STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

VOL 24 / ISSUE 28 / 21 JULY 2022 / £4.49

SHARES

WE MAKE INVESTING EASIER

LET DOWN BY BANKING SHARES

Why they haven't done better despite rates rising

Despite Asia-Pacific risks **Vietnam** continues to **shine**

Understanding **shares** and when to **sell** them

The **real assets** fund with **strong** performance

Your call may be recorded for training or monitoring purposes. Issued and approved by Baillie Gifford & Co Limited, whose registered address is at Calton Square, 1 Greenside Row, Edinburgh, EH1 3AN, United Kingdom. Baillie Gifford & Co Limited is the authorised Alternative Investment Fund Manager and Company Secretary of the Trust. Baillie Gifford & Co Limited is authorised and regulated by the Financial Conduct Authority. The investment trusts managed by Baillie Gifford & Co Limited are listed UK companies and are not authorised or regulated by the Financial Conduct Authority.

Contents

DISCLAIMER

IMPORTANT

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

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

1. In keeping with the existing practice, reporters who intend to write about any securities, derivatives or positions with spread betting organisations that they have an interest in should first clear their writing with the editor. If the editor agrees that the reporter can write about the interest, it should be disclosed to readers at the end of the story. Holdings by third parties including families, trusts, self-select pension funds, self select ISAs and PEPs and nominee accounts are included in such interests.

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

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

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


SIPPs | ISAs | Funds | Shares
AJBell
Youinvest
RETIREMENT YOUR WAY?
GET INVESTING
Open our low-cost Self-Invested Personal Pension for total flexibility and control over your retirement with free drawdown.
youinvest.co.uk
Recommended Provider
Which?
Investment Platforms May 2020
Recommended Provider
Which?
Self-Invested Personal Pensions July 2020
THE TIMES money mentor
CUSTOMER EXPERIENCE RATING
Investing & Pensions
GOLD AWARD
Autumn 2020
Capital at risk.
Pension rules apply.

Why focusing on the long term can help when so much is going on

Even professional investors are struggling to keep on top of everything right now

We live in an information age. Our minds are constantly bombarded by such a deluge of facts and figures that it's increasingly hard to keep track.

An important skill for successful investing is to narrow your focus to only the most salient data and news flow. This can help you to make informed decisions while still maintaining a level of clarity.

However, working out what matters and what doesn't is difficult right now as there's so much going on which could influence markets and valuations.

As Berenberg analysts Jonathan Stubbs and Edward Abbott observe: 'We cannot remember a period in modern history when the range and spread of factors and forces simultaneously affecting financial markets was so extended.

'Fund managers need to track multiple (and significant) political, geopolitical, macro, policy and social dynamics; everything, everywhere at the same time.

'The world has quickly become shrouded in complexity; this is also making it difficult for investors to find conviction.

'We often cite three core areas which make conviction hard to find: 1) inflation risk, 2) the Russia/Ukraine conflict, 3) government Covid-19/health policies. Where will each of these be in three, six, nine, 12 months' time?'

This argument is backed up by the performance of the markets. Having hit lows below 7,600 in mid-June, from more than 9,700 at the start of 2022, the MSCI World index of developed markets has been stuck in a tight range between 7,700 and 7,900 ever since.

In an environment where everything is so uncertain it feels like a rational decision to sit on your hands.

The best ordinary investors can do, assuming

time is on their side, is to take a long-term perspective and hold true to the principle that, however bleak things seem right now, a recovery is almost always around the corner.

And you don't want to miss out when said recovery comes by selling when the outlook is at its blackest.

That doesn't mean you should lose sight of long-term shifts which could impact the way different shares are valued by the market.

Berenberg's Stubbs and Abbott observe: 'Globalisation has been a key mega-trend since the 1980s. However, as measured by global trade/GDP, globalisation has stalled and gone into reverse since the 2008-09 global financial crisis.

'In 2022, there is fresh support for further deglobalisation with the extending Russia/Ukraine conflict and with the evolving relationships between G7 countries, NATO and China.'

We recently looked at the topic of globalisation and *Shares* will continue to keep tabs on some of the longer running themes which may have got lost amid a wall of noise on everything from interest rates and inflation to conflict and disease.

By **Tom Sieber** Deputy Editor

Wealth preserver Ruffer warns bear market is 'only mid grizzle'

Outlook from Ruffer's managers makes grim reading for investors counting on a rapid stock market recovery

Capital preservation trust **Ruffer's (RICA)** portfolio is the most defensively positioned it has been since 2003, with its managers believing the worst is not yet over for stocks and other risk assets.

Co-manager Duncan MacInnes told the *AJ Bell Money & Markets Podcast* that 'investors under the age of 60 have been conditioned to buy the dip', since central bank easing has 'always been just around the corner and market recoveries have been swift and steep'.

Yet a look further back in history shows the pattern that many bear markets take 'is a steep drop, like we've just had, but followed by a more prolonged grind lower over a number of years', warns MacInnes.

As outlined in Ruffer's year-end review, the last few months of the year to June 2022 saw portfolio risk reduced with the fund moving into what the managers call 'crouch mode' for what is expected to be a dangerous second half of the year.

De-risking actions included reducing the portfolio's share exposure to a 25% weighting, with hedges on top for good measure, the lowest weighting to stocks for Ruffer portfolios since 2003.

The managers also rotated the trust's gold exposure from listed gold miners to bullion. 'I think gold is the unreliable girlfriend,' concedes MacInnes, 'because it never does quite what you expect it to do. But over the very long term, gold works as an inflation hedge.'

Ruffer's managers continue to view the fund's inflation-linked bonds as the portfolio's 'crown jewels'. They believe the sensitivity to interest rates has now been felt and that they should offer excellent protection in a period of financial repression.

MacInnes also believes the bear market is 'only

mid grizzle' and has never had higher conviction on the longer-term move to a regime of inflation volatility when conventional portfolios 'are not going to fare well'.

As the review explains, amid central bank tightening, 'the punchbowl is being taken away. Quantitative easing is melting away and quantitative tightening is beginning. Combined with rapid-fire rate hikes, it's a recipe for financial market sobriety.'

Ruffer delivered a share price total return of 5.6% and an NAV total return of 5.9% in the year to June 2022, thereby achieving its objective of preserving and growing shareholders' capital, as what MacInnes dubs 'our unconventional protective toolkit' such as options which 'saved our bacon' in the Covid crash performed as desired again.

Hamish Baillie is stepping down as co-manager and as a Ruffer partner at the end of July to pursue other opportunities. MacInnes will continue to manage the trust and Numis Securities doesn't view Baillie's exit as a significant issue for the fund 'given Ruffer's single approach across the firm and considerable resources to back that up'. [JC]

Find out why consumer health group Haleon's debut fell flat

Sensodyne-to-Panadol owner's shares off to inauspicious start as a standalone entity

Shares in **Haleon (HLN)** slipped 6.6% in a disappointing debut (18 July) as a standalone business on the London Stock Exchange following the consumer healthcare group's long-awaited demerger from **GSK (GSK)**.

The stock dropped from a 330p start price to 308.35p on the first day of dealings and as *Shares* went to press, Haleon traded even lower at 298.5p.

While the business behind brands such as Panadol, Sensodyne and Advil has defensive characteristics, investors are clearly worried about the impact of inflation on the company, which also joined the market saddled with significant debt.

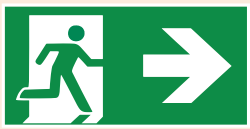
Cash-strapped shoppers are increasingly trading down to supermarket own-label products as the cost of living crisis bites, and where there are cheaper options for toothpaste and headache tablets than those sold by Haleon.

Guided by CEO Brian McNamara with former **Tesco (TSCO)** boss Dave Lewis in the chair, such pressures suggest Haleon may struggle to meet its stated targets. Management anticipates delivering 4% to 6% organic annual revenue growth with a sustainable moderate margin expansion and high cash conversion.

Before the demerger, Haleon was the subject of a takeover bid from consumer goods goliath **Unilever (ULVR)** pitched at £50 billion. Though it is still very early days, Haleon's current market value below £28.5 billion heaps pressure on management to deliver, with many investors wondering why GSK didn't accept Unilever's much higher bid. [JC]

Investors are rushing to exit funds as small cap specialists really suffer

Outflows continue to mount up for under-pressure asset management firms



RECENT FUND FLOWS data suggests investors have been withdrawing money from the market rather than waiting for it to rebound.

According to Morningstar's asset flows report, in June investors redeemed £2.6 billion from open-ended UK equity funds.

This chimes with recent announcements from asset management firms.

Blackrock (BLK:NYSE), the world's largest asset manager, recently reported nearly $10 billion of outflows in the quarter to the end of June, and a larger fall in profit than expected.

In a similar vein **Premier Miton's (PMI:AIM)** assets under management fell 8% to £12.8 billion in the six months to 31 March, as investors pulled £279 million from the group's equity funds.

Polar Capital (POLR:AIM) experienced a 14% decline in assets under management in the three months to June, in part due to net outflows of £316 million and fund closures of £459 million.

Liontrust (LIO) suffered £500 million of net outflows over the same period, the majority accounted for by UK retail funds.

Some of these asset managers are small cap specialists and redemptions are problematic for UK smaller company funds, particularly with people rushing to exit what are already illiquid stocks.

In order to give investors their money back portfolio managers may be forced to sell investments at big discounts. [MGar]

Profit warnings galore as companies struggle with higher costs and lower demand

Direct Line, Deliveroo, Made.com and Hotel Chocolat among those with earnings shocks

Insurer **Direct Line (DLG)**, food delivery platform **Deliveroo (ROO)**, sofa seller **Made.com (MADE)** and chocolatier **Hotel Chocolat (HOTC:AIM)** are among the latest companies to warn about earnings as inflationary pressures and recession fears bite.

In general, companies issuing profit warnings this year have been dealing with the twin effects of rising costs and reduced demand, leading to a drop in earnings guidance.

While the market has already priced a lot of these risks into share prices, investors still seem to be taken by surprise given the reaction to the latest trading updates.

Consultant EY says the number of profit warnings issued by UK-listed companies jumped 66% year-on-year in the first half of 2022, with over half blaming higher costs.

It found 136 companies warned on earnings, up from 82 in the first half of 2021. More than half of these warnings came from consumer-facing sectors as demand and confidence fell.

There are signs that inflation could soon peak, such as a fall in commodity prices. However, that will take time to work its way into the system.

Deliveroo bucked the trend on 18 July when its share price rose on a profit warning. It said gross transaction value growth fell to 3% in the second quarter versus 12% in Q1, adding that forward growth guidance would be significantly less than previously expected.

It is now looking at between 4% and 12% gross transaction value growth in the full year from a previous range of 15% to 25%.

Normally that would be enough to spook the market, but investors liked the news that it expects to subsidise fewer takeaways.

Sectors with the highest number of profit warnings in Q2 for UK-listed stocks

Sector	Number of warnings
Travel & Leisure	8
Retail	7
Personal Care, Drug and Grocery Stores	7

Table: Shares magazine • Source: EY

Made.com's shares have fallen by 88% in value since its stock market debut in June 2021. It has suffered from supply chain disruptions causing major delays to customer deliveries. This was followed by higher costs and a drop in demand as consumers cut back on spending.

Yet another profit warning from the sofa maker on 19 July saw the company say the rate of sales and earnings decline could be up to twice as much as it previously expected for the full year.

A key part of Hotel Chocolat's growth story was the opportunity to expand across the US and Japan. Unfortunately, things haven't gone quite to plan and a restructuring for these territories was a key contributor to its latest profit warning.

