also attending investment club meetings.

David also attends a variety of company presentations through various organisations.

FOCUS ON TECHNOLOGY

David has a technology focus because he believes the sector has the fastest growing companies and therefore offers the best potential returns over the long run.

A strong work ethic is vital in David's opinion to achieve investment goals. He says: 'I think it is most important to state that to do this takes a lot of time and effort.'

He offered up an example of how hard work leads to success by referencing tennis teenage star Emma Raducanu, explaining 'she has worked very hard to achieve her success'.

David adds: 'I read all the RNS (regulatory news service) statements at 7am; I read lots of journals, investment reporters in the media and I watch all the company presentations I am interested in.'

David is an avid reader of investment books and says he has been influenced by Mark Slater's *The Zulu Principle, The Art of Execution* by Lee Freeman Shor and *The Reminiscences of a Stock Operator* by Edwin Lefevre which was first published in 1923.

The last book's main character is thought to have been based on famed trader Jesse Livermore who made and lost three fortunes.

In the US stock market panic of 1906 Livermore's huge short positions netted him a cool $1 million in a single today, worth around $30.5 million in today's money. Shorting involves selling shares with the intention of buying them back at a lower price and netting the difference.

David has adopted one of Livermore's investing methods for his own use, involving what he calls 'baby steps'. The idea is to invest slowly at first with a view to adding over time on news flow that supports his original investment.

BABY STEPS

For David a single step is worth £3,000 and the maximum number of steps he generally works with is generally is five, although he has made exceptions for investments which he considers have a lot of potential.

One example is when David recycled a profitable investment in web-based portfolio analysis and asset pricing services company Statpro into 'system on a chip' processor company **Ethernity Networks (ENET:AIM)**.

That gave him a starter position of five steps which he has subsequently added to, resulting in an eight-unit position.

One of the advantages of David's system is that mistakes are quickly weeded out and don't hurt as much as they otherwise would because they tend to be smaller positions.

One of the traits of the technology sector according to David is that momentum can be a key driver stock returns, so he reasons that adding to already winning positions should be rewarded over time.

In a nutshell David is looking for an attractive growth narrative, a good management team and evidence that the shares have positive momentum.

David believes that his baby steps approach aligns

David is excited by Ethernity because the company's programmable' chips might play in the next generation or 5G phone networks

his perceived risks with each position size and therefore allows him to 'sleep at night, which is also important'.

One drawback is that if an investment works 'out of the blocks' the performance is diluted by its relatively small portfolio weight.

KEEPING CASH ON HAND

A further trait that David has adopted from reading about Livermore is his insistence on keeping a cash reserve (a lesson Livermore adopted late in his life), in David's case around 10% of his portfolio which he described as 'untouchable'.

One of the reasons that David is excited by Ethernity is the potential role that the company's 'programmable' chips might play in the next generation or 5G phone networks.

The chips can be programmed in the field and process data in parallel as opposed to sequentially which significantly reduces latency and power usage.

David explains: 'Ethernity's ACE-NIC (network interface card) is currently the only SmartNIC with a router on its FPGA, (field programmable gate array) and its technology is protected by patents.

'It can save up to 80% cost compared to software-only solutions using CPUs. It has been optimised for telecoms over 17 years.'

David has found it a good discipline to map out his thoughts and investment decisions through an investment blog which he updates regularly.

By **Martin Gamble**
Senior Reporter

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We're looking for individuals or couples to take part in our case study column, particularly those willing to talk about how they manage they money in retirement or have become more active in the past year in choosing stocks, funds or bonds.

Please email editorial@sharesmagazine.co.uk with 'case study' in the subject line.

INDEX

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

29 Oct: Scancell, Time Out. **1 Nov:** K3 Capital, Lok'n Store. **2 Nov:** Oncimmune, UP Global Sourcing. **3 Nov:** Nanoco.

Half-year results

3 Nov: Braemar Shipping Services, Trainline. **4 Nov:** BT, Electrocomponents, Sainsbury's, Wizz Air. **5 Nov:** Kainos.

Trading updates

29 Oct: Evraz. **2 Nov:** BP, Flutter, Standard Chartered. **3 Nov:** Coca-Cola HBC, Next, Smurfit Kappa. **4 Nov:** Derwent London, Howden Joinery, Lancashire, Smith & Nephew. **5 Nov:** Beazley, International Consolidated Airlines.

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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