STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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MORE CHOICES FOR INCOME

Why dividend-paying funds still appeal despite better cash rates

NETFLIX Investors are getting excited about big advertising move


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Contents

What can GSK do to catch up with its global health care rivals?

Pharma firm has come a distant second place to UK peer AstraZeneca for years

It's been a tough few years for UK pharmaceutical giant **GSK (GSK)**. Arguably the time is ripe for health care stocks. They enjoy decent pricing power, demand is relatively uncorrelated to a troubled global economy and margins are typically strong.

Added to this, the Covid-19 pandemic offered a reminder of just how crucial the sector's products and services are. However, while **AstraZeneca (AZN)** shares have doubled in the last five years and recently traded at record highs, GSK is pretty much flat over the same period.

This is reflected in their respective stock market valuations, AstraZeneca trading on 16.7 times 2022 earnings while GSK is on a price to earnings ratio of just 10.8 times. Can GSK do anything to change this, starting with its imminent third quarter update on 2 November?

Several factors have held the share price back. Despite being much more experienced in the development of vaccines, GSK was left behind by its UK peer AstraZeneca which teamed up with Oxford University to develop a Covid jab which, while not without its issues, was vital in the battle against the disease.

The company has also struggled to generate returns commensurate with its research and development spend and this has undermined its case for keeping dividends flat to prioritise R&D and subsequently rebasing the payout after the spin-off of its consumer health arm which now trades as **Haleon (HLN)**.

More recently risks from US litigation associated with claims its Zantac heartburn treatment might have links to cancer have hit the stock – with a key trial date coming in February 2023.

However, there are signs that GSK might finally be able to deliver meaningful growth – a new respiratory syncytial virus (RSV) vaccine candidate is seen as highly promising. With no vaccine in place for the prevention of RSV, the company has touted a similar potential to its flagship shingles vaccine Shingrix with sales of up to £3 billion.

Chart: Shares magazine • Source: Refinitiv

Shingrix continues to perform well and so are the company's roster of HIV drugs. Chief executive Emma Walmsley, in place since 2017, will have to deliver sooner rather than later though, or her position might come under greater scrutiny.

By **Tom Sieber** Deputy Editor

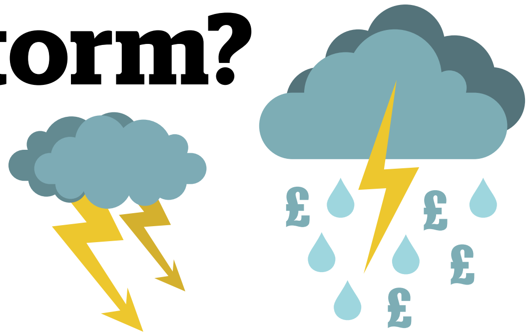
MARK GARDNER

It is with great sadness that we announce the death of *Shares* journalist Mark Gardner.

Mark started his career in the 1990s focusing on the tech, media and telecoms space. After working for several investment banks, he spent nine years at research group Gartner before joining *Shares* in 2021, where he became a highly respected member of the team.

Everyone at *Shares* and AJ Bell would like to extend their deepest condolences to Mark's family.

Markets steady as Sunak becomes PM, but is this the calm before the storm?



It would be unwise to rule out further surprises

UK financial markets gave their verdict on the victory of Rishi Sunak as the next prime minister with 10-year gilt yields dropping 22 basis points and the pound moving higher.

Despite the relative calm unfolding after an extraordinary period of political chaos the UK's cost of borrowing remains higher than where it stood before the disastrous mini-Budget (23 September).

The proposed unfunded tax cuts, most of which have now been cancelled following the appointment of Jeremy Hunt as chancellor, have possibly done lasting damage to the UK economy.

Internationally, the UK's reputation will take time to rebuild while the spectre of an earlier general election cannot be ruled out given recent political wranglings.

Fixed income analyst at Carmignac, Michael Michaelides commented: 'Until the mini-Budget, the UK was perceived as having a best-in-class fiscal framework under the Office of Budget Responsibility (OBR).

'Its reports are closely scrutinised, and international investors trust its role in monitoring the UK's fiscal rules.'

Some in the Tory party believe a Sunak and Hunt leadership will do the trick and restore some semblance of order.

Former chancellor George Osbourn said: 'An uncontested election of Rishi Sunak would reinforce the return of market credibility and show the Tories have rediscovered a will to win.'

OWN GOAL?

Given how fast events have moved it was not a major surprise to see the new fiscal plans and OBR report pushed back, with a full Autumn Statement now scheduled for 17 November.

The UK has one of the largest fiscal deficits in

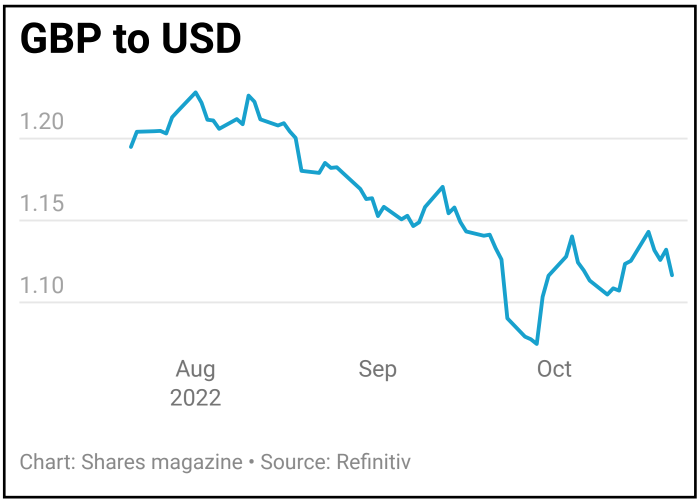


Chart: Shares magazine • Source: Refinitiv

the G7 and a plausible plan to reduce debt while stimulating growth is urgently needed to settle bond and currency markets.

The problem is that damage has already caused by the mini-Budget which has seen mortgage costs surge, threatening millions of household budgets.

Bloomberg economics estimates the UK economy may shrink by 1% over the next year, lowering future tax receipts and removing the government's flexibility for manoeuvre.

Meanwhile the Bank of England is expected to hike rates by 1% on 3 November and 0.75% at its December meeting as inflation remains in double digits.

Hunt's watered-down spending plans included backtracking on the energy freeze cap which will now only last until the spring of 2023, adding further to inflationary pressures.

While fiscal and monetary policies pull in opposite directions financial markets will remain volatile as investors price in greater uncertainty. [MGam]

Tesla hints at $10 billion share buyback to prop up sagging share price

Worries over increased competition and slowing demand have hit stock hard

Electric vehicle maker **Tesla (TSLA:NASDAQ)** is mulling a massive share buyback as it looks to bolster its stock price. Elon Musk recently revealed that the Tesla board has 'debated the buyback idea extensively,' and that the general feeling was that it 'makes sense'.

Musk said that it was 'likely that we will do some meaningful buyback,' with up to $10 billion mooted, pending board review and approval.

Tesla has fallen 23% over the past month as investors grapple with the prospect of rising competition, falling demand from a weakening global economy and stubbornly resistant supply chain issues.

Delayed third-quarter economic data from China showed GDP grew 3.9% over the past 12 months, better than 0.4% reported for the previous quarter, but well below the Communist Party's 5.5% growth target. China is world's largest market for electric vehicles.

Earlier this week Tesla announced that it was slashing the cost of its Model 3 and Model Y vehicles in China by up to 9%, with CMBI analyst Shi Ji warning of a 'possible price war'.

Tesla has been ramping up production in China this year as it looks to capitalise on the enormous potential for electric vehicle sales. In September, Tesla set a new monthly record of 83,135 China-made vehicles sold in the country, the China Passenger Car Association reported. [SF]

Why Netflix's big move into advertising is getting investors excited

The ad-based initiative aligns Netflix with streaming rivals

ALTHOUGH EXPECTATIONS FOR subscription growth had been significantly lowered after two disappointing quarters, **Neflix's (NFLX:NASDAQ)** big third quarter beat puts it back on the growth track.

The maker of *Better Call Saul* and *Stranger Things* is evolving its business model by segmenting its customer offering and introducing an advertising tier.

It also plans to clamp down on password sharing by introducing sub-accounts for families and friends. The new revenue streams mean it will be difficult to make an apples-to-apples comparison in future and new subscriptions will become a component of overall revenue growth.

Customers opting for the ad-supported tier, costing $6.99 a month (£4.99 in the UK) can expect to see around five minutes of advertising for every hour they watch and receive a lower video quality. The tier will only allow one device to access Netflix.

The advertising initiative was generally well received. Netflix estimates the size of the market for TV advertising in the 12 markets where it is launching to be worth about half the overall size of the $300 billion pay-TV and streaming industry.

In other words, the company has just increased its potential market by around 50%. If Netflix could ultimately convert its roughly 8% share of the US and UK total TV time, it would generate more than $10 billion in incremental revenues. [MGam]

Why Chinese trusts and funds are hitting new multi-year lows

Investors are dumping Chinese stocks as internal and external pressures rise

Holders of funds and trusts investing in China probably woke up on Monday wondering why their holdings had taken such a drubbing overnight.

The sharp fall in mainland and Hong Kong-listed stocks was all the more incongruous given third quarter GDP figures, which had been delayed by a week, were actually ahead of expectations at 3.9% instead of 3.2% as forecast.

The reason for the sell-off was market unease at president Xi Jinping's blatant power grab during the Communist Party Congress which ended at the weekend.

As well as building the party around himself by filling the ruling committee with acolytes and allies, Xi sent a message to would-be opponents with the very public removal of his progressive predecessor Hu Jintao from the congress for 'health reasons'.

Shares in **Baillie Gifford China Growth Trust (BGCG)** fell 6%, **Fidelity China Special Situations (FCSS)** fell 7% and **JPMorgan China Growth & Income (JCGI)** fell as much as 8.7% taking them all to multi-year lows.

The sell-off prompted a statement from Welkin China Private Equity Fund which said it had 'paused' its initial public offering due to increased levels of macroeconomic uncertainty and market volatility.

With an unprecedented third term, Xi has tightened his grip on power meaning there is no chance his policies – ranging from increased state control, continuation of the Covid-zero strategy, tighter regulation of the property sector and hostility towards Taiwanese 'separatists' – are diluted.

On an economic level, Xi's policies are not only hampering growth but are creating unemployment which has hit nearly 18% among 16-to-24-year olds.

China-focused investment trusts and funds have had a miserable 2022

Trust	Year-to-date performance
abrdn China Investment Company	−30.7%
Fidelity China Special Situations	−33.6%
Baillie Gifford China Growth Trust	−37.2%
JPMorgan China Growth & Income	−42.6%

Table: Shares magazine • Source: FE Analytics. Data to 24 October 2022 in GB

On a political level, his determination to strengthen China's military – of which he is commander in chief – and his assertion that the 'wheels of history' are rolling toward China's 'reunification' with Taiwan has increased tensions at a time when global relations are already strained.

Just last week, America's top diplomat Secretary of State Antony Blinken warned China was on a 'much faster timeline' than previously thought to attempt to take control of what it considers a rogue province.

A military operation to seize Taiwan would send world markets into panic mode as the island is a major global supplier of semiconductors and other essential IT hardware.

Earlier this month, the Biden administration ramped up its efforts to constrain China's ambition to develop AI (artificial intelligence) projects by introducing new restrictions on exports of semiconductors and related technology including chipmaking equipment and software.

The move is one of the most aggressive blocks on US exports since the end of the Cold War, with technology magazine *Wired* saying the sanctions would effectively 'kneecap' China's AI capabilities. [IC]

Find out why Frasers has bagged a stake in ASOS

Billionaire retail magnate sees value in ASOS brand, but Adidas warning is a worry for Frasers

Like Ashley-controlled retail conglomerate **Frasers (FRAS)** has become troubled online fashion seller **ASOS' (ASC)** fourth biggest shareholder and increased its investment in German fashion brand **Hugo Boss (BOSS:ETR)**.

These bold investments have been made despite further evidence of a downturn in the sector's fortunes, with numerous retailers coughing up profit warnings and the latest Office for National Statistics (ONS) figures showing a bigger than expected dip in UK retail sales in September; high inflation weighed heavily on consumer spending power and contributed to a fall of 1.4% in both sales values and volumes.

Retail kingpin Ashley is clearly not done when it comes to his deal-making in the sector. The news Frasers has built a 5.1% stake in ASOS emerged days after the embattled online fast fashion firm's new CEO José Calamonte outlined a recovery plan as ASOS lurched into the red for the year to August 2022.

Core tenets of the turnaround strategy include cost-cutting, enhancing the customer offer and stock management, as well as improving ASOS' order economics, maintaining a robust balance sheet and refreshing the leadership team.

Frasers' stake won't give the Sports Direct-to-House of Fraser owner any control over the business or a position on the board, but Frasers is likely to use its stake to build a partnership with ASOS which could involve selling each others' brands or sharing distribution.

It is worth noting Frasers' expanding retail empire now includes ASOS' fast fashion competitors Missguided and I Saw It First and the group also has stakes in **N Brown (BWNG:AIM)** and **Mulberry (MUL:AIM)** and is taking full control of Australian online retailer **MySale (MYSL:AIM)**, so we'd expect the shrewd Ashley to eke out significant synergies.

And while the cost-of-living squeeze is constraining the spending power of ASOS' core demographic and the company faces rising costs, Ashley clearly believes there is still value in the brand.

One worry for Frasers is the resilience hitherto exhibited by athleisure could be on the wane. A profit warning-driven sell-off (21 October) in shares of key Sports Direct supplier **Adidas (ADS:FRA)** spilled over into Frasers and sports retail rival **JD Sports Fashion (JD.)**.

German trainers-to-sports apparel maker Adidas cut its full year revenue growth guidance to just mid-single digits, blaming 'the deteriorating traffic trend' in China as well as a 'significant inventory build-up as a result of lower consumer demand in major Western markets since the beginning of September'.