The US is to become an online and wholesale operation only, while Covid disruptions have derailed progress in Japan. Hotel Chocolat will now only fund necessary working capital in Japan and leave its partner to find additional funding elsewhere. [DC]

Fevertree's earnings forecasts slashed by nearly 50% after problems get worse

A major profit warning raises questions around brand strength as expectations are significantly pared back

The combination of supply chain problems and rising costs has prompted analysts to nearly halve their earnings per share forecasts for **Fevertree Drinks (FEVR:AIM)** for each of the next three years.

The manufacturer of premium mixers warned on 15 July that several factors, including the soaring cost of glass for its bottles, higher transport fees and a shortage of workers, would lead to profit around a third lower than previous guidance.

While sales of £365 million remains the expectation for 2022, underlying profit will be no more than £45 million compared with the £65 million which had previously been pencilled in.

Analysts have also slashed estimates for 2023 and 2024. In doing so, Berenberg analyst Ashton Olds also flagged the risks associated with consumers trading down to cheaper products from other drinks companies.

Investors might have hoped Fevertree could pass on costs quite freely. When measured against the cost of the alcohol it accompanies, Fevertree's mixers do not represent a particularly big outlay so asking drinkers to pay a bit more shouldn't have been such a big ask.

The fact Fevertree is having to surrender profitability is slightly worrying and raises questions about the company's procurement strategy, supply chain management and, of even more concern, the strength of the brand.

Fevertree has had three distinct phases to its life as a public company. Having joined the market in 2014, for a time it could seemingly do no wrong, with constant earnings upgrades helping drive the shares from a price at listing of 134p to peaks in August 2018 of more than £37.

Big downgrades for Fevertree

Year	Cut to earnings per share forecast (%)
2022	-45%
2023	-48%
2024	-42%

Table: Shares magazine • Source: Average of forecast changes by Numis, Berenberg and Liberum after 15 July 2022 profit warning

The stock then stalled as the company consolidated its market position amid some fears it may have reached saturation point in the UK.

Expansion in the US and other geographies raised the prospect of further growth, but this potential is still not fully proven.

The impact of inflationary pressures and a potential cost-of-living related hit have seen the shares retreat from more than £27 at the start of 2022 to 920p.

Co-founder and chief executive Tim Warrillow bought a little more than £1 million worth of shares immediately after the profit warning-induced share price slump.

Liberum analyst Wayne Brown commented: 'Logistics disruption and inflationary cost pressures continue to hurt and likely to do so for longer than we had expected but the US East Coast bottling plant is gradually ramping up and it is engaging with suppliers on various cost initiatives which will help mitigate the inflationary pressure but maybe more so next year than this one.' [TS]

A great way to get global exposure to healthcare

Sector seems to have been left behind despite tried and tested defensive qualities

In uncertain times it is useful to have some have exposure to defensive and relatively stable areas of the market. This £1.3 billion global tracker fund has done a good job of mirroring the FTSE World Healthcare index for an attractive 0.3% a year ongoing charge.

The healthcare sector also provides some protection against rising prices due to the essential nature of the services it provides. Historically spending on healthcare has kept pace with inflation.

Despite their steady growth and defensive characteristics, the fund's investments trade at a relatively attractive rating with an average price to earnings ratio of around 16.5 times.

The fund has delivered a compound annual growth rate of 12% a year over the last three years and 14.8% a year over the last decade.

It seeks to replicate as closely as possible the underlying constituents of the benchmark in similar proportions to the index.

L&G Global Healthcare and Pharmaceuticals - geographical split

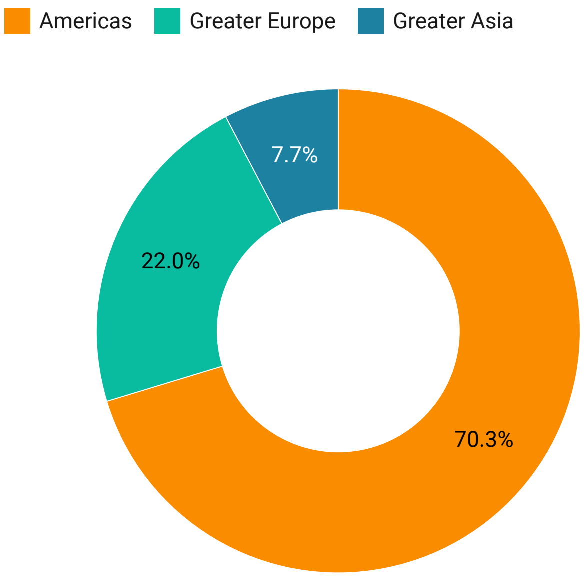


Chart: Shares magazine • Source: Morningstar

L&G GLOBAL HEALTH AND PHARMACEUTICALS INDEX TRUST

BUY

(B0CNH38) 121.4p

Net asset: £1.3 billion

The fund provides investors with diversified exposure to the largest healthcare names in the world by market capitalisation which comprise over 80% of the portfolio and virtually zero exposure to the small cap end of the market. The fund invests across more than 200 companies worldwide.

Around 70% of the fund is invested in the US which comprise the largest healthcare names, while Europe and the UK makes up 22% and the rest is invested across Greater Asia including Japan.

The fund's largest position representing around 7% of assets is the US healthcare group **UnitedHealth (UNH:NYSE)**. The company operates the Optum and UnitedHealth platforms.

Consumer products giant **Johnson & Johnson (JNJ:NYSE)** represents around 6.7% of the portfolio and gives investors access to iconic US brands such as pain relief medicine Tylenol and mouthwash Listerine. [MGam]

L&G - Global Health & Pharmaceuticals Index Trust

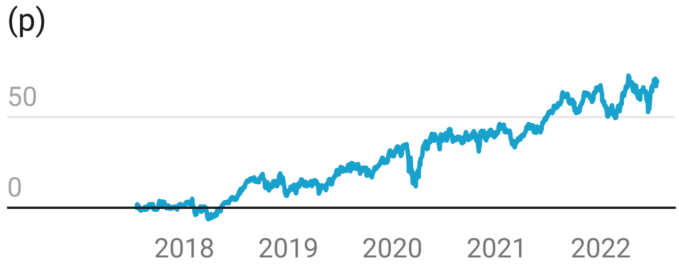


Chart: Shares magazine • Source: Refinitiv

A rare chance to buy into the SDI growth story on less than 20 times earnings

Buy and build science kit maker's stock looks underappreciated at current levels

Pandemic aside, it's been more than two years since investors could buy shares in AIM-quoted **SDI (SDI:AIM)** on a price to earnings multiple below 20. You can now. The stock currently trades on a forward PE of around 19, and *Shares* believes investors with an eye for the longer-run recovery of the economy and stock market should invest now.

2022 has tossed many a challenge at SDI yet the company has not only continued to grow, it has done so above and beyond expectations. Analysts at FinnCap added an extra £2.5 million and £1 million, respectively, to fiscal 2023 adjusted revenue and pre-tax profit when the company issued its trading update in May.

Since then, the share price trend has been largely sideways, drifting from 151p to current levels, yet there remains a multi-year growth story with the potential to add substantial value to retail investor portfolios over time.

SDI is a collection of subsidiaries that design and manufacture digital imaging, sensing and control equipment used in life sciences, healthcare, astronomy, manufacturing, precision optics and art conservation applications.

Its a model that closely resembles that of health, safety and environmental kit maker **Halma (HLMA)**, a constituent of the FTSE 100, buying good value businesses that add consistent cash flow and profits to the overall company.

For example, SDI's Atik cameras business helped carry the company through much of the pandemic, winning orders from PCR testing equipment manufacturers at a time when other SDI operating companies were struggling. It also helps that the group concentrates on industries where regulation is high, competitive moats can be enforced and capital investment is less likely to be impacted by economic downswings.

Not only does SDI's growth stretch back multiple years, has been high-quality growth. Gross margins typically run at around 65%, high for a manufacturing business, while returns on equity and investment of around 22% to 25% beat industry averages.

Naturally, no investment is without risk. It has some exposure to China, where parts of the nation appear to bounce from one lockdown to another. It also relies on identifying a consistent stream of acquisition targets to help underlying growth.

That said, the company believes this is a very fragmented space with lots of bolt-on sized deals there to be done if the price is right, and management has a proven record for paying conservative prices and running a tight balance sheet. Net debt is about £8 million. [SF]

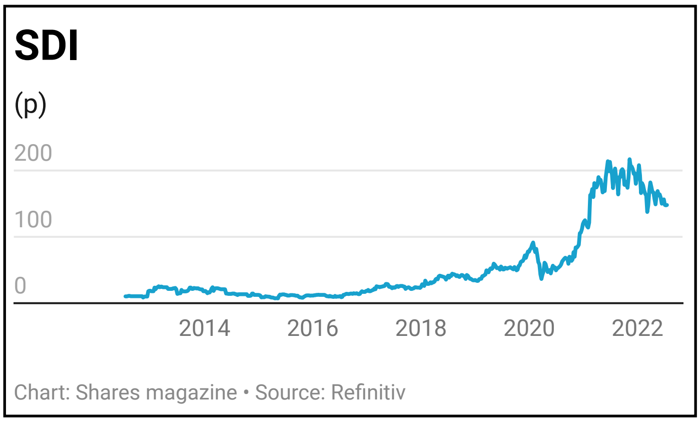


Chart: Shares magazine • Source: Refinitiv

AJBell Media

SHARPEN YOUR INVESTING SKILLS WITH SHARES

A SUBSCRIPTION TO SHARES HELPS YOU TO:

- Learn how the markets work
- Discover our best investment ideas
- Monitor stocks with our customisable watchlists
- Enjoy our guides to sectors and themes
- Get the inside track on company strategies
- Find out how fund managers make money

Digital magazine

Online toolkit

Investment ideas

JP Morgan's real assets trust offers inflation protection and uncorrelated returns

The trust is up nearly 30% since we said to buy 12 months ago despite heavy market volatility in the interim

JP MORGAN GLOBAL CORE REAL ASSETS

(JARA) 104.5p

Gain to date: 28.6%

We recommended buying **JP Morgan Global Core Real Assets (JARA)** in July 2021, noting that the shares were trading on a 12 month low and a 8% discount to net asset value.

This looked interesting given the shares had traded at a premium to net asset value of 15% at the beginning of 2021 and the fund also offered investors a degree of inflation protection given its exposure to real assets.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

The share price has risen by 28.6% since our initial buy recommendation and the discount to net asset value has narrowed from 8% to 1.86%.

The trust has been a natural beneficiary of the recent surge in inflation.

This is due to the trust's asset exposure that is split between real estate, infrastructure and transportation.

Speaking with *Shares* Philip Waller manager of the fund emphasised that inflation was relatively positive for core real assets given their ability to increase income earned over time in-line with inflation.

'Power and energy contracts, for example, are invariably long term in nature, with an element of inflation protection built in,' he said.

The fund has also benefited from dollar strength given that it has a 64% US dollar exposure and 53% of its assets are based in North America.

WHAT SHOULD INVESTORS DO NEXT?

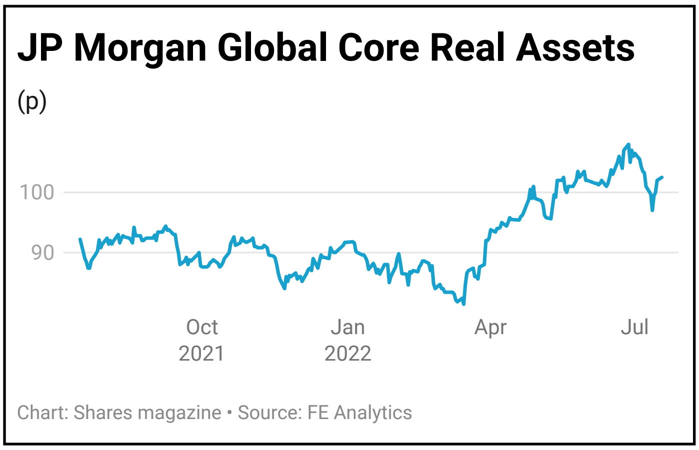
Keep buying the shares.

