

STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

WHAT TO EXPECT IN 2023

THE OUTLOOK FOR
STOCKS, BONDS,
GOLD AND MORE



FUNDSMITH EQUITY FUND SET FOR FIRST ANNUAL LOSS

A unique investment philosophy

Finding value overlooked or misunderstood by the market



Asset Value Investors (AVI) has managed the c.£1.1bn* AVI Global Trust (the “Trust”) since 1985. The strategy over that period has been to buy quality companies held through unconventional structures and trading at a discount to estimated underlying net asset value; the strategy is global in scope, and we believe that attractive risk-adjusted returns can be earned through detailed research with a long-term mind-set.

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

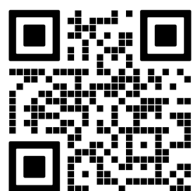
AVI has a well-defined, robust investment philosophy in place to guide investment decisions. An emphasis is placed on three key factors: (1) companies with attractive assets, where there is potential for growth in value over

time; (2) a sum-of-the-parts discount to a fair net asset value (“NAV”); and (3) an identifiable catalyst for value realisation. A concentrated core portfolio, with the current top 10 holdings accounting for nearly 60% of NAV, allows for detailed, in-depth research which forms the cornerstone of our active approach.

Once an investment has been made, we seek to establish a good relationship and actively engage with the managers, board directors and, often, families behind the company. Our aim is to be a constructive, stable partner and to bring our expertise – garnered over three decades of investing in asset-backed companies – for the benefit of all.

AGT’s long-term track record bears witness to the success of this approach, with a NAV total return well in excess of its benchmark. We believe that this strategy remains as appealing as ever and we continue to find plenty of exciting opportunities in which to deploy the Trust’s capital.

Discover AGT at aviglobal.co.uk



*As at 31 October 2022

Past performance should not be seen as an indication of future performance. The value of your investment may go down as well as up and you may not get back the full amount invested. Issued by Asset Value Investors Ltd who are authorised and regulated by the Financial Conduct Authority.



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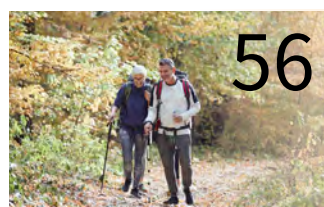
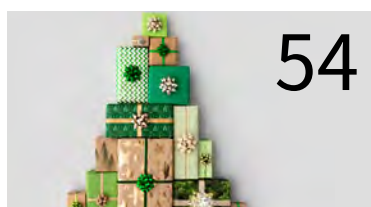
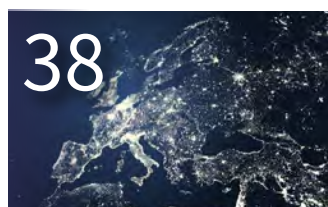
AVI-Global-Trust

AVI

Asset Value Investors

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Are the worst performing sectors the best ones the following year?

Discover the trends among FTSE 350 sectors over the past 16 years

There is a widely held view among many investors that a successful investment strategy is to buy the previous year's losers. The idea is that bad news might be fully priced in, and you're paying a cheaper price to buy something that could rebound on good news.

To test this theory, I looked at the performance of each FTSE 350 sector on an annual basis dating back to the start of 2007, a long enough period to encompass good and bad economic conditions.

The conclusions were fascinating but not as straightforward as one would hope. Rather than being a simple 'worst performer one-year, best performer the next', one can make the following observations.

The most economically sensitive sectors such as banking typically see feast or famine. They tend to see a bad period then a very good one, but each period often lasts two or three years before reversing, rather than alternating each year.

A good example is industrial metals and mining. It fell approximately 57% in 2007 and down another 84% in 2008 as the global financial crisis gripped the world. But in 2009 the sector jumped 307% and then rose a further 72% in 2010. Performance then reversed, falling 54% in 2011, down 29% in 2012 and dropped another 49% in 2013. The seesaw motion then continued, including a 212% surge in 2016 and a 71% rise the following year. The retail sector has seen similar trends, albeit not as extreme.

Some apparently defensive sectors did not offer a smooth ride including telecoms services and electricity. Investors might presume that paying for your broadband or electricity is non-discretionary

Worst performing FTSE 350 sectors in 2022

	% change
Automobiles & Parts	-60
Precious Metals & Mining	-45
Household Goods/Home Construction	-43

Table: Shares magazine • Source: SharePad, data to 9 Dec 2022

and therefore the utility provider's earnings are solid and growing, and so by extension the share price slowly ticks up. That certainly wasn't the case with nine 'down' years out of 16 for the telecoms services sector.

Other defensive sectors were kinder to investors. Tobacco has only seen three 'down' years since 2007 and healthcare has been up 12 out of the past 16 years. The latter was matched by the beverages sector.

The data shows many of the more volatile sectors provided the highest average returns – a reflection that you're taking on more risk in the hope of winning big. Industrial metals and mining was the most volatile sector and also the most rewarding, with an average 26.8% annual return between 2007 and 2022. The worst was telecoms equipment with an average 5.2% annual loss.

Beverages and chemicals provided the same average return at 10.8% yet most investors would accept that much greater risks come with the latter sector, given demand is highly leveraged to economic activity and input costs are unpredictable.

In general, the fact so many sectors eventually bounced back after a down period goes to show the importance of being patient. For example, anyone who sold out of consumer services after a 28% slump in 2018 would have then missed four straight years of gains.