Nevertheless, Ashley and son-in-law Michael Murray, recently handed the CEO baton at Frasers, have doubled down on their deal-making by increasing Frasers' investment in Hugo Boss. The FTSE 100 retail giant now owns 4.3% of Hugo Boss shares directly and holds a further 28.5% through financial instruments known as put options, giving it a 32.8% interest in the apparel seller worth almost €1 billion without having to make a takeover bid. [JC]

Moving HIGHER

Pearson's digital transformation puts it on an upward path as margins improve

Education publisher is reaping the benefits from its transformation programme

EDUCATION PUBLISHER **PEARSON (PSON)** has been one of the big winners in 2022 with the shares up 60% compared with a drop of 6% in the blue-chip FTSE 100 index.

A key driver has been the momentum in the business which has prompted analysts to revise their earnings forecasts up significantly. Since the start of the year 2022 earnings expectations have risen by 22% while 2023 earnings are up by almost a third.

In other words, after a lengthy transformation process Pearson appears finally to be firing on all cylinders.

Over the last few years, the company has moved away from school printed material towards online digital tools for schools to fill the skills gap.

Investors should expect further analyst upgrades after the company said (24 October) it was aiming to deliver £100 million of efficiencies in 2023 which would accelerate margin improvements two years ahead of its original plans.

Underlying group revenues for the three months to September were up 7% thanks to an 'outstanding' result in English Language Learning which delivered 36% year on year growth.

The Workforce Skills division also reported strong growth, with sales up 20% on last year, while Virtual Learning and Assessments grew their revenues by high single digits.

Pearson had repurchased £240 million of shares out of a planned £350 million buyback as of 30 September. The buyback potentially adds around 10% to future earnings per share growth. [MGam]

DOWN in the dumps

Why FTSE 250 piping group Genuit is down in the dumps

The former market darling has experienced a big reversal of fortunes this year

ONCE A FAVOURITE among UK fund managers, **Genuit (GEN)** has fallen out of favour this year with a near-60% share price loss. The FTSE 250 company, formerly called Polypipe, is one of Europe's biggest plastic piping manufacturers and is also involved in underfloor heating and ventilation.

The £630 million company has been investing in factory automation, it has scale, and it is a key player in environmental construction projects.

The share price decline can be attributed to a slowdown in growth and falling margins.

A warning that full year profit will be at the lower end of expectations as trading deteriorated in the last few weeks of the third quarter underlined these negative trends.

There are now calls from MPs and business leaders for the UK Government to cut projects like the HS2 rail expansion, where Genuit has exposure.

Its earnings forecasts have been downgraded since the summer amid a multitude of negative factors include a cyberattack and a shortage of boilers in the UK hurting its Adey business which helps to improve the efficiency of heating systems.

The company is holding an investor event (10 November) to give more detail on its business which may help the market to better understand its prospects. However market sentiment towards construction is currently weak leaving Genuit's share price with headwinds to overcome.

It trades on 8.8 times 2023 forecast earnings, and it had a £167.9 million net debt position on 30 June 2022. [DC]

Revealed: stocks with the most weekly upgrades and downgrades

We look at the companies where analysts are becoming more positive and negative

Using data from Stockopedia *Shares* has identified those stocks which have the most upgrades and downgrades over the past week.

Among the stocks where analysts have been nudging forecasts higher, tobacco firm **Imperial Brands (IMB)** stands out.

We looked at the Imperial Brands investment case in detail in this article. The company has demonstrated its pricing power, with its core product's addictive qualities allowing it to pass higher costs on to smokers and this is clearly having positive implications for earnings estimates.

Miner **Petra Diamonds (PDL)** seems to have impressed with its recent site visit to Antwerp to meet the company's sales team.

Packaging firm **DS Smith (SMDS)** guided analysts higher with a 10 October trading update and they have responded in kind as fears have been allayed about the impact of a weakening economy on the wider sector. Berenberg analyst Lydia Kenny commented: 'Strong pricing momentum, good cost control and resilience in fast-moving consumer goods (FMCG) end-markets are the key drivers of this upgrade, which gives us confidence in the near-term outlook for the group.'

Interestingly, there were downgrades for the firm's peer **Mondi (MNDI)** as it unveiled a slightly more mixed update recently (14 October).

Comparison site **Moneysupermarket (MONY)** may have delivered third-quarter revenue growth of 33% as people looked to make savings where they can, but nervousness around the UK economy and the launch of a price comparison service by **Amazon (AMZN:NASDAQ)** spurred a round of downgrades. [TS]

Earnings upgrades

Company	Number of weekly upgrades
Petra Diamonds	2
Imperial Brands	4
Epwin	1
Sureserve	1
Man	3
DS Smith	7
Robert Walters	3
Record	1
Diageo	6
SCS	2

Table: Shares magazine • Source: Stockopedia, 24 October 2022

Earnings downgrades

Company	Number of weekly downgrades
Mondi	3
Vesuvius	2
Capricorn Energy	2
Moneysupermarket	2
Standard Chartered	2
Man	2
DS Smith	2
Ashmore	4
Taylor Wimpey	2
Johnson Matthey	2

Table: Shares magazine • Source: Stockopedia, 24 October 2022


SIPPs | ISAs | Funds | Shares
AJ Bell
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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.

High-class Lam Research is a brilliant company at a brilliant price

Microchip kit supplier faces short-term challenges that will be overcome in time

LAM RESEARCH

BUY

(LRCX) $373.96

Market cap: $51.2 billion

As the world increasingly embraces a digital-first future, anything that can help the semiconductor industry to drive down costs, boost efficiency and bulk up the power of microchips should have a bright future. This is exactly where Nasdaq-listed **Lam Research (LRCX:NASDAQ)** oozes pedigree yet its stock currently trades on a discounted price to earnings multiple that you might associate with a low growth, low quality company.

Based on recently published forecasts from investment bank Berenberg, the June 2023 PE is 12.3. So why does the market seem to hate the stock? Before we get to that, let's understand what Lam Research does.

This is a Silicon Valley-based business that designs and makes a range of unique semiconductor manufacturing equipment focused on meeting the industry's escalating demands, especially given the increasing complexity of semiconductor designs and manufacturing processes. Lam Research designs specialist equipment that helps semiconductor manufacturers improve yields, lower costs, shrink processing time and reduce defects on microchips.

Lam Research shares have seen a big derating

Price to earnings ratio (historic)

Chart: Shares magazine • Source: Refinitiv

TRENDS DRIVING THE BUSINESS

Traditionally big in memory chips, this is an area booming thanks to the rapid rise of cloud computing, big data analytics, mobile devices and other connected world applications. Since data storage is the starting point of the digital economy, there is a huge demand for memory chips, particularly the more efficient variety. But technological advancements in areas like in-car electronics, 3D device architecture and advanced packaging technologies are also playing to Lam's strengths.

Since 2015, revenues have gone from $4.6 billion to more than $17.2 billion (to 30 June 2022), while net income has jumped over 600% to $4.66 billion or $33.11 per share. Gross margins last year were 45.6%, impressive for a capital equipment manufacturer, while net profit margins were 26.7%.

Return on equity and investment has averaged over 50% and 30% during the past five years. Net debt of $1.35 billion last year was just 67% of equity, and Berenberg believes Lam Research will report net cash of nearly $4 billion this year thanks to a $6.5 billion free cash flow projection.

Berenberg is one of 27 analysts that follow the stock, 16 of which have buy recommendations on the shares; the remaining 11 are neutral, there's not one sell recommendation, according to Investing.com data. The consensus share price target is $574, implying 53% upside, but even if we use Berenberg's more conservative $470, it still implies 25%-plus upside to a PE of about 16 on financial year 2024 estimates.

WHAT ARE THE RISKS?

This paints a compelling investment picture for Lam Research, so what are the caveats? The big elephant in the room is the souring relationship between Washington and Beijing that has led to tightening restrictions on Chinese companies' access to US technology.

The technology space has emerged as a major battlefield as nations fight for political and social hegemony around the world. Microchips are the building blocks of the tech industry, so it is no surprise that China and the US are increasingly at loggerheads over the industry, putting Lam Research sales to China under scrutiny.

While the company reported first-quarter results (to 30 September 2022) a week or so ago, and guided for Q2 above consensus estimates, there are concerns about what's coming down the line, with Lam Research warning that 2023 will likely see a $2 billion to $2.5 billion impact from the China restrictions.

According to one analyst at KeyBanc Capital Markets, investors are likely to 'take little comfort' from Lam Research's upbeat results and guidance, as it 'indicated that 2023 wafer fabrication equipment revenues could fall in the low-$70 billion range, and that the company would likely underperform the WFE decline given its memory exposure'.

Chart: Shares magazine • Source: Refinitiv

Yet the market has been witnessing stiffening restrictions on China by the US authorities for most of the year and have been massaging down estimates accordingly. The share price has also fallen to reflect the gradually changing reality, having weakened throughout 2022. Year-to-date the shares are 48% lower.

This was illustrated by Berenberg comments following the Q1 results. 'During Lam's earnings conference call on Wednesday, management said it expects WFE to be in the low $90 billion range for 2022, followed by a more than 20% decline in 2023, with memory capex accounting for a large portion of the decline; this is in line with the street's view at this point.'

In other words, this is already in the price, and we believe, then some, given the market's propensity to exaggerate both good prospects and poor. 'In our view, the only risk that is not in the numbers today will be foundry and logic spending cuts in 2023 if there is any delay to **TSMC's (2330:TPE)** 3nm (three nanometre) ramp-up plan,' said Berenberg.

Lam Research remains a brilliant business at an attractive price because the market is focusing too much on short-term issues and not enough on its massive opportunities from a multi-year industrial growth phase. [SF]

F&C Investment Trust can help you weather the storm

The world's oldest investment trust is delivering consistent performance amidst an uncertain market environment

Visibility is clouded and markets volatile at present, which means portfolio diversification should be the watchword for the cautious investor.

A great way to gain exposure to a reassuringly broad spread of investments, diversified by geographic region and industry sector, is to buy **F&C Investment Trust (FCIT)**, a global fund that covers a lot of bases with one asset purchase with a low ongoing charges figure of 0.54%.

The first ever investment trust launched back in 1868, this multi-manager fund offers a 'one-stop-shop' of asset diversification at a stroke that should appeal to experienced and first time investors alike. F&C's dependability is demonstrated by the fact the storied trust has increased its dividend for 51 consecutive years and is confidently planning a 52nd successive rise in the shareholder reward this year.

WEATHERING THE STORM

The world's oldest collective investment scheme, Columba Threadneedle-managed F&C Investment Trust has navigated numerous financial crises and conflicts during its history, including troublesome periods of high inflation and rising rates, while continuing to generate long-term growth of capital and income.

Run by Paul Niven since 2014, F&C Investment Trust's portfolio is constructed through investing in a selection of both internal managers within Columbia Threadneedle Investments as well as externally delegated managers. The trust has fared rather well year-to-date, the shares down just 3.1% during a difficult 2022 for global funds.

And over one year, the trust has delivered a share price total return of 3.5%, being one of only two funds in the Association of Investment Companies' (AIC) Global sector to post a positive return over that period. In fact, according to AIC/Morningstar data, F&C is also the Global sector's second best performer on a five year view, its 53.2% return only surpassed by **Scottish Mortgage (SMT)**.

ONE-STOP-SHOP SUPERSTAR

F&C Investment Trust's ultra-diversified portfolio gives investors exposure to most of the world's markets through investments in more than 400 companies in 35 countries. The company's array of holdings includes publicly listed equities, as well as unlisted securities and private equity exposure.

As at 30 September 2022, the 20 largest listed equity holdings spanned a reassuring spread set of industry sectors, ranging from mega cap technology names such as **Microsoft (MSFT:NASDAQ)**, **Apple (AAPL:NASDAQ)** and **Alphabet (GOOG:NASDAQ)** to US healthcare via **UnitedHealth (UNH:NYSE)** and discount retail across the pond through **Dollar General (DG:NYSE)**. [JC]

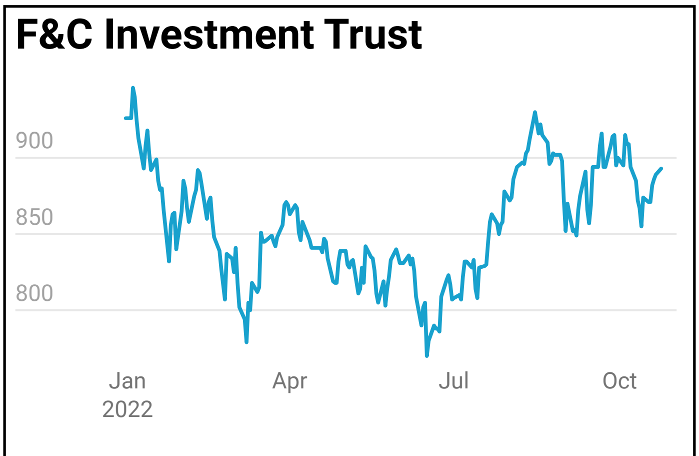


Chart: Shares magazine • Source: Refinitiv

Spectris is delivering on its promise, the market should respond

Full year guidance is confirmed, medium-term targets have been raised

SPECTRIS
(SXS) £28.48

Gain to date: 5.1%
Original entry point:
Buy at £27.09, 28 April 2022

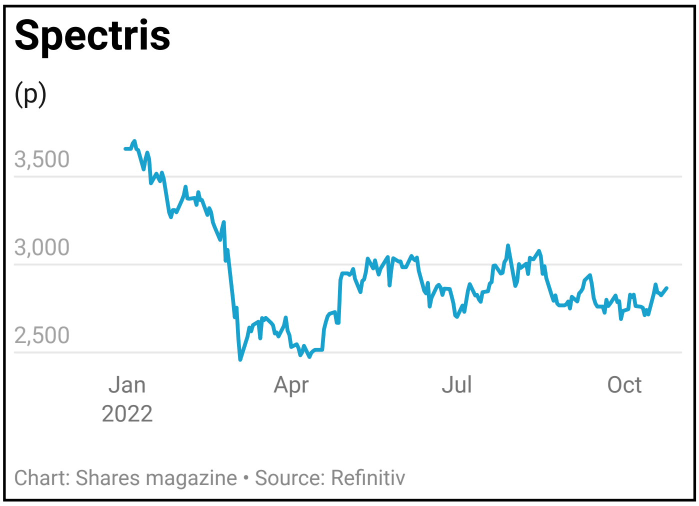
WE'RE PLEASED to say it has been 'full speed ahead' for precision measurement firm **Spectris (SXS)** since our initial recommendation in April.