The fund offers investors access to a pool of global real assets that are uncorrelated with equities and bonds.

It therefore offers a unique ability to offer diversification at a time when the traditional 60% shares 40% bonds portfolio model is looking broken.

The fund has a target return of 7% to 9%, with between 4% and 6% of this total return coming from income.

Looking forward Waller highlights that the fund is particularly interested in renewable and liquefied natural gas markets and will benefit from higher energy prices and Europe having a greater focus on energy independence. [MGam]



Continuing earnings growth and increased dividends from Photo-Me International

Company demonstrated its strong market position after raising photo booth prices

PHOTO-ME INTERNATIONAL

(PHTM) 81.2p

Gain to date: 14.3%

Instant service equipment company **Photo-Me International (PHTM)** has continued to deliver strong business momentum which have propelled the shares higher since we said to buy on 16 June 2022.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

A very confident first-half trading update saw the company reiterate full-year guidance of at least 20% revenue growth and pre-tax profit of between £47 million and £50 million. In addition, the company announced a new progressive dividend policy and a special dividend.

Going forward the company intends to pay out at least 50% of annual profits in dividends and approximately £24.57 million as a special dividend, equivalent to 6.5p per share on 1 September 2022.

Broker Canaccord Genuity has materially upgraded its dividend forecast and highlighted that the new policy represents a normalised dividend yield (excluding the special payout) for fiscal 2022 of 7.5%.

Canaccord argues this is very attractive considering the stable cash flow characteristics of the group and the concession-like nature of the business.

For the first-half the company grew revenues by 22% year-on-year while EBITDA (earnings before interest, taxes, depreciation, and amortisation) jumped 40% to £40.2 million.

The company has ambitions to grow EBITDA to

£100 million by the end of the 2023 fiscal year. The company ended the half with net cash of £43.2 million, up from £16.9 million.

Chief financial officer Stephane Gibon told *Shares* that the company's growth was focused on increasing the density of its operations (adding more machines per head of population), opening new territories, and developing new technologies.

In the medium term the company expects to achieve more balance across the different technologies with photo booths representing around half of revenues, washing machines contributing around a third and the nascent food vending machine business contributing the rest.

In October the company plans to change its name to ME Group to better reflect an increasingly diversified concessions group. In October 2022 the company will celebrate its 60th anniversary on the London Stock Exchange.

WHAT SHOULD INVESTORS DO NEXT?

The business continues to perform strongly while the shares look too cheap relative to the potential growth and yield. Keep buying. [MGam]

Chart: Shares magazine • Source: FE Analytics

AJBell Youinvest SHARES

MON£Y & MARKET$

LISTEN TO OUR WEEKLY PODCAST

RECENT EPISODES INCLUDE:

Best deals on cash, how Ruffer protected investors' money and cracks in the inflation story

What's hitting the new Chancellor's to-do list, UK growth fears, pound falls and outlook for UK banks

Miners, defence stocks and the return of the pension triple lock

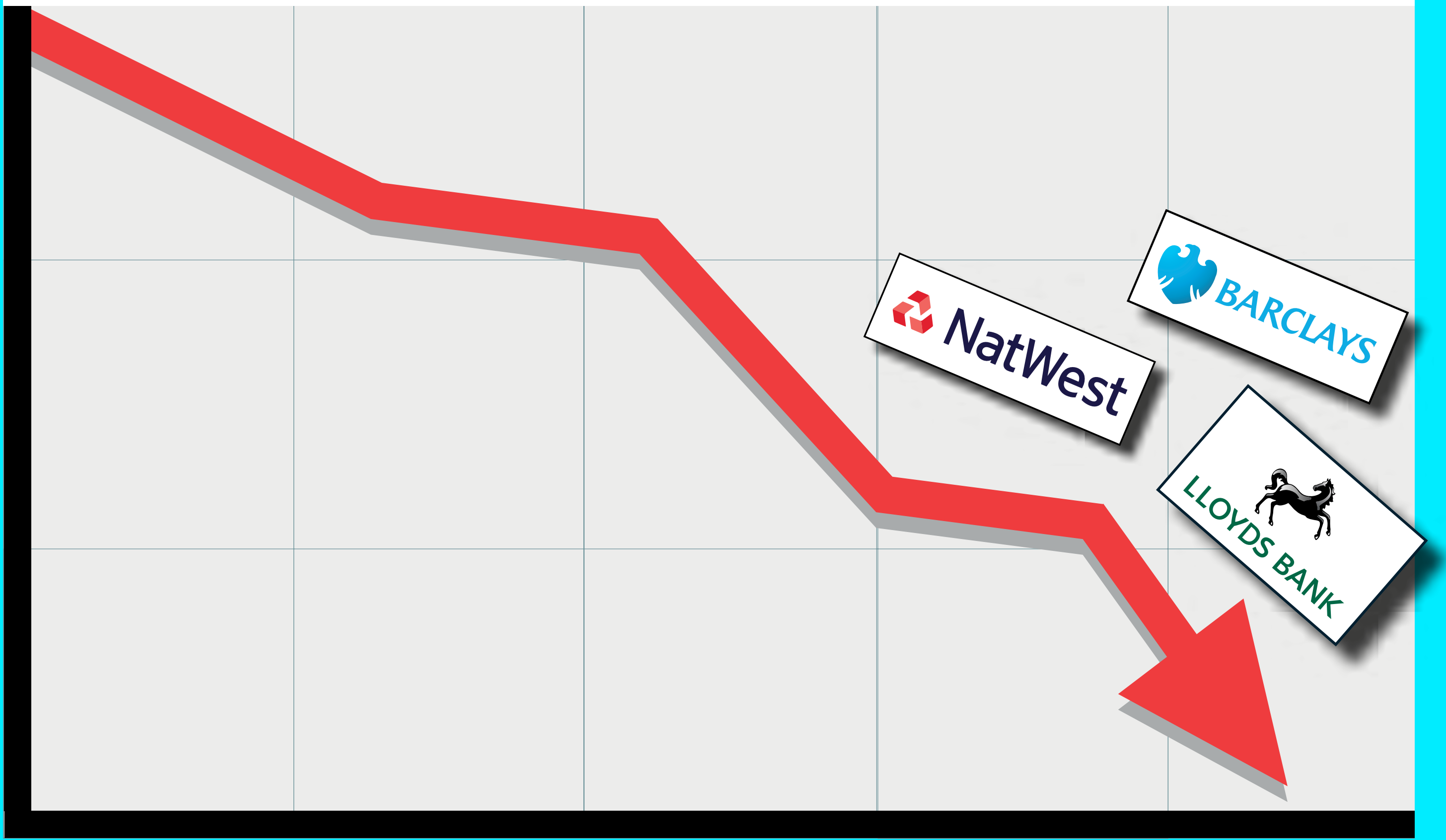
LISTEN ON SHARES' WEBSITE HERE

You can download and subscribe to 'AJ Bell Money & Markets' by visiting the Apple iTunes Podcast Store, Amazon Music, Google Podcast or Spotify and searching for 'AJ Bell'. The podcast is also available on Podbean.

Listen on Apple Podcasts | Available on Podbean | Listen on Google Podcasts | Listen On Spotify | amazon music

LET DOWN BY BANKING SHARES

Why they haven't done better despite rates rising



By **Mark Gardner** Senior Reporter

Rising interest rates are typically good news for banks and recent results have been encouraging but UK banking stocks have singularly failed to deliver so far in 2022.

This reflects their close ties to the UK economy amid concerns of a possible recession – something which is neatly illustrated by the relative outperformance of **HSBC (HSBC)**, which has a much bigger presence in Asia than it does domestically.

In a recent *AJ Bell Money & Markets* podcast interview Laura Foll, fund manager at Janus Henderson, explained: 'There is a fear of us going into a recession and historically banks have not wanted to be the sector you own in a recession because you start to get fears about bad debts.

'Or in other words, have banks lent to people at the end of the cycle that they shouldn't have lent to.'

Yet first quarter results from the UK banks demonstrated better than expected profitability and increased confidence in delivering strong returns.

Foll added: 'At the moment there are a huge amount of deposits in the banking system, almost too many. This means that the banks can pass on interest rates to you and me as the deposit holders relatively slowly. And yet if you are out there looking for a mortgage, it is apparent that that mortgage rates have gone up pretty steeply over the last couple of months'.

'So that margin the banks make between what they pay you and me as the deposit holder and somebody getting a mortgage is getting bigger. This means that banks' margins in theory should be going up and that should be good for banks' earnings.'

This underpins the high dividend yields the sector offers. **Lloyds (LLOY)** and **Barclays (BARC)** are currently trading on 2023 prospective dividend yields of 7.1% and 7.9% respectively.

Broker Numis suggests that Barclays and **NatWest (NWG)** have the potential to offer significantly higher total effective yields (these include special dividends and share buybacks).

However, the prospect of earnings upgrades and generous income is manifestly not being rewarded by the market.

Given the fragility of the UK economy, investors who believe the US economy will prove to be more resilient could consider the alternative option of investing in US banks.

The US banks sector has significantly more capital, greater liquidity, and generates strong returns, even if its quarterly results season is off to a shaky start.

The sector recently cleared their annual stress test exercise. This success has potentially paved the way for higher dividends.

WHO GAINS THE MOST FROM RISING RATES?

Research by Jefferies outlined in the table shows the impact a 25 basis point interest rate increase has on the net interest income of each UK bank.

NatWest is the standout winner. For every quarter point rise in interest rates it experiences a 5.5% uplift to its net interest income – a key measure of a bank's profitability.

Estimated impact of a 25 basis point rate rise on the net interest income of UK banks

Bank	Estimated impact (%)
Virgin Money	1.3%
Barclays	1.6%
Lloyds	2.0%
HSBC	2.2%
Natwest	5.5%

Table: Shares magazine • Source: Numis

This is one of the key reasons why it is one of the largest active positions in the **Edinburgh Investment Trust (EDIN)**.

Fund manager James de Uphaugh explains: 'The period since the Great Financial Crisis in 2008, has not been a normal period for banks. Many have been in cash deleveraging mode working through bad loans and rebuilding their capital levels under the hawkish eye of regulators. UK base rates have been on the floor over the period so NatWest, which has a 16% share of the deposit market has struggled to make a normal margin'.

'The risk reward for UK banks is favourable as valuations stand out at historically large discounts to tangible book with very robust capital levels and strong balance sheets'.

'We favour NatWest given the de-risking of its loan book over the last few years. It currently stands at over a 25% discount to tangible book value and should generate a return of on tangible

equity above 12% over the next few years as interest rates begin to normalise.'

In a recent research note Credit Suisse analyst Omar Kennam highlighted how Lloyds also benefits from a steepening yield curve.

'Pricing in a Bank of England rate of 2.25% leads us to upgrade our net income estimates for Lloyds by 2%-7% for 2022-2024'

First quarter results for Lloyds beat expectations. Pre-tax profit of £1.62 billion was ahead of consensus by 12% with outperformance on income, costs and impairments.

The net interest margin guidance was upgraded to more than 270 basis points in 2022 versus a previous expectation of 260 basis points.

Expectations for return on tangible equity in 2022 has also risen from 10% to above 11%, which is among the highest for the large mainstream UK banks.

HOW THIS IS UNDERPINNING DIVIDENDS

The UK bank sector is a great source of potential dividend income. In a research note published at the beginning of this year broker Numis highlighted that UK banks are now generating respectable earnings profits, 85% of which should convert to capital over the next three years.

Numis estimate that UK banks sector distributions will total £32 billion between the January 2022 and the end of 2024. This represents 34% of the sector's market value, with cash dividends half of that.