Regulators put Microsoft and Meta under scrutiny as big tech growth slows

Acquisitions and privacy rules are causing a kerfuffle with global watchdogs

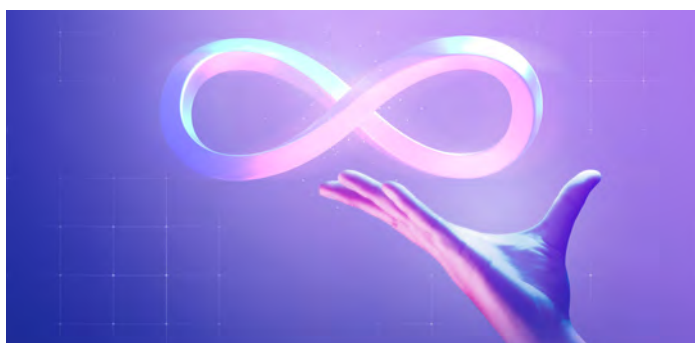
Microsoft (MSFT:NASDAQ) and Facebook-owner Meta Platforms (META:NASDAQ) are facing growth roadblocks as regulators in the US, UK and EU bare their teeth.

The US Federal Trade Commission has moved to block Microsoft from its planned \$69 billion deal to buy gaming giant **Activision Blizzard** (ATVI:NASDAQ), claiming that it could undermine competition in high-performance consoles and gaming subscription services.

In a recent complaint, the FTC argued that Microsoft and Sony already 'control' the high-performance gaming industry, via Xbox and PlayStation consoles, and acquiring Activision Blizzard would increase Microsoft's power in the sector.

Holly Vedova, the FTC's Bureau of Competition director, noted Microsoft's record of acquiring ZeniMax and limiting the publishing of popular games, such as *Starfield* and *Redfall*, to Xbox consoles. The watchdog is speculating a similar fate for Activision's *Call of Duty*, *World of Warcraft*, *Diablo* and *Overwatch*, and other games in the Activision ecosystem.

Activision has blasted back, saying the watchdog's decision is based on 'misconceptions about the tech industry' and believes the deal will still happen.



'The allegation that this deal is anti-competitive doesn't align with the facts, and we believe we'll win this challenge,' said Activision chief executive Bobby Kotick. Sony objected to the buyout claiming that PlayStation would no longer be able to compete in the 18+ shooter space should *Call of Duty* become an Xbox exclusive.

Making *Call of Duty* exclusive to Xbox doesn't make good business sense, claims Kotick. 'Microsoft would lose billions of dollars in lost sales and would infuriate both PlayStation owners and Xbox owners, who would lose the ability to play with their friends on PlayStations. The player backlash would be disastrous,' Kotick added.

Microsoft has already offered Sony a 10-year licence that would allow *Call of Duty* to feature on PlayStation consoles as the software giant looks to expand its growth scope.

Meta faces its own troubles after a potentially damaging EU ruling that could hit Facebook and Instagram revenues hard. EU privacy regulators ruled that Meta should not demand Facebook and Instagram users opt into personalised advertisements based on online activity. Because Meta's European headquarters is based in Ireland, it falls under the EU regulatory scrutiny.

If the ruling is upheld, it could see millions of users potentially opt-out of this type of targeting, leaving Meta with less user data to use to generate audiences for the tailored advertisements that analysts and those close to the business say account for the majority of its bookings. [SF]

House prices cooling quickly after two years of red-hot growth

Buyer caution is forcing housebuilders to rein in forecasts

As more survey data on asking and selling prices rolls in from mortgage lenders and estate agencies, it is clear that the UK housing market peaked in August with the turning point most likely being September's mini-Budget which spooked financial markets and consumers.

While there is usually a seasonal slowdown in the final quarter of the year, selling prices are now rising by mid-single digits on an annual basis but have begun falling on a monthly basis.

'Economic headwinds including rapidly rising mortgage costs mean some would-be buyers may have paused their plans for the foreseeable future,' says online property portal **Rightmove (RMV)**.

The company reports the number of home views is up 11% on last year, suggesting potential movers are watching the market and weighing up their options for 2023 when it predicts the emergence



of a 'multi-speed, hyper-local market' with some locations and property types doing much better than others.

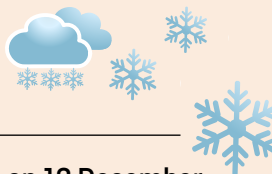
Housebuilders have seen the writing on the wall with most reporting a sharp drop in reservations since September and tailoring their production towards a less robust outlook.

Berkeley Group (BKG) announced last week it was keeping its earnings guidance for the year to next March but lowering its forecasts for 2024 and 2025 by 16% or £200 million per year.

Despite bouncing from their October lows, shares in most UK developers are still down more than 40% this year. [IC]

How freezing temperatures saw power prices rocket to record levels

A lack of wind contributed to pressures on the UK's energy network



Freezing temperatures have sent UK power prices to record highs, with the surge in demand created by the wintry weather accompanied by very still conditions which led to a lack of wind power.

This meant higher demand for gas for power generation at the same time as households and businesses were turning up the thermostats.

At one stage on 12 December grid operator **National Grid (NG)** asked **Drax (DRX)** to put two coal plants on standby to generate electricity – though in the end they were stood down.

And while the price of UK natural gas futures hit two-month highs, robust supplies from Norway, imports of liquefied natural gas and

high nuclear output helped keep a lid on prices for now.

Thanks to limited storage capacity and relatively limited domestic gas production, Europe and the UK were always at risk of moving from a position of feast to famine in terms of gas supplies despite a glut building up during a mild autumn.

Investors can gain exposure to global natural gas prices through exchange-traded product **Wisdomtree Natural Gas (NGSP)**. This tracks the Bloomberg Natural Gas Subindex which is comprised of a basket of natural gas futures contracts. [TS]

Could the Royal Mail final dividend be decided in Westminster?