Despite growing evidence of a global slowdown, organic sales have continued to grow at an impressive rate and the firm has continued to return capital from the sale of its Omega Engineering division.

WHAT'S HAPPENED SINCE WE SAID BUY?

The company posted a 9% increase in underlying sales in the second quarter and improved on that in the third quarter with an 11% increase, driven as before by strong orders from Asia and North America.

It also repeated its guidance of a high single-digit increase in underlying sales for the full-year thanks to its growing order book and an increase in the operating margin thanks to price rises, although supply chain issues and ongoing cost inflation are still live issues.



As well as returning cash from the Omega sale to investors through a share buyback, of which £150 million was completed in the first half with the remainder due to be completed by year-end, the firm has made a series of small bolt-on acquisitions to augment organic growth.

There has been one larger deal, the purchase of Dytran Instruments for £66 million, which expands Spectris's sales in the US in the aerospace and automotive industries.

Ahead of its capital markets day last week, the first for three years, the firm set out a strategy showing how it would compound growth into the future supported by organic investments and acquisitions, while growing its margins.

New medium-term targets were introduced including organic sales growth of 6% to 7% through the cycle and an adjusted operating margin north of 20%, well above last year's 16% and consistent with the 21% margin at the half-year stage.

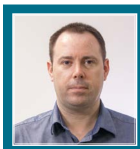
WHAT SHOULD INVESTORS DO NEXT?

The company's new targets look ambitious but achievable, and we welcome the prospect of higher growth and higher total returns.

Analysts will have to upgrade their medium-term outlook for the stock which should in turn lead to a re-rating, so we think the shares remain worth holding. [IC]

MORE CHOICES FOR INCOME

Why dividend-paying funds still appeal despite better cash rates



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

With cash savings rates approaching 5% if you're prepared to lock your money away for a few years, investors are starting to ask if this is a better place for their savings than taking the risk of investing in the stock market.

Over the past decade or so, income funds have been popular investments as they've offered more generous yields than you'd get on cash. Now the Bank of England's base rate has jumped to 2.25% and is expected to go a lot higher, banks and building societies are able to offer much better rates on their savings accounts.

At the time of writing, the top rate on an easy access savings account was 2.8%, you can get 4.6% on a one-year fixed rate account, 4.8% on a two-year fixed rate and 5.05% on a four-year fixed rate, according to Moneyfacts.

Top rate cash savings accounts

Type	Provider	Rate (%)
Easy access	Gatehouse Bank	2.8%
1-year fixed	DF Capital	4.6%
2-year fixed	Gatehouse Bank	4.8%
4-year fixed	Aldermore	5.1%

Table: Shares magazine • Source: Moneyfacts, correct as of 21 October 2022

The average dividend yield on investment trusts in the AIC's UK equity income sector is 4.4%, although quite a few pay more than 6%. Income

Examples of high yielding UK equity income investment trusts

Investment trust	Historic yield (%)
Abrdn Equity Income	7.2
CT UK High Income	7.2
Chelverton UK Dividend	7.1
Lowland	6.0
Shires Income	5.8
Merchants Trust	5.4
JPMorgan Elect Managed Income	5.4
City of London	5.2

Table: Shares magazine • Source: AIC, 21 October 2022

funds and investment trusts come with the risk that the companies or other assets in their portfolio fall in value and the dividends aren't guaranteed unlike the interest payments on cash.

On this basis you might think cash is now king. However, there are good reasons to still have exposure to income-paying investments.

Crucially, the investment route typically has the added attraction of dividend growth. With a fixed-rate cash account the rate of interest doesn't change, but you could easily see 5% dividend growth each year with an income fund. There is also the added potential for the capital value of the income fund to also grow.

Buying an income fund helps to spread the risks and so you don't feel the pain as much if something bad goes wrong with one holding in the portfolio versus owning that stock outright.

Over the long term, shares have proven to outperform bonds and the return derived from cash. Adjusted for inflation, over the past 50 years UK equities have generated an average 4.9% annual return versus 0.9% from cash, according to the 2022 Barclays Equity Gilt Study.

Cash versus shares (equities): inflation-adjusted returns (% per year)

	10 years	20 years	50 years
Shares	4.7	2.9	4.9
Cash	−2.5	−1.1	0.9

Table: Shares magazine • Source: Barclays Equities Gilt Study 2022. Figures relate to UK assets

You don't need to choose one or the other. The current market sell-off has taught us the benefit of diversification and so having some of your assets in cash and some in investments is not a bad thing now that cash rates are much more attractive.

To explore the topic further, we spoke to a range of fund mangers to get their thoughts on the cash versus investments debate.

INCOME MANAGERS HAVE THEIR SAY

Simon Gergel manages **The Merchants Trust (MRCH)**, a UK equity income investment trust with a key focus on paying a high and rising dividend that offers an attractive yield of 5.4%.

Merchants Trust has raised its dividend each year for 40 years in a row. It recognises the importance of providing a steady income as well as the compounding effects of reinvesting income into more shares.

Gergel won't advise investors on whether they should invest in cash or not. However, he points out that following year-to-date weakness, the UK stock market's valuation is 'very reasonable' from a long-term perspective, with the UK trading at a large discount to many other major markets despite most UK-listed companies' sales and profits come from overseas.

The fund manager adds that as well as low aggregate valuation, there is 'a considerable variation in valuations' in the UK market. This is enabling Gergel to identify many good quality companies trading significantly below his view of their fair value.

He adds: 'We believe that by buying a portfolio of these companies, investors can receive both an attractive dividend yield, in the short term, and the prospects of good total returns in the medium term.' The term total return refers to the gains or losses on the capital value of your investment and dividends on top.

Gergel says this is an environment where 'stock picking can give an advantage as the dispersion of valuations is so high, and economic conditions are uncertain and subject to change'.

EQUITIES WON DURING TIMES OF HIGH INFLATION IN THE 1970S

Also weighing in on the cash or income fund debate is Ben Peters, manager of **Evenlode Global Income (BF1QNC4)**, a fund which focuses on sustainable real dividend growth and invests in companies with high returns on capital and strong free cash flow.

Passing muster with Peters and populating the global fund are pricing power exemplars such as **PepsiCo (PEP:NASDAQ)**, **Nestle (NESN:SWX)** and **LVMH (LVMH:BIT)**, while other holdings include Dutch information services group **Wolters Kluwer (WKL:AMS)** and credit reference agency **Experian (EXPN)**.

'It is certainly the case that rates on cash and fixed income have got more interesting over recent months,' concedes Peters, 'but that has come from a very historically low rate.'

He explains that when you invest in a company, you get 'a business that's operating in the real world and that company's operations can cope with lots of different economic situations' including inflationary environments.

'If you look at the return on equities through the 1970s, when there was persistently high inflation, you got a positive real return from equities,' points out Peters. 'It wasn't huge, but it was a positive real return. Being in cash or cash-like instruments, you would have seen a real degradation in your purchasing power. Investing in shares maintained that purchasing power.'

Peters concedes that equities are volatile as an asset class, yet his view is if you have savings that you are 'willing to invest for a period of many years, then shares have proved themselves to be a good place to be'.

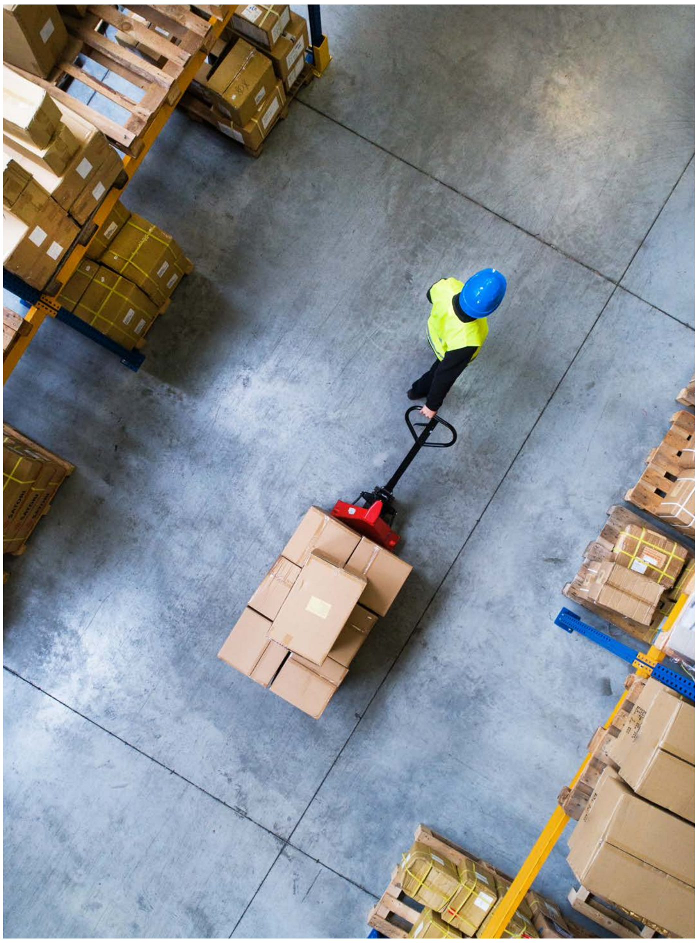
MORE SUSTAINABLE DIVIDENDS

Simon Murphy manages **VT Tyndall Real Income (BYX0D83)**, invested in the likes of inter-dealer broker **TP Icap (TCAP)**, packaging firm **DS Smith (SMDS)** and insurer **Prudential (PRU)**. While cash looks more attractive than it has been for some time, Murphy argues dividend yields on equities, particularly in the UK, 'continue to look appealing' with the historic yield on the FTSE All-Share currently circa 3.8%.

Murphy makes the point that following the painful dividend cuts suffered during the pandemic, the overall market dividend yield looks 'significantly more sustainable now than previously'.

If you believe we have entered a period of significantly higher inflation, 'then company earnings, and subsequently dividends, ought to grow, possibly significantly, helping to protect against inflation,' argues the fund manager.

Though the FTSE's headline historic yield is 3.8%, Murphy says there are many high-quality UK companies with dividend yields well above this



SHOULD I CHOOSE EQUITIES OR BONDS FOR INCOME?

'FOR YEARS THE argument has been that the lack of yield in other capital markets has meant income funds are attractive,' says James Harries, manager of **Securities Trust of Scotland (STS)**. 'We would argue the opposite.

'Yields have risen because inflation has reappeared, leading to a far less favourable policy backdrop. For years interest rates were held low and quantitative easing pursued to stimulate consumption and activity. This was fine while inflation was subdued. As this is no longer the case, policy is focused on quashing inflation rather than bolstering asset prices. Essentially the needs of the real economy are rightly being prioritised over the financial economy.'

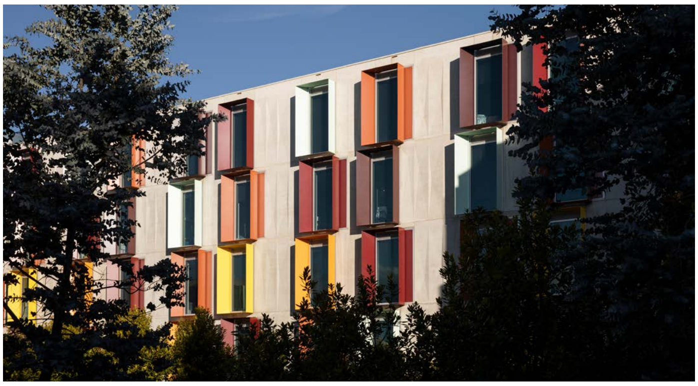
Harries continues: 'That this is happening at a time when valuations in equity markets remain elevated relative to history means that returns are likely to be lower than in recent times.

'When returns are plentiful the relative certainty of an income yield becomes overlooked by investors. But for those with irreplaceable capital and in need of growing income to pay increasing day-to-day bills, without having to dip into capital at times of stress, a balance between income and capital growth is more important than ever.

'Indeed, given the substantial gains enjoyed by equity investors since 2008, despite recent losses, we still think it is not too late to take some of those exceptional gains and secure an attractive, dependable, growing long-term income stream.'

Harries says the rise in bond yields does not invalidate this argument. 'It does give investors an opportunity to enhance the income they can generate from their assets alongside that derived from equities. We would argue that for the first time in years the conservative, income seeking investor is able to benefit from both fixed income and equity income investment.'

He concludes: 'A certain income from bonds and growing income from equities. This balance is something that has been denied investors for the last 14 years and should be seen as an anomaly. Its return is most welcome. For income investors it's not either/or therefore but both.' [JC]



level. VT Tyndall Real Income Fund has a historic yield of 4.8% and the manager is optimistic on the outlook for dividend growth from its current portfolio of companies.

DIVERSIFY YOUR INCOME STREAMS

Another attraction income funds have over cash is they enable you to diversify income sources by geography and assets. One example is **TB Wise Multi-Asset Income (B0LJ016)**, a diversified fund with the flexibility to invest in all asset classes. Equities, alternatives, property, fixed interest and cash are all part of the mix.

Co-managed by Philip Matthews with a value bias, the fund targets a consistent and attractive level of income. Equity holdings include quarterly dividend paying trust **TwentyFour Income Fund (TFIF)**, as well as **Ediston Property (EPIC)** and **Empiric Student Property (ESP)**.

Entering 2022, Matthews says it was 'incredibly difficult' to construct any sort of multi-asset income fund 'because yields across the board had just fallen to such a large extent'. Any income going begging was in 'the risk assets rather than the risk-free asset part of the market'. He adds: 'People talk about "risk-free return" becoming "return-free risk", and that's kind of where we were at the start of the year.'