It is important to acknowledge that this estimate is 20% above consensus.

However, using Numis estimates Lloyds is trading on a 2023 cash dividend yield of 6.1% but the total effective yield is nearly double this figure (cash dividend plus buybacks and special dividends) of 12.1%, given the anticipated £1.75 billion buyback.

Numis suggests that Barclays and NatWest offer even more appealing total effective yields.

The former is expected to deliver a 2023 total effective yield of 15.2%, rising to 15.7% in 2024 courtesy of a £1.5 billion buy-back forecast in both 2023 and 2024.

For the latter, an eye watering 2023 total effective yield of 17.1% is predicted based on a substantial £2.35 billion share buyback. This falls to 13.8% in 2024 as the size of the share buyback is anticipated to decline to £1.46 billion. Investors need to consider the risk that buybacks could be delayed or cancelled if banks become more concerned about bad debts.

WHAT ABOUT LEVERAGE?

In a 2020 Institute of Economic Affairs paper Kevin Dodd, professor of Finance at Durham University and Delan Buckner, an ex-regulator, argued that although the Bank of England maintained that UK banks are strongly capitalised, the evidence from banks' share prices and market values contradicts this claim.

They claim that in 2020 the UK banks were more fragile than they were going into the last financial crisis.

The authors highlight that the UK banks

UK banks offer generous yields

Bank	2023 dividend (p)	2023 dividend yield
Natwest	13.5	6.2%
Lloyds	3.0	7.1%
Virgin Money	9.9	7.4%
Barclays	12.0	8.0%

Table: Shares magazine • Source: Google Finance, Shore Capital sector had a market capitalisation of £360.9 billion at the end of 2006, but at May 2020 this had slipped to £138.8 billion, a fall of 62%.

During this period they suggest banks' average capital ratios have fallen from 11.2 % to 2.3%, worked out by dividing their total assets by market cap.

Critically, the paper also maintains that the banks average leverage on this measure has increased almost four-fold from 8.9 in 2006 to a level of 44 in 2020.

The authors do acknowledge that some people argue they should use book value rather than market value to assess leverage and on these measures, the banks are in (modestly) better financial shape than they were in 2006.

While the analysis in the IEA paper ends in 2020, recent first quarter results from Lloyds (27 April) validate some of the concerns it raises.

'Lloyds tier one capital ratio', a measure of the buffer the bank has to guard against crisis conditions, fell by 3.1 percentage points to 14.2%, which was below a consensus estimate of 14.6%.

Management also indicated that impairments for bad loans are likely to increase this year.

Chief executive Charlie Nunn stressed that: 'Whilst we are seeing continued recovery from the coronavirus pandemic, the outlook for the UK economy remains uncertain, particularly with regards to the persistency and impact of higher inflation'

Similarly first quarter results from NatWest (29 April) also revealed a tier one ratio of 15.2%, which was below a consensus forecast of 15.6%.

THE US ALTERNATIVE

Nick Brind, fund manager at **Polar Capital Global Financials Trust (PCPT)**, outlines why he has an overweight position in large US banks instead of the large UK domestic banks:

'If it was not for understandable concerns around recession risk it would be a case of a rising tide raises all boats with the tailwind of rising interest rates. However, we believe the US economy should be more resilient than the UK'

'Furthermore, US banks have stronger balance sheets, are more profitable and are benefiting from faster loan growth, so all things being equal they should perform better'.

'US regulators have also shown to be more pragmatic as evidenced by the decisions by the UK regulator to ban all dividends and buybacks and dividends in 2020 unlike in the US'.

Investors looking for diversified exposure to US banks could consider using exchange-traded funds. **iShares S&P US Banks (BNKS)** tracks a basket of large and mid-sized US banks for an ongoing charge of 0.35%. An alternative option is **Xtrackers MSCI USA Banks (XUFB)**, which is cheaper with an ongoing charge of 0.12%. However, its performance is marginally worse than the iShares product on a one-year and three-year view.

DISCLAIMER: AJ Bell owns Shares magazine. The editor of this story (Tom Sieber) owns shares in AJ Bell.

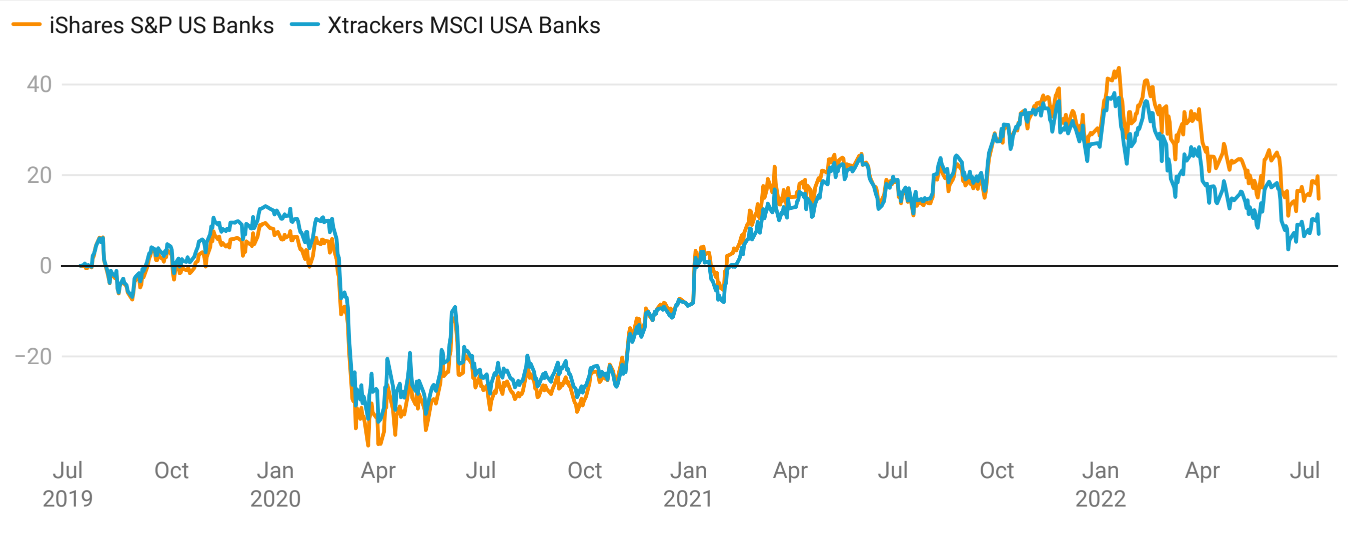
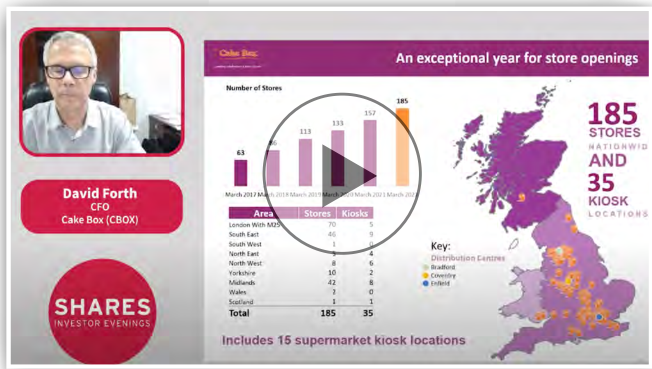


Chart: Shares magazine • Source: Refinitiv

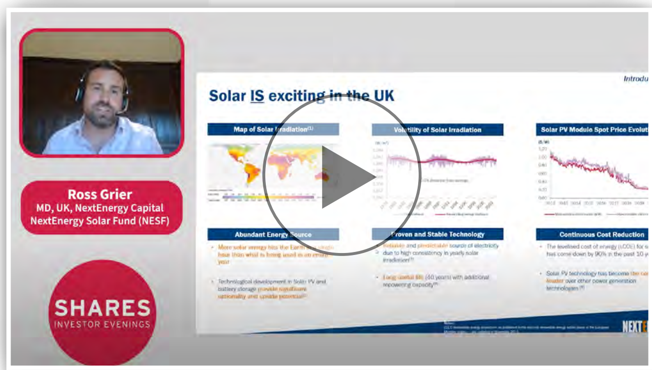
WATCH RECENT PRESENTATION WEBINARS



Cake Box

David Forth, CFO
and Chay Watkins, Marketing Director

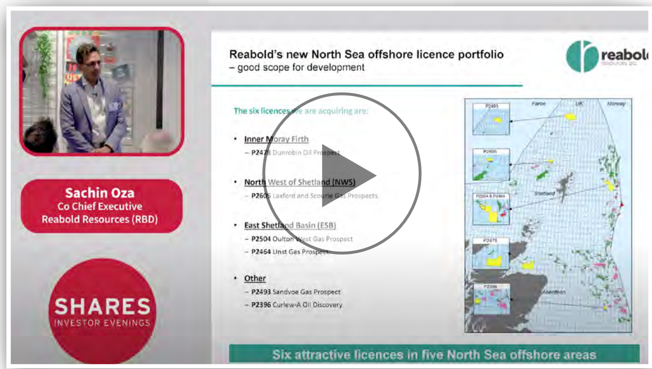
The company generates revenue from the sale of goods and services. Geographically, it derives revenue from the United Kingdom. All of our products are 100% egg free. The founders of Eggfree Cake Box follow a strict lacto vegetarian diet, and that is how they came up with idea for the company.



NextEnergy Solar Fund

Ross Grier, Managing Director

A specialist renewable energy investment company that invests in operating solar power plants and battery storage assets. NESF's investment objective is to provide ordinary shareholders with attractive risk-adjusted returns and is targeting a dividend yield of 7.52p for the current financial year. Since its IPO in 2014, NESF has invested £1,150m in high quality, diversified assets, and currently owns 100 operating solar plants.



Reabold Resources

Sachin Oza, Co Chief Executive &
Stephen Williams, Co Chief Executive

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

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

CLICK TO PLAY EACH VIDEO

SHARES SPOTLIGHT

www.sharesmagazine.co.uk/videos

Why Compass shares have beaten the FTSE 100 index this year

Shares are up 10% so far compared with a 5% fall for the benchmark

With all the gloomy headlines about rising interest rates, rising energy prices and a risk of recession it's easy to overlook the fact some companies are doing very nicely for themselves.

Take FTSE 100 food service company **Compass Group (CPG)**, whose shares are up 10% this year at £18.20, their highest level since March 2020, giving the firm a market value of over £32 billion.

BUSINESS AS USUAL

Despite fears of workplaces being unmanned due to the slow return to the office and the rise of remote working post-pandemic, Compass has seen its activity levels rise back towards pre-Covid levels this year.

In the three months to March, underlying revenues were 99% of the same quarter's revenues in 2019 thanks to strong demand in the US and Europe.

Organic revenue growth was close to 38% for the first half, leading the firm to raise its full-year growth forecast to 30% from 20% to 25% previously.

Growth was healthy across all divisions with a notable improvement in volumes in Business & Industry and Education.

The client retention rate was a record 95.8% in the half, while new business wins over the 12 months to March were also a company record at £2.5 billion, equivalent to a whole year's turnover more or less.

For many firms, being able to offer incentives such as providing food has helped greatly not just with attendance but also with staff retention and recruitment.

HIGHER RETURNS

The first half operating margin jumped from 3.4% to 5.8% as the firm kept cost rises down and is expected to continue rising in the second half with an anticipated exit rate of over 7% in September.

Higher inflation in food, energy and labour is encouraging more firms to consider outsourcing the food service operations which is generating 'significant market growth opportunities' for Compass.

The firm estimates it has around a 10% share of the £220 billion a year global market for food services, with around half of the market still operated by firms using 'in-house' caterers and another 25% of the market split between myriad smaller regional providers, giving it a long runway of growth.