Income used to be a key reason for investors to own the shares

Royal Mail continues to be disrupted by strike action amid an escalating dispute over work, pay and conditions. With no end to the dispute in sight, it is possible that the parent company's dividend could become a political issue.

The firm, which is owned by **International Distributions Services (IDS)**, last month blamed strikes and falling parcel volumes as it swung to a loss of £127 million for the half-year to September against a profit of £315 million last year.

It also pulled its interim dividend and said a decision on the final dividend would have to wait until May next year, although it warned operating losses could be as high as £450 million.

Royal Mail, like other former government-owned

institutions such as **BT (BT.A)** and British Gas, now part of **Centrica (CNA)**, occupies an awkward space between the public and private sectors.

All three provide a public service but are for-profit organisations with obligations to shareholders which arguably trump their duties to their employees.

In 2021, after parcel volumes soared during the pandemic, Royal Mail paid shareholders £400 million through a special dividend and stock buyback last year, yet its improved staff pay offer has been branded 'derisory' by the unions.

To avoid further public embarrassment and pressure from government, there is a chance that International Distributions Services might feel it has no choice but to continuing pausing the dividend until it can appease workers and get operations back on track. [IC]

Chemring's cybersecurity hidden jewel is starting to shine

Revenue from the Roke division tops £100 million as order intake increases 59%



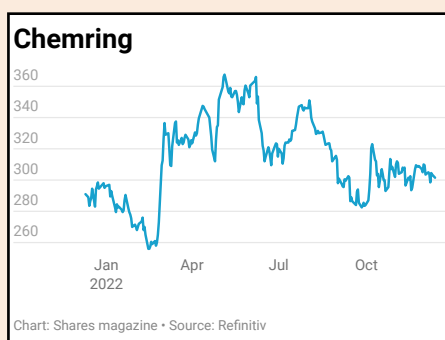
Defence business **Chemring's (CHG)** cybersecurity unit Roke is an underappreciated part of the business, but it may not go under the radar for too much longer.

The company's results for the year to 31 October revealed revenue from the division exceeded £100 million for the first time with order intake of £168 million, up 59% year-on-year.

Based on previous transactions in the cybersecurity space, which have valued companies at up to six times sales, Roke alone could account for a large part of Chemring's £856

million market valuation.

Chemring acquired Siemens' UK defence electronics unit (then called Roke Manor Research) for £55 million in 2010. Since then,



the company has increased its headcount and built up its expertise to incorporate the protection of networked systems, data analysis, artificial intelligence and connectivity.

Annual revenue for the broader group was up 13% to £442.8 million with operating margins down just a touch at 14.5% from 14.6% a year earlier despite rising input costs and increased operating expenses at Roke. Order intake for the Countermeasures and Energetics arm – which sells products which protect against guided missiles and explosives – was up 40% to £356 million.

Chemring also confirmed trading in the first weeks of its new financial year has been in line with expectations. [TS]

Balfour Beatty shares hit 11-year high on booming infrastructure market

The firm sees profits exceeding market estimates this year

Thanks to a slew of major UK and US public works programmes, revenues and earnings at construction and engineering firm **Balfour Beatty (BBY)** are set to beat expectations in 2022, according to the company.

The news sent shares in the group up 2.7% to 346p on 8 December, their highest level in more than a decade.

Major UK projects include the Queen Street station in Glasgow, Whitechapel station on the new Elizabeth Line in London and the

new engineering campus in Manchester.

Balfour Beatty is the sole contractor on the four-year, £3 billion SCAPE civil engineering framework for England, Wales and Northern Ireland, taking the value of its current order book to £16.1 billion.

In the US, new orders include a \$700 million federal building in Maryland, a \$400 million convention centre in Florida and \$300 million of data centres in Oregon.



'We expect a strong full year operational and financial performance,' said chief executive Leo Quinn. 'Looking to 2023 and beyond, our improved, de-risked and diversified order book gives us confidence that we will continue to make progress in delivering profitable managed growth.' [IC]

Balfour Beatty



Chart: Shares magazine • Source: Refinitiv

Why consumer squeeze and higher rental rates have clobbered Airbnb

Shares in the rental platform may be more affordable but its listings are not

Global platform operator for rental rooms **Airbnb (ABNB:NASDAQ)** has seen its shares slide by a fifth over the last three months taking the loss in 2022 to date to more than 40%.

The worry is that the rapid rise in the cost of living will squeeze consumer discretionary spending and dampen demand.

With the average cost of an Airbnb overnight stay shooting up by 40% since 2019 there are concerns the service will no longer



be seen as affordable.

In response, the company has been on a push to increase supply in the most popular cities. CEO Brian Chesky told the *Financial Times* it has also seen a 'dramatic' spike in cleaning fees which are added to customers' bills.

With cleaning charges up 50% in urban areas the company is considering launching a marketplace to encourage more competition and reduce prices.

In contrast to the fall in the shares analysts' earnings estimates for 2022 have risen almost by almost 200% to \$1.71 billion since January.

This means the price to earnings ratio has collapsed from 191 times in 2021 to the current 36.8 times. [MG]

AirBnB



Chart: Shares magazine • Source: Refinitiv

This Asia Pacific trust prioritises India for stock opportunities

A sharp ESG focus also helps Pacific Assets Trust differentiate itself from peers

China bulls may be excited that the emerging markets giant is finally relaxing zero-Covid restrictions, but it is still early to call the recovery in the Middle Kingdom's faltering economy. Investors who want exposure to Asia Pacific growth without losing sleep over developments in China should consider **Pacific Assets Trust (PAC)** as it only has small exposure to this country.