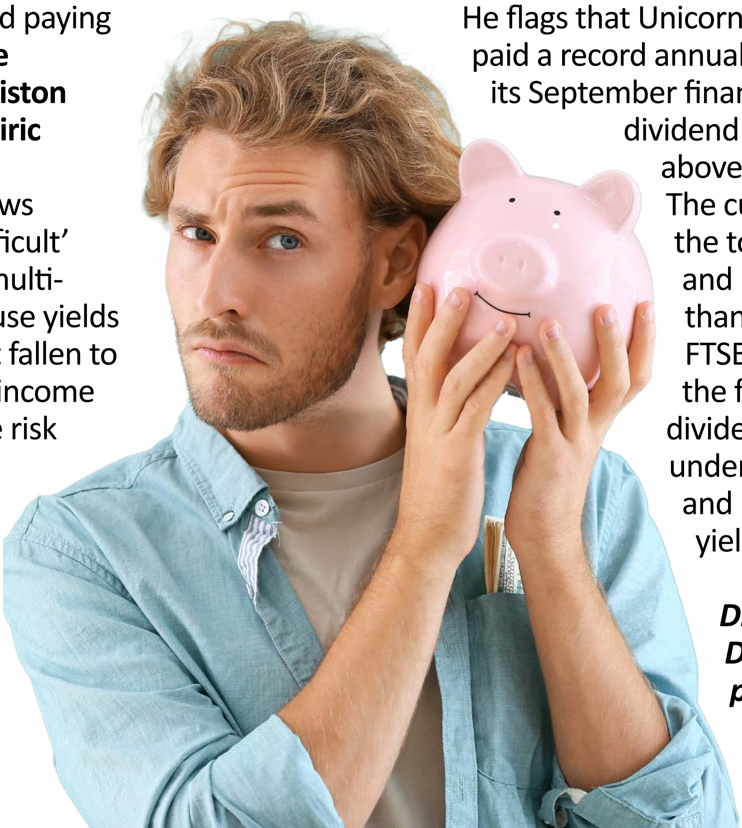
REASONS WHY YOU SHOULDN'T ABANDON SHARES COMPLETELY IN FAVOUR OF CASH

- Potential for annual dividend growth
- Potential for capital gains
- Many UK stocks are cheap
- History shows that shares have beaten cash over the long term

With inflation back and interest rates rising, Matthews says investors can now construct a much more attractive portfolio of income with more breadth in the portfolio than historically. He has added a 'fair amount' of fixed income to the fund in the past two months and says the positive is you've got a risk-free rate that has moved up and credit spreads widening, so risk across the spectrum seems to be better priced.

Funds also enable investors to put money to work across the market cap spectrum and one exemplar is **Unicorn UK Income (B00Z1R8)**. Co-manager Fraser Mackersie insists multi-cap income funds offer 'very attractive dividend yields, with strong capital recovery potential'.

He flags that Unicorn UK Income has just paid a record annual dividend per share for its September financial year-end with the dividend per share now back above pre-pandemic levels. The current 6% yield is towards the top end of historic range and is significantly higher than large cap dominated FTSE All-Share yield, and the fund has seen 'a strong dividend recovery and the underperformance of small and mid-caps has pushed yield higher'.



DISCLAIMER: Editor Daniel Coatsworth has a personal investment in Evenlode Global Income referenced in this article

WHY IT PAYS TO SIT TIGHT

VOLATILE MARKETS MAY TRIGGER COSTLY DECISIONS

Stock market investors have had a rough ride this year. Inflation, stoked by supply chain logjams and high energy prices on account of the conflict in Ukraine, has led central banks to tighten the screws of monetary policy and raise interest rates at a rapid clip.

As looming recessions and rising costs threaten earnings, investors have shunned riskier assets in exchange for safer havens and companies with a clearer and nearer sight on cashflow.

It is during moments of economic uncertainty and elevated market volatility such as these, that the constant drumbeat of negative news-flow can serve to raise our anxieties and the temptation to sell our investments and churn our portfolios. And yet, the best strategy for the health of our returns may simply be to hang on tight and remember the many virtues of long-term investing.

REDUCING RISKS

A long time horizon brings numerous benefits to the equity investor. It reduces the risks associated with short-term equity market volatility and drops in its value following investing. It enables us to harness the power of compounding – the benefits of which grow exponentially as the years progress. And it reduces costs associated with trading, a drag on returns.

In particular, though, it avoids the enormous costs associated with growing impatient such as selling at inopportune times when the market panics and buying back when a recovery has already begun taking hold.

Alliance Trust calls this the *Impatience Tax*, and they've modelled exactly how much it might impact your returns.

THE COST OF IMPATIENCE

Our model assumes two shareholders investing £10,000 in Alliance Trust shares in 1992, to which they added £100 each month, and reinvested all of their dividends. Whenever the market dipped 5% in a single day, *the Impatient Investor* sold 25% of their holdings, and when it had recovered by 10% in a single day, they bought shares back. Meanwhile, the *Patient Investor* sat tight.

After 30 years, the *Impatient Investor's* portfolio has grown to a value of **£217,884** while the *Patient Investor's* portfolio had ballooned to **£410,757**. This points to an Impatience Tax of **£192,872** - an enormous hit to returns over the long term.[1]

It's why at Alliance Trust they think patience is more than a virtue, they believe it's an investing strategy.

Alliance Trust
INVESTING FOR GENERATIONS

Discover the value of staying power at **alliancetrust.co.uk/patience** →

When investing, your capital is at risk. The value of your investment may rise or fall as a result of market fluctuations and you might get back less than you invested. TWIM is the authorised Alternative Investment Fund Manager of Alliance Trust PLC. TWIM is authorised and regulated by the Financial Conduct Authority. Alliance Trust PLC is listed on the London Stock Exchange and is registered in Scotland No SC1731. Registered office: River Court, 5 West Victoria Dock Road, Dundee DD1 3JT. Alliance Trust PLC is not authorised and regulated by the Financial Conduct Authority and gives no financial or investment advice.

1. The Profit from Patience Report, Alliance Trust, September 2022. About the research: The data model compares two hypothetical investors each making an initial investment of £10,000 in Alliance Trust in 1992 and then adding 10% of the average national salary every month for the next 30 years. The patient investor remains in the market throughout while the impatient investor sells 25% of their holdings whenever the market dips 5% in a single day and buys back in when the market recovers 10% in a single day using cash accumulated from monthly contributions, previous redemptions, and accrued interest. By September 2022, the impatient investor has accumulated £217,884, while the patient investor is sat on £410,757; in other words, the impatient investor has lost out on over £192k. NB: The model uses the Alliance Trust share price as a proxy for the market. **Source: Alliance Trust.**

What earnings from big US companies are saying about markets and the economy

Winners and losers as reporting season gets into full swing across the Atlantic

As the US reporting season rolls on, what have we learnt so far about the domestic economy and the global outlook and what challenges are firms facing?

We have already heard from the US banks that domestic consumers are bearing up despite higher food, energy and housing costs, and the economy is 'resilient' for the time being.

CONSUMER STOCKS PAINT A MIXED PICTURE

Credit card issuer **American Express (AXP:NYSE)** repeated the upbeat message put out by the banks, with card member spending up 21% in the third quarter thanks to 'continued momentum across goods and services and travel and entertainment spending'.

Total revenues net of expenses were $13.5 billion, up a record 24% on the same period last year, while earnings per share for the quarter were $2.47, comfortably ahead of the $2.38 consensus.

'We continued to see high levels of customer engagement, acquisitions and loyalty', said chief

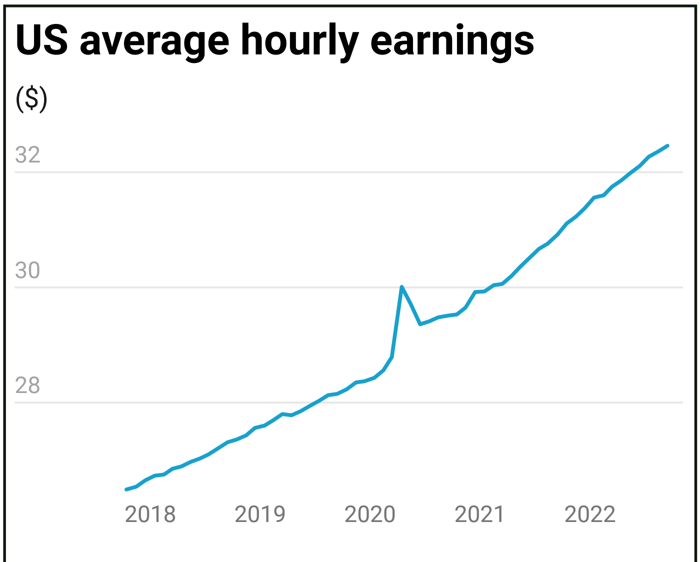


Chart: Shares magazine • Source: Refinitiv

executive Stephen Squeri.

Spending on travel exceeded the firm's expectations, with nine-month revenues up 57% and spending in international markets surpassing pre-pandemic levels for the first time during the quarter, which should bode well for airlines and other travel stocks. American Express can benefit from inflation as it takes a percentage of each transaction it processes.

However, it was a far less rosy picture from appliance maker **Whirlpool (WHR:NYSE)** which delivered sales and earnings below market estimates and cut its full year guidance blaming economic headwinds and slowing demand.

Revenue for the third quarter was $4.78 billion against an estimate of $5.2 billion while earnings per share of $4.49 fell significantly short of the $5.53 consensus forecast.

The maker of Hotpoint, Indesit and Maytag kitchen and laundry equipment reported double-digit sales declines across most major markets and 'continued elevated cost inflation'.

As a result it said it would cut production volumes by 35% for the fourth quarter and full year earnings would be around $5 per share instead of $9.50 to $11.50 as previously guided.

Chief executive Marc Bitzer said he saw the difficult trading environment 'persisting into the first half of 2023', sending the shares skidding to a two-year low.

Investors in UK retailers **AO World (AO.)** and **Currys (CURY)** should therefore keep an eye out when the firms report in November and December respectively.

INPUT COSTS HAVING A MAJOR IMPACT

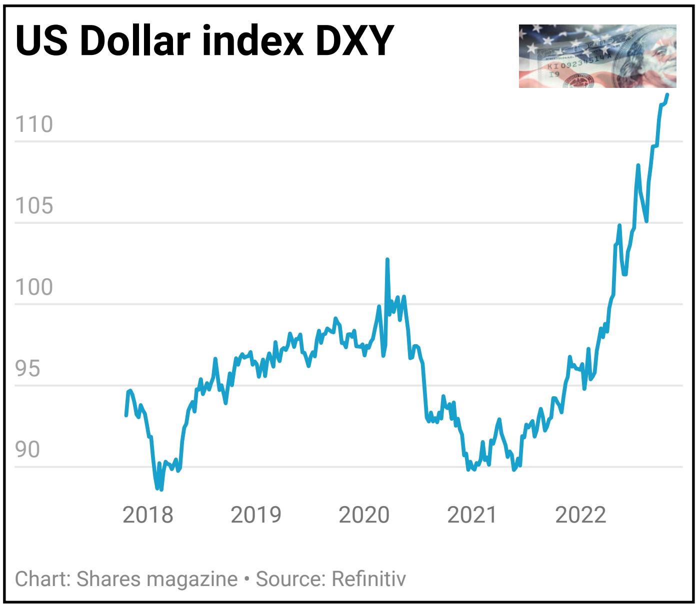
Aluminium producer **Alcoa (AA:NYSE)**, typically one of the first non-financial companies to report and a bellwether for raw materials stocks, sounded a downbeat note on current trading and the outlook for the rest of 2022.

A combination of lower selling prices, higher energy costs and higher raw material costs have pushed the firm to a thumping third-quarter loss while cash from operations was just $134 million on sales of $2.85 billion, down 22% on a year ago.

In an effort to reduce losses from what it called 'exorbitant' natural gas prices, the company slashed production at its Spanish refinery to 50% of its annual capacity while cutting output by a third at its Norwegian facility to mitigate high electricity prices.

Meanwhile, chemical giant **Dow Inc (DOW:NYSE)** posted a drop in third quarter revenue and forecast fourth quarter sales which were below market estimates as it trimmed production to meet lower demand in Europe, while at the same time trying to manage record levels of inflation in energy and feedstock costs.

If evidence were needed that high input costs are leading to 'demand destruction', Alcoa and Dow provided plenty of it and investors in other energy-intensive commodity-producing firms including the UK-listed mining companies should probably take note.



STRONG DOLLAR ALSO CAUSING PAIN

Healthcare and consumer goods giant **Procter & Gamble (PG:NYSE)** delivered sales of $20.6 billion in the three months from July to September, with underlying organic growth of 7% against market forecasts of 5.5%.

Earnings per share were slightly ahead of estimates at $1.57 against a consensus of $1.55.

The company raised prices by 9% across its range, lowest was 6% in healthcare, highest was 11% in fabric and home care – at the expense of volume sales which declined 3% on the same quarter last year.

Chief executive Jon Mueller didn't have much to say about market trends, simply commenting that the firm had delivered 'solid results in a very difficult cost and operating environment'.

The most notable aspect of P&G's results was the damage being caused by the strength of the US dollar, which knocked 6% off sales meaning reported revenue growth was just 1% for the quarter.

For the year to next June, the company cut its reported revenue growth guidance to between minus 1% and minus 3% due to $3.9 billion of increased costs, $600 million more than forecast in July due mainly to the strong dollar.

In a similar vein, drug maker **Abbott Labs (ABT:NYSE)** beat sales and earnings forecasts for the quarter and actually raised its profit guidance for the full year, but the dollar created major headwinds.

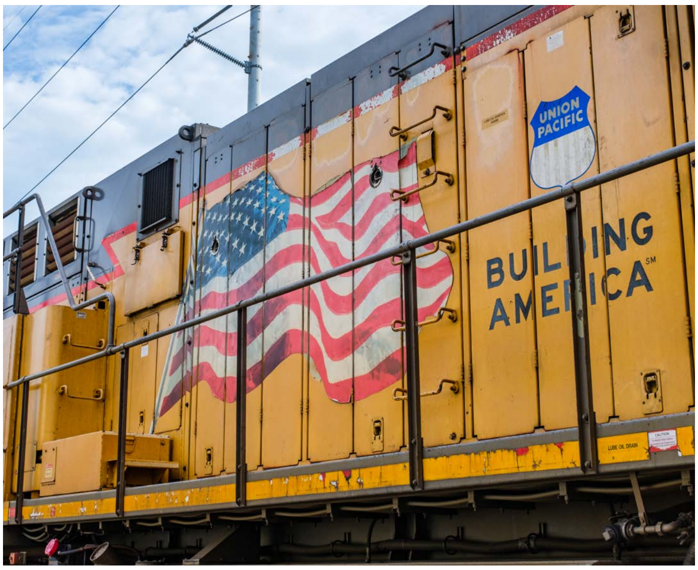
Third quarter sales were $10.4 billion, comfortably ahead of the consensus forecast of $9.6 billion but down from $10.9 billion last year whereas without foreign exchange impacts sales would actually been up 1% on the same period last year.