After investing between 3% and 4% of revenues in the business and making bolt-on acquisitions, which have to pass strict return criteria, the firm is set to increase shareholder returns.

At the half-year stage it committed to pay out 50% of underlying earnings in dividends and to return any excess capital through buybacks and special dividends.

With revenues and earnings rising at a double-digit rate and the firm already having announced a share buyback of up to £500 million, total returns for this year are looking pretty attractive already.

By **Ian Conway** Companies Editor

Vietnam still looks one of the most attractive markets for investors

Amid turmoil in Asia-Pacific this fast-growing nation stands out

The Vietnamese market still looks an attractive destination for investment despite the risks hovering around the wider region.

International investors in Asia-Pacific and emerging markets in general have been put on high alert after widespread civil unrest in Sri Lanka which culminated in the resignation of the president and prime minister.

The island nation has faced months of protests about the state of the economy, and on top of spiralling food and fuel prices it is struggling with a huge interest bill on its foreign-currency debt.

Unfortunately, Sri Lanka isn't the only Asian country facing economic hardship and potentially a recession according to a survey of leading economists.

Asian economies' recession probability forecasts

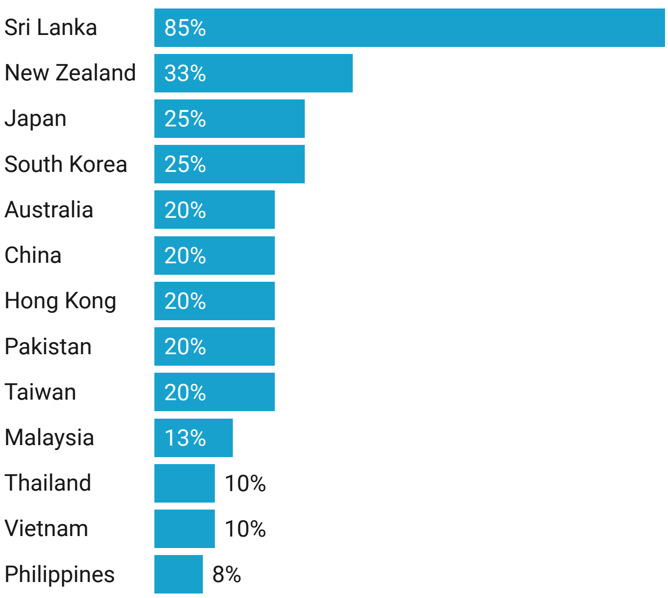


Chart: Shares magazine • Source: Bloomberg survey. Data correct as of 6 July 2022

RISKS RISING

The latest poll by Bloomberg suggests while Sri Lanka has an 85% chance of falling into recession in the next year, up from a 33% chance in the previous survey, economists have also raised their expectations of recession across the region.

China and Taiwan have a one in five chance of entering recession in the next 12 months, as does Australia, while Japan and Korea have a one in four chance and New Zealand's chances are one in three according to the survey.

In fairness, Bloomberg Economics' proprietary model gives the US a 38% chance of falling into recession in the next 12 months, compared with zero chance at the start of the year.

However, unlike the US, what is compounding investor worries about Asian economies is their high external debt levels and the risk of default.

MOUNTAIN OF DEBT

Emerging economies around the world could be on the precipice, according to Bloomberg, with a pile of close to $240 billion of distressed debt 'threatening to drag the developing world into an historic cascade of defaults'.

Lebanon stopped paying foreign bondholders for the first time in March 2020, followed by Sri Lanka this May and Russia last month.

The cost of insuring emerging market debt against non-payment has rocketed since Russia invaded Ukraine, with Egypt, Ghana, Pakistan and Tunisia all seen all vulnerable to default.

Even countries like Argentina, which has an estimated 74% ratio of government debt to GDP (gross domestic product) and whose sovereign bonds yield close to 21%, could be drawn into the downward spiral.

'With low-income countries, debt risks and debt crises aren't hypothetical. We're pretty much already there', said World Bank chief economist Carmen Reinhart on *Bloomberg TV*.

Of the $1.4 trillion of outstanding emerging market sovereign debt priced in dollars, euros or yen, around a fifth is trading at 'in distress', which means they are yielding more than 10% above US Treasuries with similar maturities, indicating potential default.

The concern among economists is that there could be 'contagion' or a domino effect if foreign bondholders decide to pull the plug, as has happened in previous crises.

Markets which on the face of it have no connection with each other could start to topple simply because investors start taking money out with no warning, as happened during the Asian crisis of the late 1990s and the Latin American debt crisis of the 1980s.

The current crisis is reminiscent of the 1980s, as rapid interest rate rises by the Federal Reserve to curb inflation are forcing the dollar higher, adding to the pain for developing countries already struggling to service their foreign debt.

Many emerging economies rushed to sell foreign-denominated bonds during the Covid pandemic when interest rates were rock bottom and their borrowing needs were high, but with central banks in the US and Europe raising rates capital is draining out of these markets again.

Now, with food and energy prices soaring and the threat of more political turmoil, some countries may decide, somewhat understandably, that what little reserves they have would be better off spent helping their own citizens rather than repaying foreign bondholders.

Vietnam in numbers

Nominal GDP (2022 Est)	**$376 billion**
GDP Growth (2022 Est)	7% to 8%
Inflation (June 2022)	3.4%
Exports/GDP (Est 2022)	104%
Consumption/GDP	>70%
FDI (2022 Est)*	$24 billion
FX reserves (May 2022)	$110 billion
Market Size	$270 billion
Market valuation (price to earnings ratio)	9.4x
EPS Growth (2022 Est)	21%

Table: Shares magazine • Source: GSO (Government Statistics Office), VEIL. Data correct as of 30 June 2022. * Foreign Direct Investment

NOTABLE EXCEPTION

One country which isn't on the list of potential defaulters and has just a 10% risk of entering recession in the next 12 months, according to Bloomberg, is Vietnam.

A so-called 'edge' market, because it borders China, Vietnam has a growth record most nations would be proud of, a low debt to GDP ratio and plenty of foreign currency reserves.

GDP rose by 7.7% in the second quarter, the strongest April-June increase since 2011, bringing first half growth to 6.4% and leading international economists to raise their full-year estimates.

Industrial production for the first half rose by 8.5%, while exports increased by 17.3% to $186 billion creating a small trade surplus.

Meanwhile, the ratio of sovereign debt to GDP is just over 40%, lower than China (78%) and South Korea (52%), as the government resisted splurging on welfare and social spending during the pandemic unlike other Asian countries.

Having been badly affected during the global financial crisis, fiscal discipline and monetary stability are now ingrained.

Vietnam is also one of the few countries worldwide to enjoy positive real interest rates, as inflation is just 3.4%, although rising oil costs are pushing items such as transportation up by double digits.

Crucially, food price inflation isn't an issue as the country is largely self-sufficient in basic foodstuffs such as rice, grains and fish, and it is a major exporter of agricultural products to the US, China and Japan.

Another positive for the nation is that, due to the breakdown in global supply chains following the sudden demand surge post-pandemic, there has been a record increase in foreign direct investment this year.

Among others, US tech giant **Apple (AAPL:NASDAQ)** is relocating iPad manufacturing from China to Vietnam while Chinese smartphone maker Xioami has opened a new plant in the country.

As a result of its economic growth and success in attracting foreign investment, S&P Global Ratings upgraded Vietnam's long-term sovereign credit rating in May from BB to BB+ with a stable outlook, one notch below investment grade.

VALUE OPPORTUNITY

Despite its strong economic performance, however, the Vietnamese stock market has been a victim of the unwinding of global risk positions with the Ho Chi Minh stock index down nearly 22% year to date.

Dien Vu, manager of UK-listed investment trust **Vietnam Enterprise Investments Limited (VEIL)**, argues the biggest stocks in the market are growing their profits by more than 20% this year, putting the index at a five-year valuation low of nine times prospective earnings.

On the one hand it's reasonable to expect economic growth to moderate in the second half, while inflation could continue to creep up.

However, with oil making up more than half of the increase in inflation the recent fall in crude as a result of demand destruction in markets like the US should be enough to offset rising material input prices.

There could also be a major catalyst for the market down the road when the global index compilers like MSCI and S&P finally put Vietnam on their emerging markets 'watch list'.

There are a couple of reasons why the country doesn't yet feature in the emerging markets indices, the main one being the market isn't open to foreign investors.

The simple reason for this is the government doesn't want its much larger northern neighbour piling in and buying up large swathes of the economy.

The regulator is in the process of allowing Vietnamese companies to issue non-voting depository receipts, or NVDRs, which will have the same dividends and rights as ordinary shares without a vote.

Vietnam's prime minister is pushing hard to allow foreign investment in the market, which will go a long way to getting the country on the 'watch list'.

Once the country officially joins the emerging market indices, there will be a huge inflow of money as big global investors scramble for a piece of the pie.

BEAT THE CROWD

For UK investors, there are already a couple of ways to invest in Vietnam through London-listed, country-specific investment trusts which are all trading at a discount to net asset value, meaning they offer a 'double discount' to the market's usual valuation.

The largest is Vietnam Enterprise Investments, which has £1.6 billion of assets and trades at a 20% discount to net asset value with an ongoing charge of 1.89%.

This is followed by **Vietnam Opportunity Fund (VOF)** with £980 million of assets, also trading at a 20% discount and with an ongoing charge of 1.64%, and **Vietnam Holding (VNH)** with £104 million of assets, trading at a 16% discount with an ongoing charge of 2.52%.

DISCLAIMER: The author owns shares in Vietnam Enterprise Investments Limited.

By **Ian Conway** Companies Editor

Explaining the basics around shares and how they can make you money

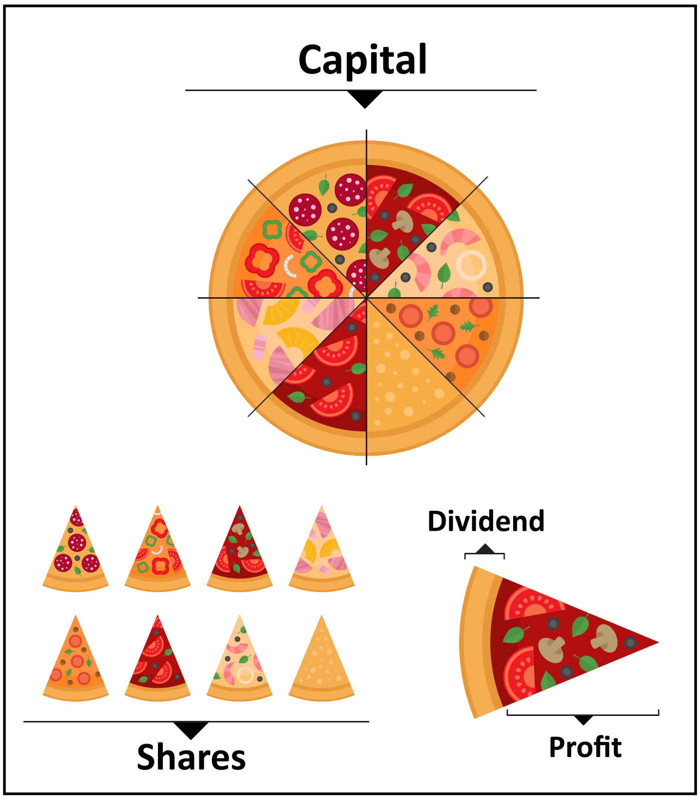
Share prices may move around a lot in the short-run, but over the long-run they tend to track profits

What are shares, why do they exist, what rights do their holders enjoy and how can you make money from owning them?

In this article we will answer these questions and help give you an introduction or refresher on the basics of share ownership.

When companies list on a stock market they divide their capital into shares with each share representing a percentage ownership of the company.