Shares in the Stewart Investors-steered investment trust trade at an attractive 8.1% discount to the portfolio's net asset value, despite an impressive record of outperforming Asia Pacific funds and trusts, particularly during more difficult market conditions.

A high-conviction portfolio spread across 63 holdings, Pacific Assets gives investors a differentiated exposure to Asian equities through a significant allocation to populous India that has proved helpful during the recent China sell-off, though an ongoing charges figure of 1.14% is higher than that of peers.

The £428 million trust seeks to generate long-term capital growth by putting money to work in carefully selected companies in the Asia Pacific region and Indian sub-continent, but excluding Japan, Australia and New Zealand. Portfolio construction, according to stockbroker Investec, is focused on 'identifying high-quality Asian franchises that are capable of thriving through challenging macroeconomic periods.'

Stewart Investors has a keen ESG (environmental, social and governance) focus. Its managers seek high-quality companies with exceptional cultures, strong franchises and resilient financials that will benefit from the sustainable development of the Asia Pacific region.

As Investec notes, 'at a time when almost every

PACIFIC ASSETS TRUST

(PAC) 354p

Market cap: £428 million



investment vehicle is scrambling to demonstrate ESG credentials, and we are encountering a plethora of newly discovered ESG experts, we highlight that the manager's core philosophy, which is founded on the principle of good stewardship, has been in place since 1988.'

A tilt towards India and only limited Chinese exposure has proved beneficial for Pacific Assets Trust, which is the Association of Investment Companies Asia Pacific sector's best one-year share price total return performer and the second-best performer over five and 10 years.

India, which is forecast to deliver one of the globe's highest earnings growth stories this year supported by a pro-growth budget, has traditionally provided rich pickings for Stewart Investors.

Pacific Assets Trust's exposure to India stood at 47.4% as of 31 October 2022 through investments in areas like power generation products, finance, and coffee and tea production and distribution. That compares to a modest 7.4% allocation to China, while other regional exposures included Taiwan and Indonesia at 8% and 7.9% respectively. [JC]

Pacific Assets Trust



Chart: Shares magazine • Source: Refinitiv

Why this young growth stock could be a great pick in a cost-conscious climate

Eagle Eye's customer loyalty and coupons platform is just what retail needs now

It might sound premature to invest in a relatively young growth company, but we believe **Eagle Eye Solutions (EYE:AIM)** is an interesting idea in the current budget-conscious consumer climate.

Eagle Eye claims to have developed a best-in-class loyalty and promotions omnichannel software-as-a-service platform called Eagle Eye AIR. It allows customers of big brands to validate and redeem digital promotions in real-time, principally to large supermarket chains, retailers and hospitality organisations across Europe, North America and Australasia.

Clients include **Sainsbury (SBRY)**, Asda, Waitrose, John Lewis, **Diageo (DGE)**, **Greggs (GRG)**, **Coca-Cola (KO:NYSE)** and Budweiser-owner **Anheuser-Busch InBev (BUD:NYSE)**. It also integrates with major payments services, such as Apple Pay, Google Pay, **PayPal (PYPL:NASDAQ)** and Stripe.

Eagle Eye AIR integrates with existing point of sale terminals, helping businesses to market and send vouchers, coupons, and loyalty incentives to customers, either by text, email or store apps. The platform also provides clients with useful customer data and insights, such as the number of redemptions taken up on a specific offer, and in which store.

This is a massive help when it comes to targeting customers with increasingly personalised rewards, a holy grail for retail and hospitality brands, and a great way to keep budget-conscious shoppers coming back.

Eagle Eye made its first net profit in the year to June 2021, but progress could be rapid going forward. Earnings last year went from 3.2p per share to 8.1p and Shore Capital forecasts EPS to double by fiscal 2025, pulling the price to earnings multiple into the realm of 35-times or so.

EAGLE EYE
(EYE:AIM) 605p

Market cap: **£168 million**



Yes, it is a little jam tomorrow and there are execution risks. There could also be occasional share placings in the future to raise extra growth funding, like the recent £15 million cash call. But this is a huge opportunity.

Researcher Fact.MR estimates the global digital loyalty market is set for rapid growth over the next decade, from about \$40.3 billion last year to \$98 billion by 2032, far outstripping global GDP. Eagle Eye's own earnings forecasts have been steadily rising too.

Terry Leahy, who ran **Tesco (TSCO)** for 14 years, and Robert Senior, former boss of advertising group Saatchi & Saatchi, are on the board bringing huge experience. Leahy owns a 9.27% stake in the business, while founder and chief technology officer Steve Rothwell owns another 5.19% of the company, so there is decent alignment of objectives at the top table with ordinary investors. [SF]

Eagle Eye Solutions

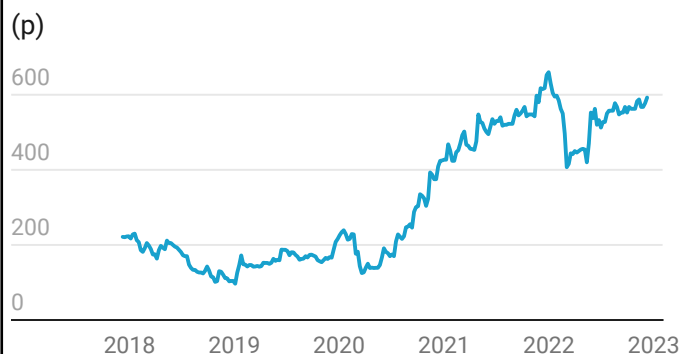


Chart: Shares magazine • Source: Refinitiv

Takeover suitors follow our lead at Homeserve, K3 Capital and Crestchic

The stocks have enjoyed strong gains as third-party bid interest has emerged



THREE COMPANIES WE'VE highlighted as *Great Ideas* over the past year are in takeover situations, demonstrating we were right to flag the appeal of the shares.