The flip side to the strong dollar is UK firms which operate mainly in North America, such as **Ashtead (AHT)** and **Ferguson (FERG)**, should enjoy a tailwind to earnings once they are converted back into sterling.

THE TRIFECTA: LABOUR COSTS ARE SURGING

Union Pacific (UNP:NYSE), one of America's leading transportation companies with a railroad business which covers 23 states across the western two-thirds of the country, is a good benchmark for how well the US economy is doing.

With connections to all major West Coast and Gulf Coast ports, the railroad has around 7,500 locomotives hauling goods across the US as well as up to Canada and down to Mexico day in, day out on trains almost 10,000 feet long.



ISM US Purchasing Managers Index - Manufacturing

Chart: Shares magazine • Source: Refinitiv

The volume of goods transported, measured in total revenue carloads, was only up 3% in the third quarter, but thanks to higher prices and fuel surcharges operating revenues were up 18% to $6.6 billion.

As a purely domestic business, Union Pacific doesn't have to worry about currency headwinds, and it is passing higher fuel costs straight onto its customers, but it is starting to see a margin squeeze from higher labour costs.

In its quarterly results it took an exceptional charge of $114 million 'related to new, tentative and ratified' wage agreements with its 12 unions.

Also, in further evidence of the slowing US economy, the company reduced its forecast for volume shipment growth this year to 3% against 4% to 5% previously.

The latest US Institute of Supply Management survey of purchasing managers shows business sentiment has not only given up all its post-pandemic gains but is almost below its pre-pandemic level.

More worrying, if the downward trend continues it will soon break below the 50 level which means the economy is no longer expanding and is starting to contract instead.

By **Ian Conway** Companies Editor

Boom and bust, where do investors now stand with semiconductor stocks?

Sector has been bashed up this year, but there are optimistic signs, say experts

In 2021, global semiconductor revenues hit a record 527.9 billion, yet so far, 2022 has been horrible for microchip stocks. Since the end of December 2021, the 30-stock Philadelphia Semiconductor benchmark, or SOX for short, has fallen 43%.

For comparison, the S&P 500 has lost about 23%, the tech-heavy Nasdaq Composite 33%.

Stock valuations have been ransacked, even for standout sector names, like **Nvidia (NVDA:NASDAQ)**, **Qualcomm (QCOM:NASDAQ)**, **Intel (INTC:NASDAQ)**, **TSMC (2330:TPE)** and **ASML (ASML:AMS)**.

It's not hard to see why investors are concerned. A chip shortage that has hobbled the manufacturers of everything from smartphones to medical equipment, toys to wind turbines, stubbornly rumbles on, the global economy is starring hot inflation squarely in the face and recession hangs like a dark cloud over many of the world's largest economies.

SOX VS S&P 500

(Rebased to 100)

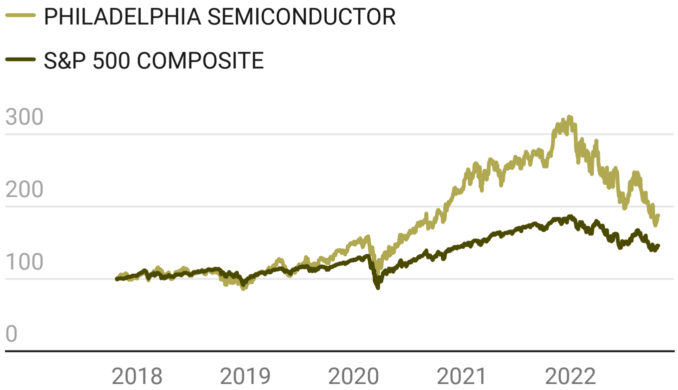
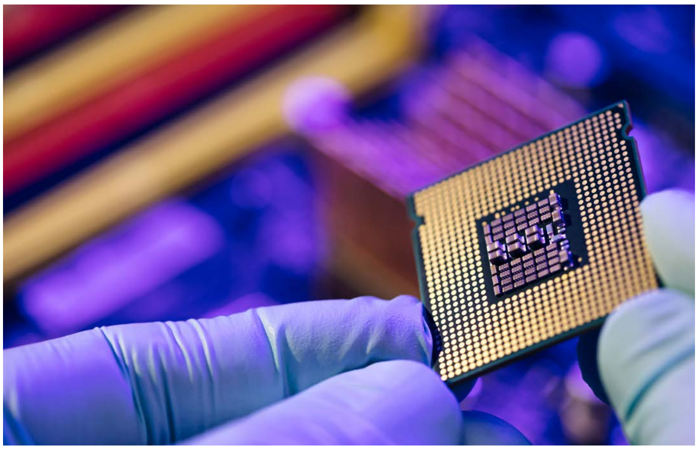


Chart: Shares magazine • Source: Refinitiv



But you know what they say, when the market mood is peak bleak, that's often time to buy. 'I think there is an absolutely massive opportunity here, and it might be realised quite quickly at this point,' says William de Gale, a fund manager who followed and analysed the semis industry for 20 years at BlackRock.

Now running his own **Bluebox Global Technology Fund (BN4H3T7)**, de Gale remains wedded to the semis sector, with 37% of the fund's assets tied up in the space, in names such TSMC, ASML and **Applied Materials (AMAT:NASDAQ)**.

WHY IS THE MICROCHIP INDUSTRY IN TROUBLE?

Given that semiconductors are critical building blocks of modern society, often have compelling cash flow metrics, and generally have positive end market growth trajectories, what's gone wrong.

The semiconductor industry initially eased back on manufacturing in 2020 as coronavirus lockdowns made it difficult to keep chipmaking facilities fully staffed. As restrictions eased, fabrication (fabs) started to move back towards capacity, with a long-lasting demand surge for PCs, smartphones, TVs, gaming consoles and much else replacing orders put on ice by other markets, including the auto industry. As those latter sectors recovered, it put enormous strain on fabs, which simply could not ramp up to meet the suddenly sky-high demand.

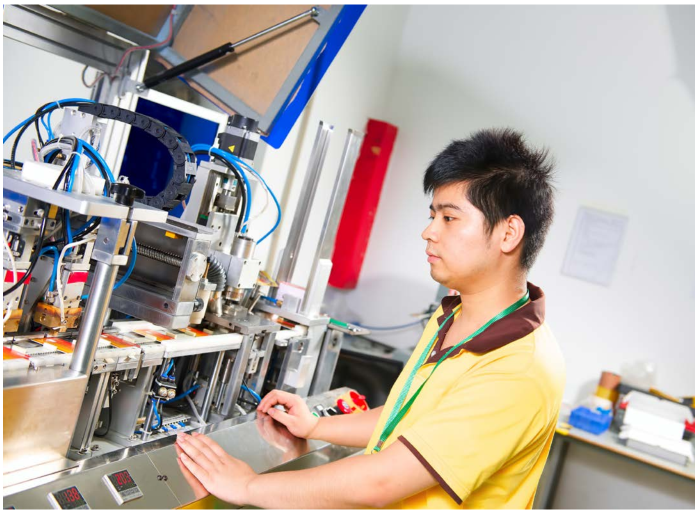
The effort to stabilise and boost chip supplies also faced headwinds from geopolitical conflicts, an increasingly fractious relationship between Washington and Beijing, natural disasters, and recurring Covid-19 outbreaks near important manufacturing hubs in China.

How long microchip supplies will remain tight is still an open question, but the consensus indicates that semiconductor fab capacity will fall short of incoming orders at least until the first half of 2023. However, some recent rumblings have raised the hopes of a faster recovery.

For example, automotive computing giant **NXP Semiconductors (NXPI:AMS)** saw signs of improvement in July's second-quarter earnings announcement. Chief executive Kurt Sievers noted that NXP is 'probably moving away from supply constraints' in the mobile chip market and the auto industry has started to increase its vehicle-building volumes.

Of course, the order backlog is still growing and NXP's customers have to count on lead times of several months, but NXP sees light at the end of the chip-shortage tunnel.

Just last week 19 October, ASML shares jumped 7% after the Dutch lithography equipment maker told investors that it would beat fourth-quarter analyst estimates and that it won't be badly impacted by the latest US restrictions on sales of silicon chips and technology to China.



How SOX stocks have performed

	2022 performance
Advanced Micro Devices	−60.9%
Applied Materials	−48.5%
ASML	−42.0%
Azenta	−59.6%
Broadcom	−33.1%
Coherent	−55.0%
Entegris	−44.2%
GlobalFoundries	−17.2%
Intel	−49.3%
IPG Photonics	−46.2%
KLA	−32.2%
Lam Research	−48.8%
Lattice Semiconductor	−34.3%
Marvell Technology	−55.8%
Microchip Technology	−29.6%
Micron Technology	−41.5%
Monolithic Power Systems	−32.7%
NXP Semiconductors	−36.3%
Novanta	−28.5%
ON Semiconductor	−6.5%
Qorvo	−46.4%
Qualcomm	−37.8%
Skyworks Solutions	−47.3%
Teradyne	−53.5%
Texas Instruments	−16.2%
TSMC	−38.7%
Wolfspeed	−12.7%

Table: Shares magazine • Source: Google Finance, data correct as at 24 October 2022

Simple guide to semiconductor stocks

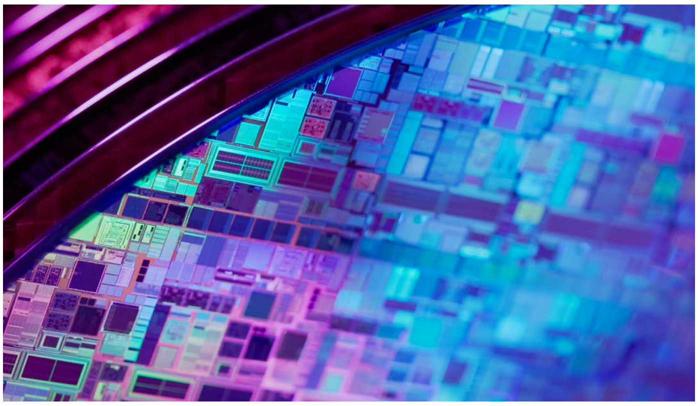
Fabless (designer not manufacturer) companies	Integrated suppliers	Foundry manufacturers	Equipment Providers
Nvidia	Intel	TSMC	ASML
Advanced Micro Devices	Toshiba	Samsung	Lam Research
Qualcomm	Micron Technology	GlobalFoundries	Applied Materials
Broadcom	Texas Instruments	United Microelectronics	Tokyo Electron
Marvell Technology	Microchip Technology	Semiconductor Manufacturing International	Teradyne
MediaTek	Infineon		
	NXP Semiconductors		

Table: Shares magazine • Source: SOX, Tech Insights, IC Insights, Shares

As inflationary fears hold consumers back from spending on new smartphones and other chip-powered devices, fading demand here will free fab capacity for microchips needed for industrial purposes, helping manufacturing giants to get back on track. Contract microchip maker TSMC supported this view in its own July earnings release

'Softness' on the consumer side allows the company to reallocate its manufacturing capacity to support more substantial order flows, where demand remains steady or rising. This way, TSMC is inching closer to meeting total market demand. However, the fight isn't over quite yet. TSMC said that the manufacturing pipeline will 'remain tight throughout 2022'.

This year has seen 'great pricing power come through, like TSMC putting up prices by about



20%... its order book remains incredibly robust,' said Nick Clay of the **Redwheel Global Equity Income Fund (BMBQMY8)**.

That said, TSMC has had to adjust, cutting this year's capital spend budget by 10% to realign its growth plans.

So even optimists agree that semiconductor shortages are likely to remain for some time yet. Given that the problem depends, to some degree at least, on macro and geopolitical issues, trying to predict exact timings is a mugs' game.

SEMICONDUCTORS ARE LONG-RUN THEME

Foretelling the future is an exercise Bluebox's de Gale typically sidesteps, but he does feel '80% confident' of improvements for the sector are incoming, and he makes an interesting point. 'Third-quarter reporting represents the end of the news vacuum,' he says, stressing the limited information that usually emerges from the industry during May to September.

This could see concerns of worrying inventory build-ups ease as quarterly reports emerge from sector players over the coming days and weeks. Higher inventories suggest that microchips already manufactured are not finding homes as quickly as they might, which is sometimes seen as a signpost to softening demand and weakening margins. Conversely, with expectations already low for this year and 2023, near-term financial results could be stronger than expected and prompt a sharp revaluation of sector stocks, especially given the long-run opportunity.

'Over the long run, semiconductor revenues are likely to oscillate around a trend line,' said analysts at Deloitte in their semiconductors industry outlook earlier this year. 'Still, that trend line looks steeper than ever before as we enter a period of robust secular growth.'

This is backed up by robust growth forecasts years into the future. According to Worldwide Semiconductor Trade Statistics, the market is expected to increase 13.9 percent in 2022, while figures presented by the Fortune Business Insights report predict compound average growth rates of nearly 13% a year out to 2029, which would imply revenues in excess of $1.38 trillion

This growth will be in part powered by a vast spending spree that many chipmakers have embarked on. In January 2022, TSMC, the world's biggest contract manufacturer, said it would spend up to $44 billion on new capacity in 2022. That is up from $30 billion last year, triple the number in 2019 and ahead of earlier plans to spend over $100 billion in total over the next three years.

Elsewhere, Intel earmarked $28 billion of investment this year, with new fabs in Ohio set to come onstream by 2025 at a total cost of $20 billion. An option to build six more later would take the overall price tag to $100 billion. **Samsung (005930:KS)** has hinted that its capital spending for 2022 will surpass last year's $33 billion, and others in the sector are also splurging on capacity expansion.