The primary function of the stock market is to raise capital for growth. It also provides an opportunity for owners should they wish to convert some of their 'paper' wealth into cash.



Source: Shares magazine

The main reason for owning shares is to participate in growth and hopefully get rewarded in time through a rising share price (capital gain) and dividends (income).

ONE SHARE ONE VOTE

Owning more shares increases an investor's economic interest in a company as well as providing bigger voting power. For example, investor John owns 100 shares of a company which has 100,000 shares outstanding.

John owns an economic interest of 0.1% in the company (100 divided 100,000).

In most companies one share represents one vote at shareholder meetings. This means John would have 0.1% voting power.

But there are other classes of share which have restricted rights or no voting rights as well as classes which convey additional rights. These structures are also referred to as dual-class structures.

Dual-class structures are more common in the US. They appear in large technology firms like **Meta Platforms (META:NASDAQ)**, better known as Facebook and **Alphabet (GOOG:NASDAQ)**, better known as Google.

Meta's 'B' shares give holders 10 votes rather than one which allows founder Mark Zuckerberg to control the company since he controls around 90% of the B shares.

In the UK the stock exchange Listing Rules were amended in 2021 to allow dual-class structures. The idea was, in part, to encourage entrepreneurs to list in London.

The critical difference between UK and US dual-class structures is that in the UK founders are not allowed to use their extra voting rights to determine the composition of the board.

The rules apply to companies listed on the premium segment of the London Stock Exchange. This has higher governance standards compared with a standard listing.

Recent newbies to the stock market **Deliveroo (ROO)** and **Wise (WISE)**, are both listed on the standard segment and have elected to adopt US-style dual-class structures.

Deliveroo has said it will move to a single class of share after three years on the stock market. It listed in March 2021.

KNOW YOUR RIGHTS

Shareholders can attend annual general meetings and extraordinary meetings and vote on company resolutions. These range from appointing directors and auditors to approving certain acquisitions.

A copy of the annual audited accounts must be made available to all shareholders.

The Companies Act requires companies to operate lawfully and within a company's constitution. In most circumstances, shareholders have a right to sue a company to make it act lawfully.

MAKING MONEY FROM SHARES

Shareholders can make money from shares in two ways: the distribution of (some or all) profit in the form of dividends, and capital gains. Together these are known as total shareholder return.

Dividends are discretionary items. Most firms strive to maintain a consistent dividend policy but there is no legal obligation to pay them.

In 2020 dividends were cut across the board as companies struggled during Covid lockdowns.

For investors not reliant on dividends for income, it is important to reinvest dividends to capture the maximum potential total return. An example will help illustrate this.

Our investor from earlier John buys 100 shares at £10 for an investment of £1,000. The company pays a 5% dividend yield which means John receives a £50 dividend, enabling him to buy five more shares.

A year later the shares are £11 which represents a 10% return. But John now owns 105 shares which equates to an investment value of £1,155, or a return of 15.5%. (£1,155 divided by £1,000 minus 1 x 100)

Over time reinvesting dividends can significantly boost total returns.

CAPITAL GAINS ARE UNCERTAIN

As mentioned at the start of the article investors own shares primarily to participate in the future growth of a company.

Theoretically, bigger profits should drive a higher share price, resulting in capital gains for shareholders.

In practice it is not quite as straightforward. Expected profit may not materialise and an added complication to consider is that market expectations for growth might be too high.

Expectations are captured in the PE (price to earnings) ratio. This is simply the share price divided by expected earnings per share. A higher PE implies more growth.

Any dampening in expectations will be reflected in a lower PE which generally means a lower share price.

As investors have experienced over the last few months higher interest rates can reduce the PE because they lower the theoretical value of future profits.

A good example is specialist distributer of industrials controls, seals, and life science equipment **Diploma (DPLM)**.

Diploma's PE has dropped from 36 times expected 2022 earnings per share in December 2021 to 23 times, a fall of 36%, pushing the shares down by a similar magnitude.

This is despite expected earnings per share rising from 92p to 103p over the same period.

Remember, the same risk factors can work to an investor's benefit. That is, rising growth expectations and falling interest rates can drive a PE higher.

By **Martin Gamble** Education Editor

The risks of getting sucked into high yielding motor insurers

Sabre profit warning has led to big sell-offs at rivals Admiral and Direct Line

Shares in motor insurance group **Sabre (SBRE)** and **Direct Line (DLG)** both slumped heavily on profit warnings on 14 July and 18 July respectively.

This has led to selling across the wider peer group and has pushed dividend yields to double-digit levels in some cases. However, there are big risks to consider for investors attracted to this generous-looking income.

Sabre is now guiding for earnings per share declines of 70% in 2022, and 30% in 2023.

According to consensus estimates, at the current share price fellow motor insurer **Admiral (ADM)** offers a 9% dividend yield for 2022, falling to 6.9% for 2023.

Direct Line offers a 10.8% dividend yield and an eye-watering 11.3% dividend yield next year.

However, Direct Line has indicated it will cancel a planned share buyback and keep the dividend flat for now. Investment bank Jefferies has reduced its own dividend estimates by 36%.

This demonstrates the risks of investing in a stock with a very high yield, particularly without serious investigation. Often it is a sign that payouts are unsustainable.

Thanks to a combination of escalating claims inflation and declining volumes motor insurers are experiencing a big drop in their combined ratio. This is calculated as expense claims and costs divided by the premium.

This should not come as a huge surprise when you consider that during the pandemic people still paid to keep their cars insured but were less likely to be on the road and therefore claims fell substantially. That situation has now unwound and it will likely take some time for premiums to catch up with claims inflation.

SABRE SLICES DIVIDEND

As a result of the tough backdrop Sabre's management has already said it will cut its dividend for this year.

Sabre is considered to be one of the better performers in the market and it is reasonable to assume that if is encountering difficulties then other insurers are also feeling the pain.

In theory Direct Line is more diversified than its peers, given that the group has a sizeable home and commercial line business.

By owning its repair garage network DLG Auto Services, Direct Line has been able to keep underlying claims inflation at lower levels than its competition, giving it a competitive advantage.

Currently 55% of work goes through DLG Auto Services but the longer term aim is for 70% of repairs to go through the centres.

Berenberg recently noted that, in the context of the recent weakness in the Admiral share price, the group has a proven track record of outperformance in a competitive environment.

However, the severity of Sabre's warning will have given investors pause for thought. Direct Line posts first half results on 2 August with Admiral following suit on 10 August.

By **Mark Gardner** Senior Reporter

The key considerations to factor in before selling a share

This is one of the hardest decisions for investors but having a simple framework can make the process less difficult

Following the collapse of global stock markets this year, many observers may think the 'when to sell' boat has been missed. Not so. History shows that investors consistently get this wrong, buying high and selling low, despite the opposite being the objective.

Many investors sit on poorly performing stocks in the hope that they will eventually recover. Others get timing hopelessly backward, selling perfectly good companies after a sharp stock market fall, fearing running up even larger losses when recovery is just over the horizon.

BABY OUT WITH THE BATHWATER

Here's an example. In October 2016, shares in ID management and fraud prevention software company **GB Group (GBG:AIM)** lost a third of its value after reporting mildly disappointing growth and a slow start on an online identity verification programme for the UK government.

Chart: Shares magazine • Source: Refinitiv

In response *Shares* said at the time that this was a heavy-handed market response to a short-term hiccough, but no doubt plenty of ordinary investors shared the market's cold feet and sold the stock.

Big mistake. By the summer of 2017 the share price had recovered all of its previous losses and more at close on 400p. The stock was close to 600p another 15 months on, and had surged

beyond 900p late last year, before the latest market shake-out took hold.

GB is not unique but serves as a lesson in keeping your emotions in check, reassessing your investment thesis, and acting accordingly when a bad spell strikes a company you have previously backed. Just because a share price has fallen sharply doesn't necessarily mean you should ditch a company.

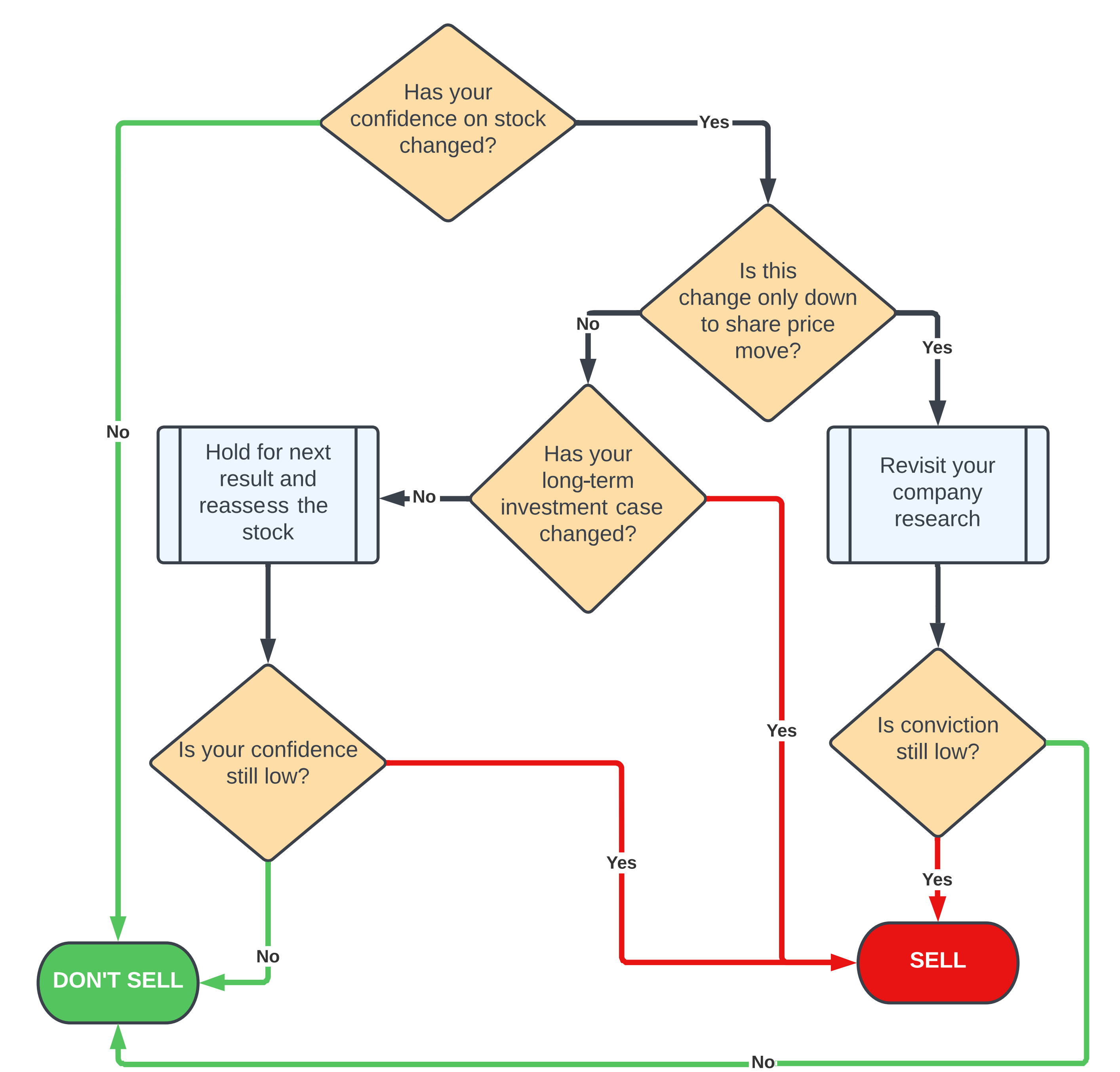
What investors should do is ask yourself some tough questions, such as has the fundamental investment thesis changed, are you simply reacting to a share price fall, and is it worth monitoring the stock a little longer to see if your continued confidence is justified? All easy to say, harder to do, but to make this process easier for readers, we have provided a simple decision flow chart (see graphic overleaf).