We said to buy home repair specialist **Homeserve (HSV)** at 675p in March, citing a 'proven operating model and a strong balance sheet' and promising growth prospects in the US. We highlighted **Crestchic (LOAD:AIM)** at 270p in October noting the transformation of the group to focus purely on load banks – in-demand kit used to test power systems. Ambitious growth plans attracted us to business services and advisory firm **K3 Capital (K3C:AIM)** in February.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

Homeserve accepted a £12 per share offer from Canada's Brookfield Asset Management in May but the deal is yet to close as it goes through several regulatory hurdles. Completion is now expected by early 2023 at the latest.

Crestchic and K3 Capital both reported takeover approaches in early December. The situation at Crestchic looks more advanced with emergency power outfit Aggreko agreeing a recommended cash bid of 401p – directors and institutions representing 38.5% of the share capital said they would back the deal.

HOMESERVE
(HSV) £11.93

Gain to date: **77%**

CRESTCHIC
(LOAD:AIM) 398p

Gain to date: **47%**

K3 CAPITAL
(K3C:AIM) 318p

Gain to date: **12%**

The price has attracted criticism on social media. One Twitter user wrote: 'Not happy with the #LOAD offer and surprised (major shareholder) Harwood have agreed to it. I'll continue to hold Crestchic, at least for a bit, just in case we see a higher offer emerge.' K3 Capital remains in talks with US private equity firm Sun Capital over a £257 million offer.

WHAT SHOULD INVESTORS DO NEXT?

Take profits on Homeserve but wait to see how it all plays out at Crestchic and K3. [TS]

Rebased to 100

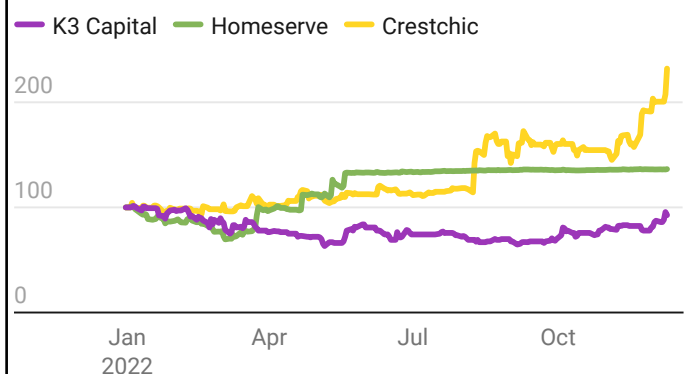


Chart: Shares magazine • Source: Refinitiv

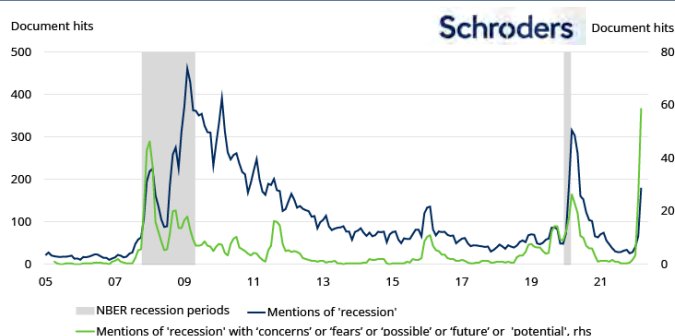
Investment Trusts: opportunities in all market conditions

The UK investment trust industry has prospered for more than 150 years.¹ During this time, it has endured depressions, wars, pandemics and other major crises. Today's market conditions bring their own unique challenges, but history suggests the UK investment trust industry is well-positioned to deal with them. Here, we take a look at how the current market conditions are impacting the opportunities that lie ahead for Schroders investment trust range.

What's happening in financial markets?

It's been a tough year for investors in most asset classes. Against a backdrop of high inflation, slowing global growth and a significant change in monetary policy from the world's major central banks, equity and bond markets have suffered widespread declines. As the chart below illustrates, references to recession in company conference call transcripts recently hit an all-time high, and our economists currently expect recession in the UK, US and Eurozone economies in 2023.

Recession fears have jumped to an all-time high



Note: The data is smoothed using a three-month moving average. Source: Schroders Economics Group, Schroders Data Insights Unit (DIU), Sentiseo, 12 July 2022, 605603

With powerful global economic forces at play, it is worth spending some time looking at how the opportunity that lies ahead for the Schroders' investment trust range is evolving in these volatile conditions. Schroders runs investment trusts in five different sectors: private equity, impact, UK, Asia and real estate. We take a look at each of these areas in turn below.



Private equity – differentiated opportunities from structural growth

Schroders runs two private equity investment trusts: Schroder British Opportunities Trust, which as the name suggests, focuses on the domestic market, and Schroder UK Public Private Trust, which targets an increasingly global opportunity set.

Investment trusts are a very appropriate structure for private equity investments. Their closed-ended nature provides a permanent source of capital, which can be deployed in less liquid assets.

The risks involved in individual private equity investments may be higher, because it typically involves investing at an earlier stage in a company's development. But a diversified portfolio of private equity assets offer the potential to deliver a premium long-term return to compensate for this higher risk.

Meanwhile, although private equity is clearly not immune to the global economic headwinds, it is relatively well-placed, because the asset class represents one of the best ways of accessing structural long-term trends, such as digitisation, disruptive innovation and the energy transition required to reduce the global economy's reliance on fossil fuels.