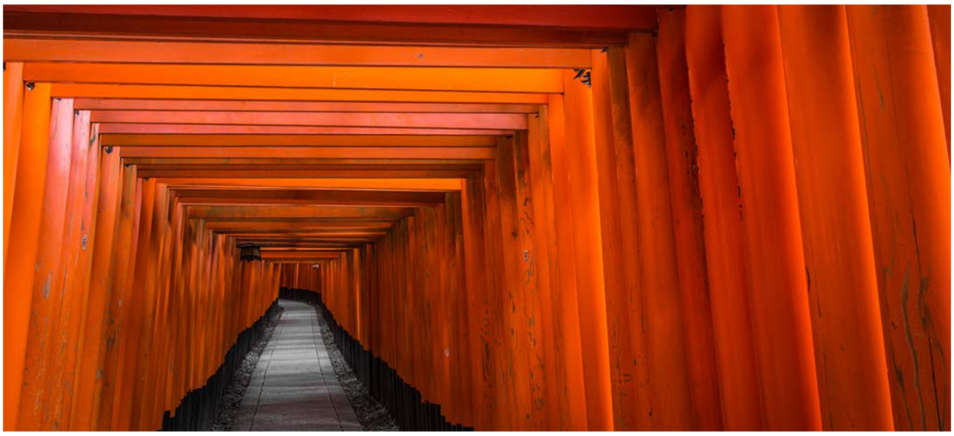
This is an industry with big structural drivers, with almost everything from cars to industrial infrastructure needing microchips, says Redwheel's Clay. ' We feel the backdrop to that market, the ability to put up prices and structural demand put them in strong position.'

By **Steven Frazer** News Editor

abrdn

A perspective on Asia

- Asian economies are not immune to inflation, higher interest rates and slowing growth, but the problems are far less acute than for many Western markets
- abrdn managers have sought to lean into the recovery seen in some countries and to capitalise on lower valuations
- A quality overlay remains vital to navigate volatility and focus on resilient companies



For many investors, China represents a conundrum: on the one hand, it seems unwise to ignore the potential opportunities created by the world's second largest economy, as 1.4 billion people grow wealthier. On the other, it has been a particularly difficult place to invest since the start of this year, weighed low by geopolitics, the government's Covid strategy and weakening economic growth.

Asian markets have been mixed as the weakness of the Chinese economy has rippled across the region. However, economies in the region may yet emerge stronger than their Western peers. They have less debt in their government and corporate sectors, fewer structural imbalances and stronger potential growth. Prioritising quality companies may help investors steer a path through the volatility and uncover long-term growth.

While Asian economies are not immune to the pressures of inflation, higher interest rates and slowing growth, the problems are not as acute as for many Western markets. Yoojeong Oh, manager of the abrdn Asian Income Fund says: "Inflation is lower and there is a better underlying growth story from domestic consumption and favourable demographics. That positions Asia relatively well to grow faster."

In Japan, monetary policy remains loose. Small amounts of inflation are, potentially, a net positive, with rising wages and improvement in demand boosting the economy. Hisashi Arakawa, manager of the abrdn Japan Investment Trust, says: "The Japanese economy has returned to pre-Covid levels and is supported by firm demand overseas. Inflation is ticking up, but is still low compared to other markets. For years, Japan was seen as an economy with deflationary pressure, but now we are seeing companies raise prices and pass on costs. It is a time of change."

China is the elephant in the room. There are two key issues – its zero Covid policy and the property market. Gabriel Sacks, manager of abrdn Asia Focus, says Covid is still prompting lockdowns, creating a stop-start situation, but the government is unlikely to change tack ahead of the Party Congress in October. He adds: "The authorities have been trying to rein in excesses in the property market. Property is such an important sector for the economy and for the wealth of households. It is affecting consumption in China." That said, there has been some easing of monetary policy, which has supported the economy.

Stock markets

Asian markets have been hit by the same combination of inflationary pressures, interest rate hikes and slowing demand that has hurt Western markets. Sacks says: "The start of the year saw commodities companies doing well alongside financials, on expectations of rising rates. In the second quarter, as the narrative shifted more towards recession, these sectors came down again. One consistently strong sector has been energy, particularly smaller energy companies, while IT has done consistently badly."

In this environment, abrdn managers have sought to lean into the recovery seen in some countries and to capitalise on lower valuations. Oh says: "We have been bringing down exposure to the large Taiwanese and Korean chip manufacturers, rotating them into companies with greater exposure to the reopening story across the region. That includes Kasikornbank bank in Thailand – which is both a strong digitalisation and Environmental, Social and Governance (ESG) story".

Sacks says: "We've been capitalising on some of the market weakness we've seen in China and Korea. We hope we've seen the market bottom for China, and have introduced two new, domestically oriented holdings there. We are trying to take advantage of cheap valuations to bring quality businesses into the portfolio." He says there are risks around earnings, given slowing growth, but companies are delivering on expectations for the time being.

Arakawa says that he is focused on a number of key themes: "Automation is important, and demand remains firm for robotics. We also favour those companies benefiting from supply chain diversification. Where US companies are bringing production back home from Asia, for example, they need new automation. We also see good demand around the energy transition theme. This includes energy saving air conditioners or heat pumps that can help homeowners."

Resilience through quality

However, all agree that a quality overlay is vital, given the uncertain environment. Oh says: "We favour businesses with balance sheets that don't face refinancing risks and business models where there is pricing power, where margins are more resilient, where your customers really need your products." Dividends are also important, she adds: "Dividends have already passed pre-Covid levels on a US Dollar basis. Quality companies that haven't taken on additional financial risks should benefit from dividend growth when there is a recovery."

Arakawa says he has reassessed the Japan portfolio to concentrate on higher quality names: "They are in a better position to navigate supply chain issues and stay ahead of the current risks. We're seeing this in earnings - high quality companies have demonstrated their ability to manage through difficult times."

In the short-term, says Oh, there is always something to worry about, from supply chain risk to geopolitics. "We try and mitigate those risks by understanding the businesses we invest in." Arakawa agrees, saying good management teams are capable of navigating these difficult times.

Sacks says he is cautiously optimistic for the year ahead: "There are pockets of weakness in some markets, but there are also companies that keep investing, keep expanding, that are becoming deeper entrenched in their niche and protecting their market position."

After the turbulence since the start of the year, valuations across Asian markets are now more appealing. There are plenty of opportunities across Asian markets, but some volatility is likely to continue and investors are unlikely to escape. Quality companies with strong balance sheets, predictable dividends and strong management teams are likely to prove more resilient through this period of volatility.

Companies selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance.

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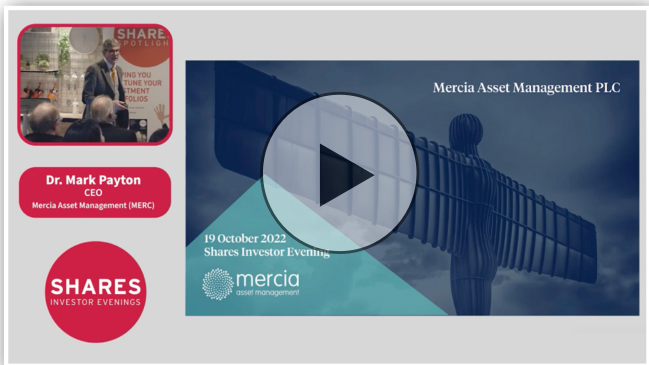

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Dr. Mark Payton, CEO & Martin Glanfield, CFO

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Marc Howells, CEO

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Steve Hunter

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How venture capital trusts provide big tax benefits while helping UK entrepreneurs

Explaining these products, the different varieties, costs and pros and cons

The VCT (venture capital trust) offer season is in full flow and recent launches include Octopus Group's £35 million fundraise for its **Octopus Apollo VCT (OAP3)** and Gresham House's £76 million raise for its generalist product **Mobeus Growth & Income VCT (MIX)**.

The Mobeus offer opened on 17 October and raised £52 million in the first three days, showing the popularity of these types of funds. Mobeus VCTs have topped the generalist performance league tables over the past five and 10 years. This feature explains the ins-and-outs of VCT investing and highlights the main advantages and drawbacks.

WHAT ARE VCTS?

Investors are allowed to put up to £200,000 a year into a VCT which attracts 30% tax relief. The money needs to remain invested for at least five years, but the advantage is that dividend income and capital gains are tax free.

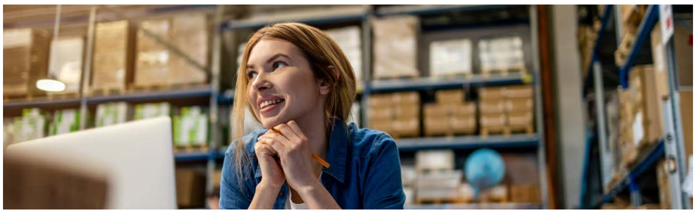
The reason behind the generous tax treatment is that some of the funds will be invested into early-stage companies which carry higher risks.

VCTs have evolved over recent years and the industry is now a mainstay of the investment landscape with around £6 billion of money invested in the sector.

WHO ARE VCTS FOR?

While the maximum investment limit might suggest the products are the exclusive domain of high-net-worth investors many products have minimum investments of as little as £3,000.

That said, investors on higher-rate or additional rate tax bands are naturally drawn to VCTs because of their tax benefits. Individuals who have maxed-out on their ISA and SIPP tax wrappers or are close to the £1.03 million pension lifetime allowance may find VCTs an attractive alternative.



Investors with exceptional one-off tax bills might consider the VCT route to reduce their tax liabilities. It is worth pointing out that investing for tax benefits alone is rarely a good strategy.

VCTs are not suitable for individuals who might need access to the cash within five years. If cash is withdrawn from a VCT within five years, the 30% tax relief must be paid back to the taxman. The nature of the product means taking on more investment risk which rules out VCT's for risk averse investors or those close to retirement.

HOW HIGH ARE THE FEES?

Typically, VCTs charge an entry fee of around 3% which is usually discounted for existing investors while annual management fees are between 2% and 2.5% a year. Performance fees can also be levied subject to minimum annual returns or 'hurdles' in the region of 5% or 6%. VCT fees are higher than those charged by plain vanilla actively managed funds, reflecting the complexity of the products and the work undertaken by managers to grow portfolio businesses.

Managers can take six months or more to conduct in-depth due diligence. They also spend a lot of time helping entrepreneurs to develop their businesses and opening doors to useful contacts.

At the end of the day the proof of the pudding is in the eating and many successful VCTs have delivered double-digit returns for shareholders.

WHAT ARE GENERALIST VCTS?

Generalist VCT's invest in early-stage unquoted companies which can be pre-revenue generating businesses. Managers are looking to 'get in on the ground floor' and benefit from strong anticipated growth and multiply their capital many times over.

The strategy will often result in a few failures because the reality is that most new businesses fail. 'A venture capital manager should expect half of their investee companies to fail,' says Hugi Clarke at specialist asset manager Foresight.

VCT managers investing in unquoted companies must deploy at least 30% of money raised within the first 12 months and 80% within three years to continue to qualify for VCT status. This means having a good idea of the amount 'follow-on' capital required to add to existing positions as well as brand new investments.

VCTs open for new investment

Fund	Minimum investment	Funds raised/ Target	Initial charge
Generalist VCTs			
Mobeus Income and Growth	£6,000	£52m /£76m	3.0%
Octopus Future Generations	£3,000	£39m/£60m	3.0%
Octopus Apollo VCT	£5,000	£0m/£35 m	5.5%
Puma Alpha	£5,000	£7.5m/£15m	3.0%
Puma VCT 13	£3,000	£5.4m/£40m	3.0%
Albion VCTs	£6,000	£14.4m/£50m	2.5%
Pembroke VCTs	£5,000	£5.6m/£40m	5.0%
Maven Income & Growth	£5,000	£1.1m/£40m	2.5%
Triple Point VCT 2011 Venture Shares	£3,000	£0.8m/£10m	5.5%
Blackfinch Spring VCT	£3,000	£0.3m/£20m	5.5%
Foresight Enterprise VCT	£3,000	0/£20m	5.5%
AIM VCTs			
Fund	**Minimum investment**	**Funds raised/ Target**	**Initial charge**
Hargreave Hale	£5,000	£15m/£20m	3.5%
Limited Life VCTs	**Minimum investment**	**Funds raised/ Target**	**Initial charge**
Fund			
Foresight Williams Technology	£3,000	£3.8m/£20m	5.5%
Edition VCT	£3,000	£0.5m/£10m	5.5%
Hybrid VCTs			
Fund	**Minimum investment**	**Funds raised/ Target**	**Initial charge**
Guniness VCT	£5,000	0/£10m	5.5%

Table: Shares magazine • Source: Bestinvest/ Wealthclub data at 20 October 2022

Chief investment officer at Mobeus Trevor Hope told *Shares* the team usually targets putting around 40% on new money into existing positions and the rest into new investments.

A good example of follow-up investment is My-Tutor which is an online platform for students and schools which Mobeus first invested in four years ago. The Mobeus team are interested in investing in businesses that can scale such as business-to-business technology and services companies.

Other areas of focus for Mobeus are healthcare services, consumer brands and e-commerce enablers. Hope said the team knew the consumer brands space very well and had previously invested in high-end furniture and lighting business Buster and Punch.

The Mobeus portfolio is invested across 42 companies. The team look at 30-to-40 companies per month and take around six into extensive due diligence from which it invests in one or two. The fund has a good track record delivering double digit returns over the last decade. Taking a £100,000 investment to illustrate the return profile, it has produced £112,000 of dividends and £75,000 of capital gains in addition to the £30,000 of tax relief.

Conscious of investor's need to access their money after the five-year lock-up, Mobeus offers an annual buyback facility at around a 5% discount to net asset value.

WHAT ABOUT AIM VCTS?

Many individuals are drawn to AIM VCT because they are already familiar with stocks on London's junior market. Unlike Generalist VCTs which are full of unquoted companies, AIM VCTs feature stocks which are more transparent in terms of corporate updates and their latest valuation.