MARKETS GO UP AND DOWN, GET USED TO IT

Put simply, market falls are a harsh reality of buying shares, and if the possibility that you may not get back all that you have invested scares you, equity markets are probably not for you. But for millions of investors, the potential to grow their real-terms wealth over many years makes the risks worthwhile.

That the MSCI World Index has lost 21.4% this year shows the widespread nature of the current

How to decide if you should sell or not



Source: Shares magazine

stock markets shake out, even if some popular indices have done better.

The FTSE 100, for example, is down just 5% or so. But it does mean that many ordinary investors who hold individual shares now know what it feels like to buy a share that drops sharply in price if they didn't before.

Today's challenges are not the same as previous downturns, and stocks that bounced back quickly in the past might not this time, and vice versa.

Storied investor Warren Buffett says his ideal holding period for an investment is 'forever'. Yet few investors are as skilled and confident as Buffett, whose 'forever' strategy relies on only buying high-quality businesses capable of withstanding periodic trading challenges and have the capacity to adapt to a changing business environment.

Think about how **Greggs (GRG)**, for example, has emerged from being a high street baker to today's hot and cold snacks on-the-go operator.

A decade ago, many investors may have wondered if Greggs might go the way of Percy

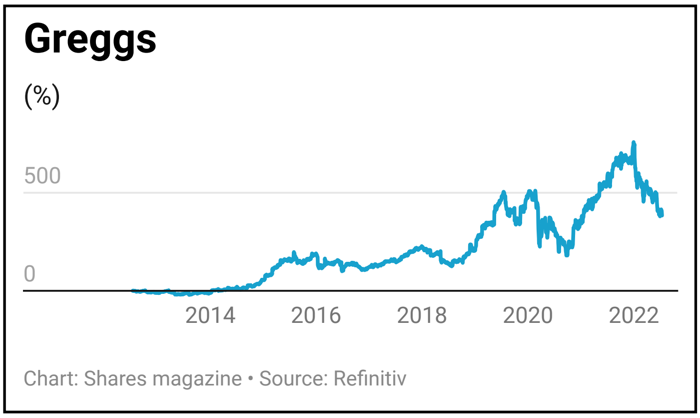


Chart: Shares magazine • Source: Refinitiv

Ingles as competition intensified and consumer behaviour changed. Go back a decade and Greggs shares were a quarter of today's £18.57, and that's having halved this year. Dividends over the decade bolster value creation further still.

Many people are looking for easy answers to difficult questions, and there are plenty willing to try to provide them. For example, equities experts at **Barclays (BARC)** say keeping emotions out of your investment decisions helps.

Barclays also advises fixing a price at which you automatically sell a share and identifying overvalued stocks and avoiding them in the first place. Taking a cold and clinical approach to investment decisions is, we believe, sound advice as is, in principle, not buying overvalued stocks, even if this is highly subjective.

For example, in November 2021 investors thought £340 was a fair price to pay for **Microsoft (MSFT:NASDAQ)** shares. Today, the market thinks $250 is closer to the right figure, despite its long-run growth opportunity being barely dented by current events. What has changed is the attitude of investors who are reacting to what may well be relatively short-term factors, such as spiralling inflation.

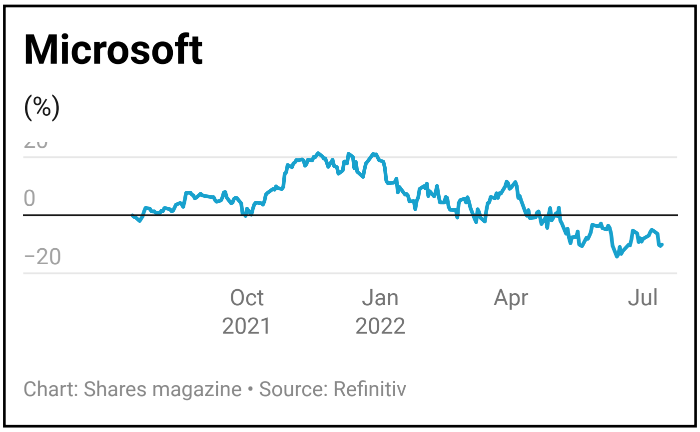


Chart: Shares magazine • Source: Refinitiv

Forcing yourself to sell winners at a fixed price is more controversial still, we would argue. 'It's never wrong to bank a profit', some say, yet that ensures that followers of this investment maxim are prepared to miss out on the compounded benefits of growth earned over decades.

COMPOUNDED GROWTH RETURNS OVER YEARS

Take health, safety and environmental electronics firm **Halma (HLMA)**. It has earned a premium rating thanks to years of consistent, high-quality growth, yet with a price to earnings multiple typically in the 30s, many fund managers and ordinary investors have refused to buy the shares.

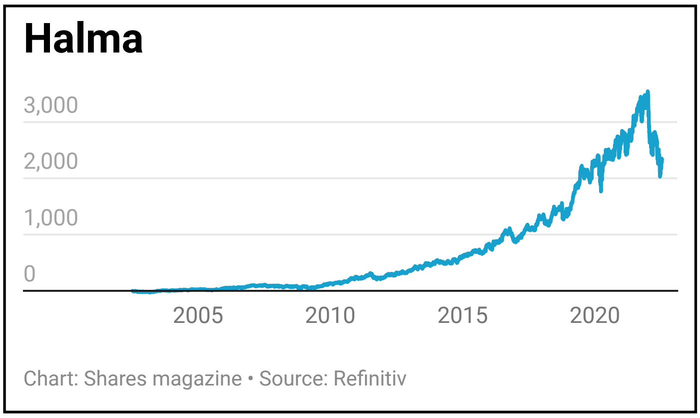


Chart: Shares magazine • Source: Refinitiv

In June 2022 it reported its 19th consecutive year of record profit, and while 2022 has been a tough year for the stock, like so many others (down 34% year-to-date), the value and wealth creation for long-term holders has been astonishing, with a 20-year total return of more than 3,200% at its recent peak, and still above 2,000% at the current lower price, according to FE Analytics.

Shares believes that investors benefit most, not by being told by experts or recent share price performance, that they should sell a share. But by being armed with a framework within which they can draw their own conclusions.

There's a reason why deciding when to sell a stock is widely seen as one of the most difficult decisions investors face. We hope that by providing readers with a simple framework, they will find future decisions, if not easy, less difficult to make.

By **Steven Frazer** News Editor

SHARES
INVESTOR EVENINGS

Sponsored by AJBell Youinvest

Find more information at

www.sharesmagazine.co.uk/events

DANNI HEWSON
AJ Bell Financial Analyst

Will advertising model prove a winner for struggling Netflix?

The outlook has become a lot weaker for the streaming giant and it is changing tack

The announcement that **Netflix (NFLX:NASDAQ)** is to offer a cheaper ad-supported option to subscribers came as no surprise to anyone.

Even as far back as 2011 there was pressure on the streaming giant to find a way to make more money in a bid to cover growing costs for content. It held firm and with a little help from lockdowns enjoyed a pandemic boom which saw subscriber numbers soar.

But all good things must come to an end and a perfect storm of inflationary pressures, increased competition and the opening up of other forms of entertainment sent Netflix's numbers tumbling in the wrong direction with the business warning that worse is still to come.

Netflix subscriber numbers (millions)

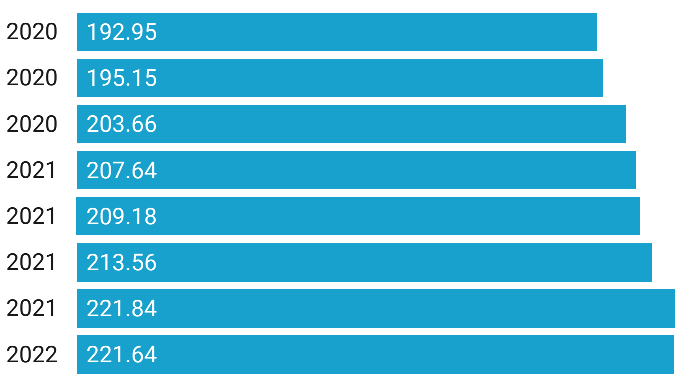


Chart: Shares magazine • Source: Netflix

Investors have been rattled; billions have been wiped off the company's value since the start of the year. But the last few weeks have seen a slight shift, a small reversal in sentiment as Netflix plays what many see as its trump card.

And it might be right, certainly the dual model has worked brilliantly for music service **Spotify (SPOT:NYSE)**, more than half of its monthly active users choose the free option according to its March trading update. And right now, consumers like free, especially younger consumers.

Latest figures from market research firm Kantar suggests that people are stopping their video streaming subscriptions in their droves with 18–24-year-olds leading the charge. The reason, no surprise, it's all down to the need to cut costs in a bid to make ends meet.

HOW WILL AD SPEND HOLD UP IF RECESSION BITES?

But is now really the right time to be dallying with advertising which always takes a hit when economies falter. And exactly how low will Netflix go when it comes to cost? The company hasn't given much detail about its price point but when you look at how much Netflix rival **Roku (ROKU:NASDAQ)**, which does carry ads, pulls in per user (at the company's last update this was $42.91) you get an idea of what Netflix stands to make on

DANNI HEWSON
AJ Bell Financial Analyst

top of any pared down subscription charge.

However, one of the first areas many companies look to cut costs during times of economic distress is with their marketing and advertising.

The first lockdowns took a sizeable bite out of ad spend according to the UK's Advertising Association and figures from an Interactive Advertising Bureau survey in March 2020 showed a quarter of US companies paused ad spend in the second quarter of 2020 with nearly half reducing their advertising budgets.

During Covid the travel and hospitality businesses sheared off their ad budgets to save cash. Traditional media bore the brunt and taking look at **ITV's (ITV)** ad revenue numbers you can see the picture clearly.

Ad revenue fell by £200 million in 2020 and though it's recovered, and even surpassed levels seen in 2018 the pandemic has shifted the focus of advertisers further into the online space. It's all about metrics, lots of lovely data that companies can extrapolate and harness to better serve and target their customers.

ITV total advertising revenue (£ billion)

Chart: Shares magazine • Source: ITV

While ITV's share price hasn't taken a Netflix-sized tumble it is down more than 40% over the year to date. It's potentially got a couple of aces up its sleeve, the first is this winter's World Cup, that appointment to view that delivers an opportunity for sponsorship deals and sky-high ad buys.

Plus, there's a chance that Ofcom might change the rules and allow longer and more frequent ad breaks as part of a review into broadcasting rules which is expected to be published in the summer.

Traditional broadcasters aren't just battling each other for eyeballs, they're also having to compete with the streaming services which are spending more and more on content.

And that brings us full circle, back to competition. And when you're thinking about competition not just for eyeballs but also for advertisers then **Alphabet's (GOOGL:NASDAQ)** YouTube is right at the top of the pile particularly with younger audiences, those with either pester power or disposable income.

Its business model is genius. A video sharing platform where all the content is uploaded by 'creators'.

Successful content gets ads placed against it via pre-roll displays and creators can get a sizeable chunk of the advertising revenue, sponsorship deals and the opportunity to sell merchandise to fans. Alphabet scoops up the rest of the cash and revenues are soaring.