We can therefore remain confident in the enduring long-term opportunity that our private equity investment trusts are targeting. As Rory Bateman, co-portfolio manager of the Schroder British Opportunities Trust, recently said:

¹Source: The Association of Investment Companies as at 31 October 2022

“We invest in high quality, high growth businesses with strong management teams. Valuations may ebb and flow but the growth in these businesses can drive long-term value. The portfolio is not immune to the forces which are buffeting the full spectrum of financial assets at the moment but, in this environment, there is opportunity.”

Impact investment – addressing the UK’s most pressing social challenges

Schroders partnered with one of the UK’s leading impact investors, Big Society Capital (BSC) to launch the **Schroder BSC Social Impact Trust** in December 2020. There is a growing private impact investment market in the UK, providing solutions that aim to alleviate some of the country’s most pressing social challenges, while also targeting a sustainable financial return.

As is the case with private equity, many of these investment opportunities are illiquid, which means they are not easily accessible to other investors without specialist expertise and deep networks. This makes investment trusts an ideal structure for delivering social impact.

Already, the portfolio is benefiting more than 160,000 disadvantaged and vulnerable people and almost two-thirds of committed assets benefit from inflation resilience.²

More broadly, this part of the Schroders investment trust range is less impacted by the current global financial market volatility, due to these types of investments historically having low correlation to traditional asset classes. Indeed, the current economic challenges make the social issues they aim to address even more pressing.

“This environment is creating significant cost of living challenges for many low-income groups in the UK. Many of the Company’s investments in areas such as affordable housing and fuel poverty are directly tackling this challenge and are seeing significant additional demand. Across our activities we are seeing an increasing opportunity set where investment can be part of the solution in addressing social issues.”

Jeremy Rogers, Portfolio Manager

UK equities – dividend income and potential takeover activity

For much of 2022, asset prices have been influenced by global headwinds, but in recent weeks, domestic events have contributed to the volatility, triggered by the new government’s mini-

budget in September. The mainstream media narrative has suggested a loss of confidence in UK plc, but although one can question the timing, communication and logic of the policies that were announced, it is interesting to note that the UK stock market is still outperforming most other major stock markets this year.

Meanwhile, the weakness of sterling has been the subject of intense media scrutiny, but this is not just a reaction to UK political developments, as Sue Noffke, Head of UK Equities and manager of the Schroder Income Growth Fund explains.

“It’s important to put the pound’s weakness into the context of a global dollar crisis. The US dollar has been extremely strong in 2022 versus nearly all other major currencies. This is due to two factors. Firstly, because of steep interest rate rises from the Federal Reserve and secondly the flight to safe assets given the energy crisis and uncertainty around the Russia-Ukraine conflict. As the world’s reserve currency, the dollar has benefited here.”

The UK is home to many large, global businesses that derive most of their revenues and profits from overseas. The sterling value of their international (primarily dollar-based) earnings, is therefore enhanced by a strong dollar. From the perspective of dividends, this is making the long-term income opportunity that Sue aims to capture even more enticing.

“The dividend yield on UK equities remains high and attractive versus other regions. At nearly 2.5x earnings, dividend cover is stronger than it has been for 10 years. Meanwhile, it’s important to note that 45% of UK dividends are paid from US dollar denominated earnings, so dividends are aided by weak sterling.”

The UK stock market has outperformed in 2022



Source: Koyfin to 18 October 2022, on a capital return basis in local currency.
Past performance is not a guide to future performance and may not be repeated.

²Source: [Schroder BSC Social Impact Trust – Investor Update July 2022](#)

Mid-sized UK companies tend to be more focused on the domestic economy, so the Schroder UK Mid Cap Fund is not as exposed to this dynamic. Nevertheless, there is another aspect of sterling weakness that could continue to unlock future value for its shareholders. Co-portfolio manager Jean Roche expects the continued undervaluation of many UK businesses to attract the attention of private equity investors and other corporates.

"We see US private equity players in particular attempting to profit from this situation. It's been a very busy period for merger and acquisition activity. Plenty of UK small and mid-caps have been acquired or approached recently and we can expect more of this. Management teams have not failed to notice the value presented by their own shares, and this is reflected in the plethora of share buybacks which have been announced."

Asian equities – attractive valuations and a brighter outlook for Japan

Schroders runs four Asian investment trusts, each of which targets a specific opportunity within this diverse and attractive region. The **Schroder AsiaPacific Fund** offers exposure to high long-term growth potential across Asia's diverse equity markets, while the **Schroder Oriental Income Fund** has an additional focus on increasing dividend income. **The Schroder Asian Total Return Investment Company**, meanwhile, aims to preserve and grow wealth through all market conditions.

Dollar strength is typically seen as a headwind for Asia's economies and stock markets, and that does appear to have weighed on returns recently. The prospect of sustained inflation across a number of commodities, as well as headwinds to global growth and therefore exports from the region, pose further challenges for the region. Meanwhile, China's struggles with Covid and its associated zero-Covid policy, continue to weigh on sentiment.