VCT managers are only allowed to invest in AIM companies when they raise capital either via IPO (initial public offering) or a share offer. In other words, they are not allowed to purchase shares in the secondary market.

The largest player in this segment is Octopus Group and its September fundraising offers investors the opportunity to invest into both **Octopus AIM VCT (OOA:AIM)** and **Octopus AIM VCT 2 (OSEC:AIM)**, which both target a 5% tax free dividend yield every year.

Kate Tidbury, senior fund manager at Octopus Investments, commented: 'We believe there is room for valuations to recover when the market outlook improves, and we're continuing to focus on finding companies and management teams that we think can deliver significant growth over the long-term.

'We expect to have opportunities to invest the funds raised at attractive valuations.' Octopus' AIM VCT portfolios contain companies across various sectors which offer what the manager believes to have significant growth potential.

One example is **Clean Power Hydrogen (CPH2:AIM)** which has developed a technology able to generate pure hydrogen and oxygen as separate gases to accelerate progress towards a zero-carbon future. Octopus invested in the company when it floated on AIM in February 2022.

Some companies have been held for over a decade, such as Scottish-based software company **Craneware (CRW:AIM)** which provides software to gather operational, financial, and clinical data that gives healthcare providers valuable insights.

LIMITED LIFE VCTs

The essential goal of these types of VCT is to ensure an investor gets his money back after five years, so he can reap the 30% tax benefit.

The investment manager's role is to increase the value of the portfolio to cover the fees, typically an upfront 4% and 2% annual management fee as well as administration fees of around 0.35%. Should the VCT manager manage to exceed that goal investors should expect to pay a performance fee in the region of 20% on the gains above the original entry price.

As an example, Jane invests £10,000 and gets £3,000 back from the tax man, leaving her with an initial investment of £7,000. Turning £7,000 into £10,000 requires the fund to grow around 43% over five years which is just over 7% a year.

Limited life VCTs will adopt a conservative investment approach to reflect the relatively short-term investment time horizon. They typically hold sizeable cash and short dated loans, and qualifying deals are asset backed, primarily through loan notes.

By **Martin Gamble** Education Editor

PANTHEON

PIP: An outstanding long-term track record

Pantheon International Plc ("PIP"; ticker code: PIN) is a FTSE 250 private equity investment company which is managed by Pantheon, a leading global private markets investor, and overseen by an independent Board of Directors. Helen Steers, Partner at Pantheon and lead manager of PIP, discusses what PIP offers to shareholders, its recent financial results and the outlook.

Helen Steers, Partner at Pantheon and manager of PIP

Investing in growing companies in resilient sectors

PIP provides investors with exposure to high growth, exciting private companies, operating in niche industry sectors, backed by many of the best private equity managers in the world. Around 45% of PIP's portfolio is invested directly in single company positions, while the remaining 55% is invested in high quality private equity funds globally. Private equity is difficult to access, due to its complexity and the "invitation-only" nature of traditional in private equity funds, however listed private equity companies like PIP, "make the private, public".

PIP's global portfolio is orientated towards control positions in small and medium-sized businesses, and those in the growth phase of their development. We like this area of the market since our private equity managers, with their "hands-on" approach and significant operational expertise, can pull a number of levers to create value in the businesses over the long term. There are also several routes through which they can sell the companies, once their value creation plan has been achieved. The majority of the exits in PIP's portfolio are to corporate buyers, who acquire these attractive, growing businesses for strategic reasons, or to other private equity managers who are aiming to take the business on to the next stage of its growth. Very few exits in PIP's portfolio are due to the companies being taken public, and in fact only 7% of PIP's realisations were through IPO last year. Therefore, PIP is not dependent on the IPO market being open in order to sell its underlying businesses. Furthermore, PIP's portfolio is tilted towards asset-light companies, which typically have no debt (in the case of companies in the growth capital stage), or lower levels of debt (in the case of small and mid-sized businesses), compared with large and mega sized firms.

PIP's portfolio is actively managed and has demonstrated resilience in a variety of market conditions, including in times of macroeconomic stress. Sector selection plays an important role in this since PIP's portfolio is tilted towards Information Technology and Healthcare, and both areas have performed well through various cycles, benefiting from long-term secular trends that are unlikely to be significantly impacted by the macroeconomic environment. The technology businesses that we invest in are typically profitable, mission-critical software and IT infrastructure companies, and those that are supporting the move towards automation and digitalisation across many other sectors. These are high quality, cash generative companies with strong recurring revenues and pricing power. We also favour Healthcare due to the tailwinds created by ageing demographics in developed economies around the world, and increased demand for high quality healthcare products and services from the growing middle classes in emerging economies.

Governance is strong in private equity, at both the underlying company and at the fund level, and PIP is no different with its independent Board of Directors who bring a wealth of knowledge and expertise from private equity, corporate finance, macroeconomics, government, accountancy, media and marketing. Strong alignment of interests and incentivisation is a characteristic of our

Annualised Performance as at 31 May 2022

	1yr	3yrs	5yrs	10yrs	Since inception
NAV per share	31.0%	17.7%	15.6%	14.8%	12.4%
Ordinary share price	8.6%	9.9%	10.5%	14.7%	11.3%
FTSE All-Share, Total Return	8.3%	5.8%	4.1%	8.1%	7.6%
MSCI World, Total Return (Sterling)	7.8%	13.2%	10.8%	13.9%	8.4%

PIP was launch on 18 September 1987. The figures since inception assume reinvestment of dividends, capital repayments and cash flows from the exercise of warrants. Past performance does not guarantee future results and loss of principal may occur.

industry, and PIP's Directors have demonstrated that they too have 'skin in the game'. As at 31 May 2022, they collectively held 2.6 million shares in PIP and this has increased significantly since then.

Consistent outperformance over 35 years

The active management of PIP's portfolio, including dynamic sector, company and manager selection, has supported PIP's objective to maximise capital growth over the long term for shareholders. In its recent annual results, PIP reported an outstanding year of performance with record growth in the value of its net assets ("NAV") as well as record net cash flow and investment activity for the 12 months to 31 May 2022. PIP's NAV grew by 31.0% during the financial year and in the 35 years since PIP's inception in 1987, it has grown by an average of 12.4% each year. This performance is stated net of all fees.

Annual report

The new financial year has started well with NAV per share growth of 5.9% in the first three months to 31 August 2022. In the first quarter, PIP made 15 new investments for a total of £226.3m and we have a strong pipeline that we believe will drive deal flow in the months ahead.

PIP also has a strong balance sheet that is being conservatively managed to withstand uncertainty. At the end of August 2022, PIP had net available cash of £121m and we recently agreed a new, enlarged £500m five-year multi-currency, revolving loan facility to replace the previous lending agreement. There is an option to extend this new facility by one year at a time beyond its expiration in July 2027. All of this enables the Company to continue to meet its outstanding investment commitments while being well-positioned to invest in compelling deal opportunities over the coming months and years.

PIP August 2022 NAV Newsletter (piplc.com)

Outlook

While we remain prudent in the current economic environment, we believe that our industry will continue to experience significant growth in the future and provide attractive net returns to investors. Private equity managers have a long-term investment horizon and are able to act quickly to help their portfolio companies through difficult times, providing both financial and operational resources. We saw that happening right across PIP's portfolio during the COVID-19 pandemic. The nimbleness of our managers means that they are also able to take advantage of the opportunities that can often arise from market dislocation.

In addition, private equity managers are not forced sellers and therefore can wait until the time is right to exit their companies, which they aim to do at attractive uplifts to holding valuations. The uplift measures the cash received on a fully realised exit to that investment's carrying value 12 months prior to the transaction. For the financial year ended 31 May 2022, the average uplift achieved for PIP's buyout exits was an impressive 42%. Since we started tracking this metric in 2012, the average uplift has been 31%. We believe that this demonstrates the embedded value in PIP's portfolio and is evidence of the skills that our managers bring to bear in helping their portfolio companies to grow.

For the past 35 years, Pantheon has managed PIP through numerous economic cycles to deliver long-term outperformance over its public market benchmarks. Investors must assess carefully what is suitable for them and their investment objectives and tolerance for risk but PIP's access, through Pantheon, to growing private companies, managed by many of the best private equity managers in the world provides us with the confidence that PIP can continue to provide attractive returns to shareholders over the long term.

Just how safe is your pension amid the current turmoil?

Examining the risks to defined benefit and defined contribution schemes as well as the state pension

You'd be hard pressed not to pick up a paper without reading about turmoil in pensions at the moment, whether it's the Bank of England having to bail out final salary schemes, or the state pension triple lock being under threat.

The negative headlines have naturally caused people to question how safe their own pensions are, and whether they might be in the firing line. No retirement plan or investment is entirely without any risk, but when it comes to pensions, a lot depends on what kind of scheme you have,

WHICH TYPE OF PENSION IS SAFER?

There are two main types of private pension in the UK. Defined benefits schemes, of which final salary schemes are a subset, are still prevalent in the public sector. They have largely died out in the private sector, but many people still have entitlements built up, even where these schemes have been closed to new contributions. Then there are defined contribution pensions, which include personal pensions, stakeholders, SIPPs, and occupational defined contribution schemes. Each type has different risks attached.

Defined benefit schemes were at the centre of the recent intervention by the Bank of England. Nonetheless these schemes are known as gold-plated for a reason. That's because members are basically guaranteed an income for life when they hit retirement. These schemes have run into trouble recently because of their exposure to government bonds, and the Bank of England had to step in to help. But even if they hadn't, there are a number of protections in place that would have shielded members from losing their pensions.

HOW PENSIONS ARE PROTECTED

The first is that each one of these schemes holds a pot of assets to pay off members. Most schemes are in surplus, which means they have more than enough money to pay pensions, so they can afford some losses. Even in a situation where they fall into deficit, that doesn't affect members' pensions, because the pension trustees can then ask the employer who set up the scheme to pay more money in.

The problem comes if the employer goes bust. But even then, the scheme would fall into the Pension Protection Fund, which is an industry-wide compensation scheme that pays benefits to members of failed schemes at, or close to, what they were promised. So, there are lots of barricades in place between defined benefit pension members and the risks of the market.

The same is not the case with defined contribution schemes. These are now the predominant form of pension saving in the UK. Here, your pension is invested in the market, and is therefore subject to the ups and downs of share prices.

AT THE MERCY OF THE MARKET

Over the long term, the ups should prevail, and provide you with a positive real return on your money. But clearly members of these schemes face investment risk, which can be mitigated to a certain extent through balanced and sound investment selection. For pension savers who are decades away from retirement though, risk is really a friend rather than a foe, because it should be associated with higher long run returns, even if there are ups and downs along the way.

Unlike defined benefit schemes, members of defined contribution schemes are also subject to longevity risk. That's the risk of people living longer, or indeed of the individual in question living a long life. If a defined benefit member lives to 110, the scheme keeps paying them until they die. But if you hit 100 as a defined contribution scheme member, you could find yourself running out of money if you haven't provisioned adequately. You can buy an annuity with your defined contribution pension. which will also pay out income until you die, but you are subject to the annuity rates on offer on the market. These are determined by interest rates and life expectancy trends, so you're still subject to the risk of these moving unfavourably, at least until you lock into an income stream by buying an annuity.

Defined contribution schemes are often seen as the poor cousins of defined benefit schemes. But the reality is, if you paid as much into defined contribution schemes, you would achieve similar outcomes, albeit with no guarantees. It wasn't unusual for employers with defined benefit schemes to pay 20% of salary into the pension to provide the promised benefits, and that's on top of employee contributions of 5% to 10%. Throw that into a defined contribution scheme, and you'll have a pretty affluent retirement.

WHAT ABOUT THE STATE PENSION?

As well as private pensions, it's also worth considering the risk in the state pension, especially given the parlous state of public finances. We've seen the state pension triple lock being used as a political football, and the truth is the state pension bill is an enormous chunk of government expenditure.

Those who are close to state pension age are probably relatively safe because politicians wouldn't like to be seen to be pulling the rug out from under voters at the last minute. Those who are further from retirement are a softer target.

State pension age is currently forecast to rise to 68 by the mid-2040s, and it wouldn't be a huge surprise to see that programme accelerated and deepened. There's not a great deal pension savers can do about this, but best buffer against retrenchment of the state pension, and against uncertainly in general, is to make-sure your pension is well-funded. That way, at least you have some insulation against any unexpected shocks.

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

How Saudi Arabia is making a strong start to life as an emerging market

The Middle Eastern state has outperformed stocks in other developing economies since 2019

Since its full inclusion in the MSCI Emerging Markets index in 2019 (and the emerging markets cohort of other index providers) Saudi Arabia has outperformed to an impressive degree.

After a difficult start in the early stages of the pandemic, a subsequent recovery in oil prices has driven Saudi stocks higher. If reports are to be believed the Riyadh market could soon be bolstered by the listing of the trading division of state-owned energy firm Saudi Aramco, after the main operations were floated in a blockbuster domestic listing in 2020.

For the three years to 30 September 2022, the MSCI Saudi Arabia index has achieved an annualised return of 13.5% compared with -2.1% for the wider MSCI Emerging Markets index over the same timeframe.

While there has been considerable volatility in Saudi stocks thanks to its exposure to energy markets, MSCI data going back to 29 August 2014 shows an annualised return of 5.3% for Saudi shares against -0.3% for the broader benchmark.

It might surprise casual observers to learn that only around 9% of MSCI Saudi Arabia is accounted for by the energy sector – which is largely Saudi Aramco's weight in the index.

Financials and materials dominate, making up more than 70% of the index combined. This dominance of banks, other financial institutions and resources firms is much more like emerging markets of the past and suggests that Saudi efforts to bolster technology and innovation and diversify the economy still have some way to go.