Worldwide Youtube advertising revenue ($ million)

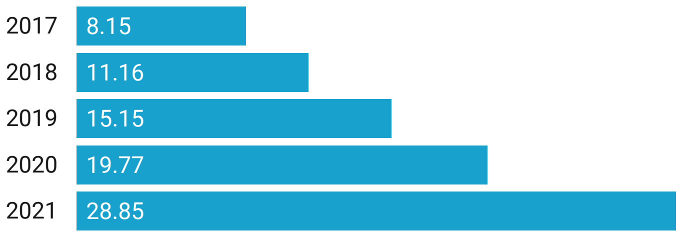


Chart: Shares magazine • Source: Alphabet

But YouTube has its own competition in the form of TikTok and there are plenty of analysts predicting that TikTok's advertising revenue will surpass that of YouTube in just a couple of years.

In the same way streaming services seem to have drunk the well dry of paying subscribers there will be a ceiling on how much ad money is floating around as global economies cool.

Companies might know the value of marketing; they might hear warnings that during difficult times they should spend more to position themselves for quick growth when the economic landscape improves. But it's hard to justify the expense to shareholders when margins are being eroded.

Holiday reading for anyone who wants to learn more about investing

Highlighting some of the best books which will help you understand how the markets work

The summer holiday season is upon us, and those who are brave enough to be risking travel disruption in search of more exotic climes will no doubt be thinking about what reading material to pack for whiling away the hours on the beach, or in the airport departure lounge.

An engrossing bestseller will often be the order of the day, but if you don't want to switch your brain off entirely, and would like to learn a bit about investments and markets along the way, the following books might be worth considering. It's by no means an exhaustive list of all that financial literature has to offer so do have a scan around yourself if nothing takes your fancy. In no particular order:

LEARNING FROM LYNCH

One Up on Wall Street by Peter Lynch is a highly influential book about how ordinary investors can use their nous and a bit of research to beat the market. If you have heard the phrase 'tenbagger' – a stock that rises in value by ten times after purchase – this is where it comes from.

Peter Lynch was manager of the Fidelity Magellan fund between 1977 and 1990, taking the assets under management from $18 million to $14 billion at the end of his tenure, both through performance and attracting inflows.

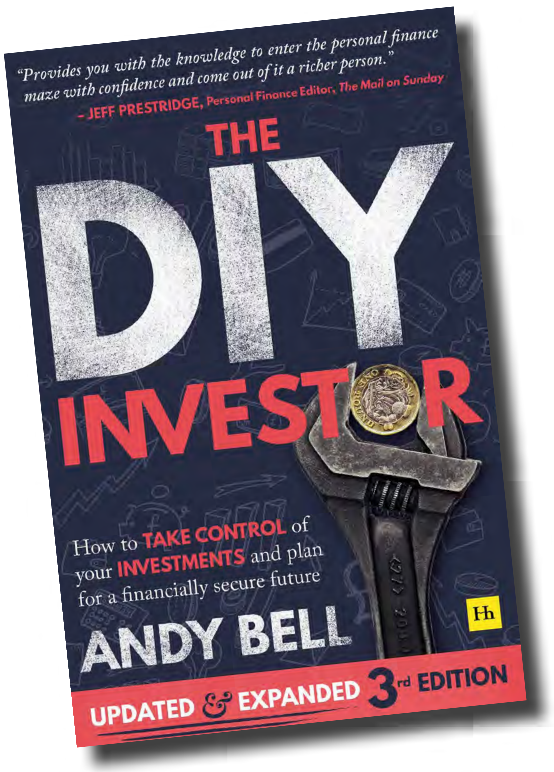
Freakonomics by Steven Levitt and Stephen Dubner, along with *The Undercover Economist* by Tim Harford are both super-accessible and look at how economics and incentives, both financial and otherwise, work in everyday life. Tim Harford also presents the BBC radio show and podcast *More or Less*, which is worth dipping into if you're interested in everyday statistics.

To give you a flavour, my favourite snippet from *Freakonomics* was the story of the child day care centre which had a problem with parents picking their children up late. They decided to fine parents $5 each time they didn't turn up to collect their child promptly, and were shocked to find the number of parents showing up late increased significantly. The $5 fine actually relieved parents of the guilt of turning up late, as they'd effectively paid for more day care, which demonstrates that financial motives are not the only ones which dictate human behaviour.

Two companion books which are eminently digestible are Joel Greenblatt's *The Little Book That Beats the Market* and John Bogle's *Little Book of Common Sense Investing*.

Greenblatt is a renowned US active fund manager who shares his secrets about how to beat the market, while John Bogle was the founder of the asset manager Vanguard, who explained why the most effective way to build wealth is by investing in low-cost index funds. Two very contrasting takes, which reinforces the old adage that it takes two views to make a market.

A NO-NONSENSE DIY GUIDE



If you're looking for a no-nonsense, self-help guide to saving and investing in the UK, then look no further than *The DIY Investor*, by **AJ Bell's (AJB)** founder, Andy Bell. The book proceeds through the concrete steps you can take to get in control of your personal finances, and to build a portfolio while keeping costs and taxes in check. Jargon is unapologetically busted, and the complexities of financial products simplified. It's a book you can return to again and again to keep your personal finances on track.

I reckon you can pick up anything by Michael Lewis and you'll be utterly engrossed, but my pick of the litter would be *Liar's Poker*. You won't learn too much that's tangibly useful in your day-to-day investing life, but it gives a real historical insight into 1980s Wall Street, and reads like a Michael Crichton thriller.

It documents the toxic culture of the Wall Street investment bank, Salomon Brothers, and in particular the excesses of its bond trading desk. It's an eye-opening, first-hand account of some truly despicable behaviour, and a cautionary tale of what happens when unchecked greed is the only game in town.

John Meriwether, one of the Wall Street bond traders from *Liar's Poker*, shows up in Roger Lowenstein's *When Genius Failed*, a more sober but nonetheless fascinating story of the collapse of the hedge fund Long Term Capital Management.

Built and run by Meriwether and a couple of Nobel prize-winning economists, the demise of this fund almost brought financial markets to their knees, and required the US government to step in and organise a bailout. It's a cautionary tale of why academic brilliance doesn't necessarily translate into investment success, particularly when it's combined with complexity, leverage, and hubris.

A BIT OF BUFFETT

Finally it would be remiss of me not to mention the world's most famous investor, Warren Buffett, about whom so much has been written. If you want to hear things from the horse's mouth though, *The Essays of Warren Buffett* is a wide-ranging and insightful read, though the title leaves a lot to be desired. For those who want a more personal insight into what makes Buffett tick, Alice Schroeder's biography *The Snowball* might go well with a Pina Colada on the beach.

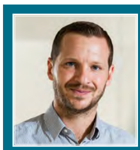
DISCLAIMER: Financial services company AJ Bell referenced in this article owns Shares magazine. Tom Sieber who edited this article owns shares in AJ Bell.

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

Help, I've nearly breached my lifetime pensions allowance and my 75th birthday is near

Our resident expert helps with a query about avoiding a tax charge

I turned 70 last month and haven't yet started taking an income from my pension. My fund enjoyed 20% growth last year and as a result I'm perilously close to the lifetime allowance. I'm thinking about withdrawing some money from my SIPP and putting it in an ISA to keep below the lifetime allowance as my 75th birthday approaches. Is this sensible?
Robert



Tom Selby, AJ Bell Head of Retirement Policy says:

As with many things in this complicated part of pensions, the answer is 'it depends on your circumstances'.

The lifetime allowance, currently set at £1,073,100, is designed to limit the amount you can save tax-efficiently in UK pensions. If you breach your lifetime allowance you will pay a lifetime allowance charge on the excess.

This lifetime allowance charge will be:

- 25% if you leave the excess in your pension and take it as an income, with income tax levied on top of that;
- 55% if you take the excess as a lump sum, with no income tax due.

There are a number of 'benefit crystallisation events' that trigger a lifetime allowance test, including taking your 25% tax-free cash, buying an annuity or entering drawdown.

There is also a test at age 75 which is designed to capture any growth in your crystallised fund value, plus any as-yet uncrystallised funds you have.

For example, at age 70 someone might have crystallised £750,000 in drawdown and £250,000 by taking their 25% tax-free cash – £1 million in total. This would use up 93.18% of their lifetime allowance (assuming they are entitled to the standard lifetime allowance of £1,073,100).

If over the next five years their fund increases in value to £1.3 million then the age 75 test will capture that growth – meaning a lifetime allowance charge would be payable.

The simple answer to the question 'could you take money out of a pension to avoid the age 75 test' is 'yes'. However, whether that will benefit you or not will depend on your circumstances. You certainly won't be able to dodge the lifetime allowance test altogether.

If your investments have gone up by 20% in single year that suggests you've taken a fair amount of risk – and therefore your investments could also fall in value significantly in any given year. If this happens, a large withdrawal designed to reduce your tax burden may in fact increase your tax burden.

This is probably easiest to illustrate with an example.

Take someone aged 74 with a crystallised £1.2 million fund who withdraws £200,000 to avoid paying a lifetime allowance charge on their drawdown fund at age 75.

For simplicity, let's assume this is their only income and so they pay almost £70,000 in income tax – including paying higher and additional-rate tax on portions of the withdrawal.

Over the year their investments drop in value by 20%. Based on the original value of £1.2 million, this would imply at age 75 their fund would have been worth £960,000 had they done nothing – well below the lifetime allowance.

They could then have managed their income after the age of 75 to minimise their tax liability – for example by ensuring they never pay more than basic-rate income tax.

If passing money onto loved ones is a consideration, you should also bear in mind that pensions are usually free from inheritance tax and can be passed on tax-free to loved ones if you die before age 75. After age 75, income tax is payable at the beneficiary's appropriate rate – but withdrawals can be managed to minimise the tax due.

Money held in an ISA, on the other hand, is always free of income tax but will form part of your estate for IHT purposes (although it is possible to gift money while you're alive to reduce any potential IHT bill).

In short, this is far from straightforward and whether your approach reduces the amount of tax you pay will depend on circumstances.

For this reason, I'd strongly recommend engaging the services of a regulated adviser, who can help you make the best decision based on a review of your entire financial position.

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.

READ MORE STORIES ON OUR WEBSITE

***Shares* publishes news and features on its website in addition to content that appears in the weekly digital magazine.**

THE LATEST STORIES INCLUDE:

SUPREME CEO SPLASHES OUT OVER £400,000 ON SHARES FOLLOWING RECENT PROFIT WARNING

ASTON MARTIN LAGONDA SHARES RACE AHEAD 25% ON NEW SAUDI INVESTMENT

SHARESMAGAZINE.CO.UK

SIGN UP FOR OUR DAILY EMAIL

For the latest investment news delivered to your inbox

INDEX

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

22 July: FRP Advisory. **26 July:** Games Workshop, Gore Street Energy Storage Fund, Trifast.
27 July: Hargreaves Services, Yourgene Health.
28 July: SRT Marine Systems.

Half-year results:

22 July: Beazley. **25 July:** SThree. **26 July:** Franchise Brands, Gresham Technologies, Unilever. **27 July:** Breedon, Ibstock, Lancashire, Lloyds, MusicMagpie, Nichols, Primary Health Properties, Quartix Technologies, Reckitt Benckiser, Rio Tinto, Smurfit Kappa, Unite. **28 July:** Barclays, Centrica, Hammerson, Inchcape, Rathbones, RELX, Rentokil, Restore, Robert Walters, SEGRO, Shell, Smith & Nephew, St James's Place. **29 July:** AIB, Croda, HarbourVest Global Private Equity, Intertek, Jupiter Fund Management, Morgan Advanced Materials, NatWest, Rightmove.

Trading updates

27 August: Wizz Air

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

EDUCATION EDITOR Martin Gamble @Chilligg

SENIOR REPORTER: Mark Gardner

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

COMPANIES EDITOR Ian Conway @SharesMagIan

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

PRODUCTION
Head of Design: Darren Rapley
Designers: Rebecca Bodi, Kevin Sharpe

CONTACT US: support@sharesmagazine.co.uk

Website: sharesmagazine.co.uk
Twitter: @sharesmag

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

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