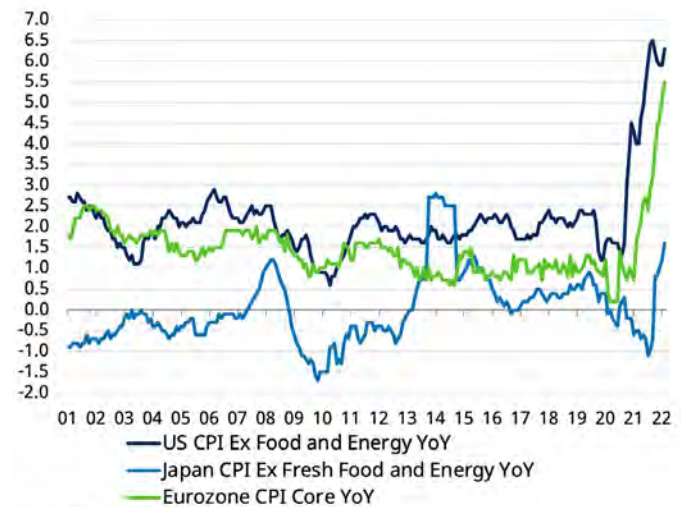
Despite this seemingly gloomy prognosis, there are reasons for optimism, as Richard Sennitt, manager of the Schroder AsiaPacific Fund and Schroder Oriental Income Fund explains:

"All of the above paints a pretty negative backdrop. However, this has in part been reflected in market action with valuations today looking much more attractive, particularly versus global equities. Although earnings downgrades may continue, aggregate valuations for the region are now trading below long-term averages and at the lower end of the range versus the rest of the world."

The fourth Asian offering is **Schroder Japan Growth Fund**, which seeks attractive investment

opportunities in the world's third-largest economy. Here, the investment outlook is perhaps brighter now than it has been in many years, thanks to continued improvements in corporate governance and a relatively benign economic outlook. Consensus forecasts continue to point to modest growth for the Japanese economy in 2023, at a time when much of the rest of the developed world is increasingly at risk of recession. After many false dawns, this could finally be Japan's chance to shine brightly once more.

Japanese inflationary pressures are more modest than elsewhere



Source: Schroder, Eikon as at 27 September 2022

Real estate – a diversified potential inflation-hedge

Like private equity, real estate is another asset class that is highly suited to the closed-ended investment trust structure, because of the illiquidity of the underlying assets. Property has many attractive investment characteristics. It has traditionally been seen as a good way of introducing more diversification to a portfolio, with low correlations against equities and bonds and less volatility than equities. Furthermore, rents tend to rise in line with other prices over the long term, providing the potential for a partial hedge against inflation and, because it is a physical asset, there is more opportunity for skilled managers to add value through delivering operational excellence for occupiers, redevelopment schemes and other initiatives, such as improving a building's sustainability performance.

However, despite these strengths, real estate is not immune to the economic headwinds which have hit financial markets in 2022. Higher interest rates have a direct impact on the ability of debt-backed investors to buy real estate and they may also deter institutions who allocate capital between

real estate and bonds. Although real estate yields are not mechanically tied to interest rates, they are likely to increase in the short term, depressing capital values. In addition, weaker economic growth is likely to reduce occupier demand, particularly in sectors such as retail and office which are already under pressure from structural changes such as e-commerce and home working. By contrast, there are a number of other real estate types which are benefitting from structural change including warehouses, data centres, student halls and laboratories.

That is why investing with experienced specialists that are capable of focusing on the most attractive parts of the market makes sense. The Schroders real estate investment trust offering consists of three funds. **The Schroder Real Estate Investment Trust** invests in UK commercial real estate, with a portfolio that fund manager Nick Montgomery describes as “a good quality, diversified portfolio that is weighted towards higher growth parts of the UK real estate market”.

Similarly, **Schroder European Real Estate Investment Trust** focuses in on the opportunity in Europe’s “winning cities”, such as Berlin, Hamburg, Stuttgart and Paris. These offer higher levels of growth, exposure to higher-value industries and well-developed infrastructure. In short, winning cities represent places where people want to live and work, which should correspond to a sensible long-term investment strategy.

Conclusion

These are clearly challenging times economically, and the near-term outlook is perhaps as inscrutable as it ever has been. Despite this considerable short-term uncertainty, it is worth reiterating the long-term perspective and discipline that is required for successful investment outcomes.

One of the interesting characteristics of investment trusts is the gap that can emerge between share prices and net asset values. Often, we see discounts widen during times of uncertainty, and the current environment is no exception. The average UK investment trust is currently trading at a 15% discount to the value of its underlying assets (source: Bloomberg as at 30 September 2022), which is the widest discount in at least a decade.

In other words, investors can currently buy a pound’s worth of assets for just 85p. Irrespective of the current uncertainty, therefore, there are attractive long-term opportunities to be found, and UK investment trusts remain a highly valid structure for unlocking value for investors.

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Bad year for investors Terry Smith and Nick Train but Warren Buffett is a winner

Fundsmith Equity is facing its first ever annual loss but 2022 has been kinder to Berkshire Hathaway

Fundsmith Equity (B4Q5X52), Terry Smith's flagship fund with over £22 billion of assets, is looking at its first annual loss since it was launched in November 2010.

For the 11 months to the end of November 2022, the total return for the T Class Accumulation shares was -15.1% compared with a 2.8% loss for global equities (as measured by the MSCI World index in sterling), a 12.9% loss for long-dated UK government bonds and a positive return of 1.1% on cash.

The year started badly with an uncharacteristic loss of 9.5% in January, the fund's biggest ever monthly drawdown, followed by a 4.1% loss in February.

From here it was hard to recoup ground due to choppy markets following the invasion of Ukraine and rising interest rates, which prompted more investor selling of quality growth companies and a widespread rotation towards lower quality value sectors.

In his half-year shareholder letter, Smith explained the effect of rising interest rates on the portfolio. He said: 'The share prices of more highly rated equities, which are in effect discounting



profits or cash flows further into the future by being rated on higher price to earnings ratios, tend to be more affected by rising interest rates than lowly rated so-called value stocks. Our portfolio is not exempt from this effect.'