MSCI Saudi Arabia - Sector breakdown

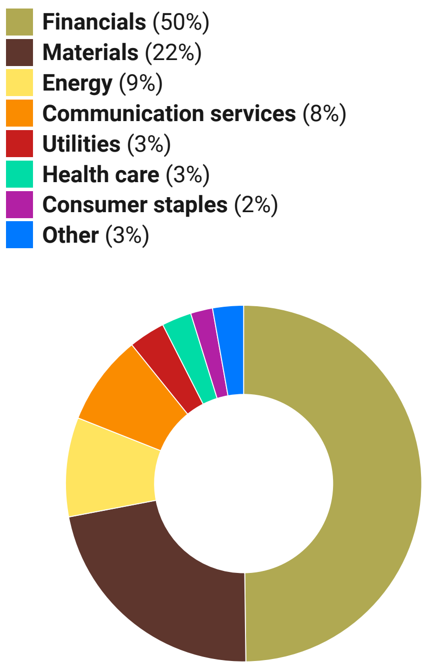


Chart: Shares magazine • Source: MSCI, 30 September 2022

Emerging markets: Views from the experts

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

1. **China National Congress.** The week-long National Congress of the Chinese Communist Party (Congress) began on 16 October. This gathering takes place every five years and is expected to re-appoint Xi Jinping as the president for a new term of five years. The Congress will also appoint a new premier, as Li Keqiang is stepping down. From an investor's perspective, attention will focus on policy measures after the Congress concludes. It is believed that more substantial policies to stimulate growth have been held back until Xi Jinping is reappointed. While investors will likely welcome more aggressive policy easing, it is taking place against a backdrop of slowing global growth, weak domestic consumption due to China's zero-Covid policies and US lawmakers' hawkish stance toward access to key technologies that China needs to accelerate growth. While China still has policy levers to pull, the global backdrop could dilute their impact.

2. **Brazil elections.** The first round of elections produced no single candidate with more than 50% of the vote, which means the two candidates with the highest share of the vote will progress to a second round on 30 October. Jair Bolsonaro, the incumbent president, will face his rival Luiz Inacio Lula da Silva in the runoff. Investors should look through the elections and focus on market-friendly developments in the coming 12 months. The potential for interest rate cuts in 2023 stands out given the central bank hiked interest rates ahead of most other central banks globally, and inflation may have recently peaked. If inflation continues to trend down, there is room for a less restrictive monetary policy, with a positive impact on the Brazilian stock market.

3. **Oil prices.** Oil prices have been steadily declining since their peak on 8 March following Russia's invasion of Ukraine. Relative to the $68.1 average price of West Texas Intermediate (WTI) crude oil in 2021, prices have averaged $98.1 year-to-date, an increase of 31%. Looking ahead, the decision by the Organization of Petroleum Exporting Countries (OPEC) to cut output, may support prices in the short term. However, with a global recession looking increasingly likely in 2023, it is difficult to see oil prices remaining elevated for a prolonged period.

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

RUSS MOULD
AJ Bell Investment Director

How to measure the new chancellor's progress

Jeremy Hunt will hope to outlast his immediate predecessor but what's the best way to judge him?

South West Surrey MP Jeremy Hunt is the fourth chancellor in four months. Assuming he remains in place under new prime minister Rishi Sunak he is likely to measure success in terms of jobs, economic growth and ultimately opinion polls and then votes when the next general election comes around, in 2024, if not earlier.

Investors will be looking to their portfolios to gauge the effect of his policies. Mr Hunt's first-day hat-trick of share prices up, sterling up and gilt yields down (17 October) was a good start, as he calmed markets with a return to something that looked like fiscal orthodoxy and promises of some numbers that would actually add up, come the now planned Autumn Statement and the Office for Budget Responsibility's independent analysis, on 17 November.

How the FTSE All-Share has performed under Conservative and Labour chancellors

		Nominal	Real
Conservative	Average gain	27.0%	10.7%
Labour	Average gain	32.2%	(4.0%)
Conservative	CAGR*	4.3%	2.5%
Labour	CAGR*	4.1%	(0.2%)

*Compound annual growth rate

Table: Shares magazine • Source: Refinitiv data, www.gov.uk.

But there is still work to be done before jokes about the UK turning into an emerging market stop being funny and start turning serious.

LESSONS OF HISTORY

Jeremy Hunt is the 20th chancellor since the inception of the FTSE All-Share index in 1962. Fourteen of his predecessors have been Conservative and five Labour. Whether he will match Gordon Brown for longevity remains to be seen, as the Labour chancellor held office for 3,708 days from 1997 to 2007, but he'll certainly be hopeful of outlasting his Conservative predecessor, Kwasi Kwarteng, who managed just 38 days.

Fourteen of his predecessors have been Conservative and five Labour, so the public has, so far, preferred to have the Tories in office and in charge of the nation's finances. At first glance, from investor's point of view, there is little in it between the two parties' financial stewardship.

Under Conservative chancellors, the FTSE All-Share has chalked up a total capital gain of 354%, in nominal terms. That equates to an average advance per chancellor of 27% (and the average is dragged down by the short tenure of both Nadhim Zahawi and Kwasi Kwarteng).

FTSE All-Share performance by chancellor in nominal terms

			Nominal capital return FTSE All-Share
Conservative	**Nigel Lawson**	1983-89	**144.4%**
Labour	**Denis Healey**	1974-79	**101.5%**
Labour	**Gordon Brown**	1997-2007	**58.9%**
Conservative	**Sir Geoffrey Howe**	1979-83	**56.4%**
Conservative	**Ken Clarke**	1993-97	**51.8%**
Conservative	**Norman Lamont**	1990-93	**36.4%**
Conservative	**George Osborne**	2010-16	**31.3%**
Conservative	**Reginald Maudling**	1962-64	**20.5%**
Labour	**James Callaghan**	1964-67	**17.2%**
Conservative	**Philip Hammond**	2016-19	**14.3%**
Conservative	**Anthony Barber**	1970-74	**8.1%**
Conservative	**Nadhim Zahawi**	2022	**3.4%**
Conservative	**Sajid Javid**	2019-20	**2.2%**
Labour	**Roy Jenkins**	1967-70	**1.5%**
Conservative	**Ian Macleod**	1970	**1.6%**
Conservative	**John Major**	1989-90	**(3.4%)**
Conservative	**Kwasi Kwarteng**	2022	**(6.3%)**
Conservative	**Rishi Sunak**	2020-22	**(6.9%)**
Labour	**Alistair Darling**	2007-10	**(18.1%)**

Table: Shares magazine • Source: Refinitiv data, www.gov.uk.

Under Labour the benchmark has risen by 161% for an average gain of 32.2%. Across 36 years of Tory chancellorships that is a compound annual growth rate (CAGR) of 4.3% against 4.1% under 24 years of Labour in 11 Downing Street and two of the top-five best spells under a single Chancellor come under Labour, again in nominal terms.

However, the picture changes profoundly when inflation is taken into account and capital returns from the FTSE All-Share are assessed in real (post-inflation) terms rather than nominal ones.

Here, Conservative chancellors come out well on top, as the withering effect of inflation upon investors' returns from the stock market under Labour's Healey chancellorship of the mid-to-late 1970s comes into play, even if Labour supporters will argue his record is tarnished by the need to tackle the mess left behind by the Conservatives' Anthony Barber's crack-up boom and the oil price spike of the early seventies.

The Barber boom and its legacy was one reason why the Truss-Kwarteng mini-Budget frightened markets, as inflation was already lofty before the stimulatory, tax-cutting plan, which conjured up the

spectre of more inflation and faster interest rate increases, even as the economy potentially slowed.

From the narrow perspective of investors, inflation also chewed up the nominal gains made by the FTSE All-Share under Barber (and under one of his Conservative successors, Geoffrey Howe, for that matter).

Investors could therefore be forgiven for wishing Hunt to look back to, and learn from, the experiences of both Barber and Healey, as, helped by the Bank of England, he attempts to steer the economy between the twin threats of inflation on one side and recession on the other.

MISERY INDEX

The economist Arthur Okun's Misery Index could

FTSE All-Share performance by chancellor in real terms

			Real capital return FTSE All-Share
Conservative	**Nigel Lawson**	1983-89	**105.9%**
Conservative	**Ken Clarke**	1993-97	**40.6%**
Conservative	**Norman Lamont**	1990-93	**27.8%**
Labour	**Gordon Brown**	1997-2007	**26.8%**
Conservative	**Reginald Maudling**	1962-64	**14.6%**
Conservative	**George Osborne**	2010-16	**13.5%**
Labour	**James Callaghan**	1964-67	**6.1%**
Conservative	**Philip Hammond**	2016-19	**4.4%**
Conservative	**Nadhim Zahawi**	2022	**2.8%**
Conservative	**Sir Geoffrey Howe**	1979-83	**1.4%**
Conservative	**Sajid Javid**	2019-20	**1.4%**
Conservative	**Ian Macleod**	1970	**1.1%**
Labour	**Denis Healey**	1974-79	**(8.9%)**
Labour	**Roy Jenkins**	1967-70	**(18.0%)**
Conservative	**John Major**	1989-90	**(14.1%)**
Conservative	**Rishi Sunak**	2020-22	**(24.4%)**
Labour	**Alistair Darling**	2007-10	**(26.0%)**
Conservative	**Anthony Barber**	1970-74	**(31.7%)**
Conservative	**Kwasi Kwarteng**	2022	**n/a**

**Inflation data not yet available*

Table: Shares magazine • Source: Refinitiv data, www.gov.uk. Adjusts nominal return by change in the retail price index (RPI) as CPI data only goes back to January 1989 in current format

be a useful tool to measure the chancellor's progress. It simply adds together the prevailing rate of inflation to the prevailing rate of unemployment, to remind all that full employment is no guarantee of content if there is inflation and that low inflation is no guarantee of happiness (or political success) if unemployment is high.

The Misery index, based on the last published unemployment rate of 3.5% and the last retail price index inflation reading of 12.4%, is 15.5% (RPI is no longer an officially recognised statistic, but the dataset has a longer history that CPI).

That is the highest reading since 1991 when the UK was in a deep recession, and one that was resolved, at least in part, by the devaluation of sterling after its inglorious exit from the Exchange Rate Mechanism in 1992. If the Misery Index starts to drag down Hunt, then sterling could be quick to show further strain.

The Misery Index keeps rising

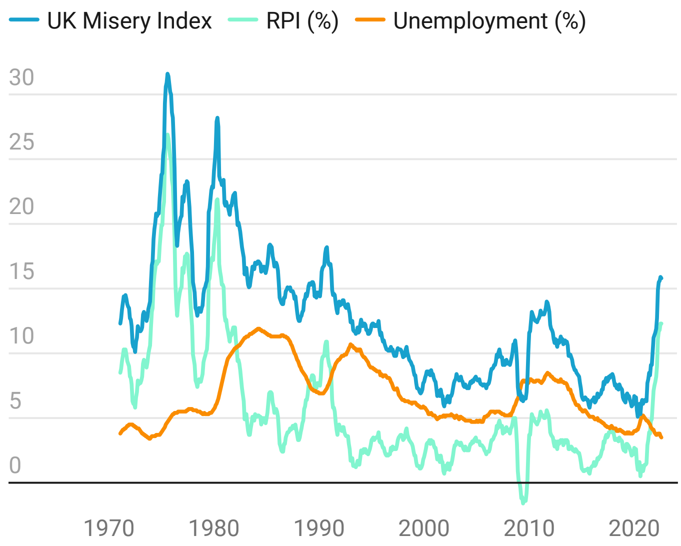
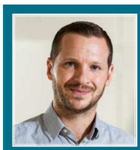


Chart: Shares magazine • Source: Office for National Statistics data

What exactly is going to happen to the state pension?

Our resident expert deals with the uncertainty around the triple-lock and whether it will remain in place

Can you tell me what the state pension will be worth next year? I'm trying to plan my spending for next year but there seems to be conflicting information about whether or not the triple-lock will be in place.
Stephanie



Tom Selby, AJ Bell Head of Retirement Policy, says:

Unfortunately, I can't tell you with absolute confidence what your state pension will be worth from April next year.

The latest position of the Government, as articulated by former prime minister Liz Truss, is that the 'triple-lock' manifesto pledge will be honoured for next year's state pension increase.

However, Truss is no longer in office and the new and current chancellor, Jeremy Hunt, had previously said state pension increases were under review. We may get more clarity on all this at an Autumn Statement now planned for 17 November.

The amount of state pension you are entitled to will primarily depend on your age and National Insurance (NI) contribution record.

The full flat-rate state pension is paid to those who reached state pension age from 6 April 2016 and is worth £185.15 per week in 2022/23. Those who have a 35-year NI record receive the full amount, with deductions made for each year missing from your record.

The basic state pension is paid to those who reached state pension age before 6 April 2016 and is worth £141.85 per week. If you had an NI contribution record of less than 30 years, then you may have received less than this amount.

You may also have built up 'additional state pension' entitlements under the old system. For those who did so and reached state pension age from 6 April 2016, these entitlements were honoured in the new system.

This means you may receive more or less than the full flat-rate amount, depending in part on whether you chose to 'contract out' of the additional state pension in return for lower NI contributions.

The triple-lock is applied to the full flat-rate state pension and the basic state pension. It promises to increase the benefits by the highest of average earnings growth, inflation or 2.5%.

The earnings figure traditionally used is for the three months to July (5.5%), while the inflation figure is usually CPI for September (10.1%). If the triple-lock is maintained, this implies that from April 2023 the full flat-rate state pension, paid to those reaching state pension age from 6 April 2016, will increase from £185.15 per week to £203.85 per week (£10,600.20 per year) from April next year The basic state pension, paid to those who reached state pension age before 6 April 2016, will increase from £141.85 per week to £156.20 per week (£8,122.40 per year).

However, if earnings growth for the three months to July is used instead, the full-flat rate state pension would rise to £195.35 per week. The basic state pension would rise to £149.65 per week.

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.

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

31 October: Lok'n Store.
3 November: UP Global Sourcing.

Half-year results:

2 November: Appreciate Group. **3 November:** Nuformix, RS Group, Sainsbury's, Trainline, Wizz Air.

Trading updates

28 October: ContourGlobal, NatWest. **1 November:** BP. **2 November:** Coca-Cola Europacific Partners, Gem Diamonds, GSK, Morgan Sindall, Next, Smurfit Kappa. **3 November:** Derwent London, Helios Towers, Howden Joinery, Lancashire, Smith & Nephew, TI Fluid Systems.

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