During the first half, the fund's best performers were defensive stocks such as **Brown-Forman (BF.B:NYSE)**, **Novo Nordisk (NOVO-B:CPH)**, **PepsiCo (PEP:NASDAQ)** and **Philip Morris (PM:NYSE)**.

By November, the fund was on more of an even

Fundsmith Equity

Performance, total return (%)

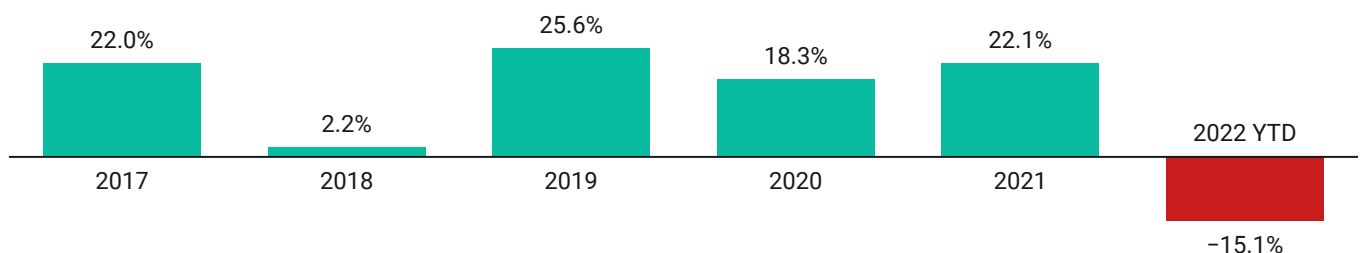


Chart: Shares magazine • Source: Fundsmith, 2022 data 1 Jan to 30 Nov



keel although for the month it still lagged global equities and UK gilts due to negative contributions from stocks such as **Amazon (AMZN:NASDAQ)**, **Intuit (INTU:NASDAQ)** and **Visa (V:NYSE)**.



Smith is undeterred, however, and is maintaining his bias towards quality companies in the consumer, healthcare and technology sectors with **Microsoft (MSFT:NASDAQ)**, **Novo Nordisk**, **L'Oreal (OR:EPA)**, **Philip Morris**, **IDEXX (IDXX:NASDAQ)** and **LVMH (MC:EPA)** making up his top six holdings.

HOW HAS NICK TRAIN PERFORMED IN 2022?

Even though Nick Train is one of the UK's best-known fund managers, he is facing his second year

in a row of underperforming the benchmark for his **Finsbury Growth & Income Trust (FGT)**. In the year to 7 December, his trust was down 7.5% versus a 4% decline in the FTSE All-Share index.

[‘It’s irrational to think about investment in discrete 12-month chunks,’](#) he told *Shares’* editor Daniel Coatsworth in late November, ‘but my net asset value for Finsbury is a couple of percent behind the benchmark year-to-date. That wouldn’t fuss me too much except for the fact that last year I was also a few percent behind. I’ve got two back-to-back years, potentially, where we may fail to meet our minimum aspiration which is to do better than the FTSE All-Share index. Maybe I do feel a bit disappointed.’

Train was at pains to point out the underlying performance of most companies in his portfolio was still good. ‘During the course of the year, the investment trust increased its dividend by 6% over last year. In the context of unquestionably difficult times in markets and economies, I was reassured that the underlying earnings and dividend-paying power of this portfolio remained pretty resilient in what isn’t anyone’s favourite calendar year.’

For Finsbury’s financial year ending 30 September 2022, the trust saw a -5.8% net asset value per share total return versus -4% from the FTSE All-Share.

In *Citywire’s* ranking of equity fund managers investing in UK companies, Train came in 50th place for performance across his mutual funds **Lindsell Train UK Equity (B18B9X7)** and **Lindsell**

Train Global Equity (B644PG0) for the 12 months to 31 October 2022. While the UK fund has underperformed this calendar year, the global one has beaten its MSCI World benchmark with a 3.1% decline versus a 7.3% loss from the comparative index.

Train's investment style is hinged on being patient and his followers would be wise to do the same. On a longer-term basis, his funds have outperformed, and a few bad years are not going to see the manager try something different in pursuit of better returns.



Some of the biggest holdings in Finsbury's portfolio have enjoyed a good 2022 including a 14.4% rise in **Burberry's (BRBY)** share price and **London Stock Exchange (LSE)** up 11.4% year-to-date. **Unilever (ULVR)** and **Mondelez (MDLZ:NASDAQ)** have also seen share price gains though there have also been some headwinds from share price weakness in the likes of **Schroders (SDR)** and **Experian (EXPN)**.



Train used the broader market sell-off in 2022 to buy more of what he already owns including more shares in Experian and **Fevertree (FEVR:AIM)** rather than initiate new positions.

Quite a few stocks in Finsbury's portfolio are currently in demand – businesses that are defensive in nature and whose products are being

bought by consumers and businesses no matter if the economy is good or bad. However, Train is at pains to stress that Finsbury is not a pureplay defensive investment. He believes the portfolio will not only help to protect investors' capital in difficult times, but also generate 'competitive absolute returns over all longer time periods.'

HOW HAS WARREN BUFFETT PERFORMED?

With exposure to economically sensitive parts of the US economy such as energy and financials, it isn't a surprise that Warren Buffett's **Berkshire Hathaway (BRK.B:NYSE)** investment vehicle has outperformed this year with the shares up 2.3% compared with a 17% loss for the S&P 500 index.

Over the 65 years under Buffett's tenure Berkshire has outperformed the S&P 500 (including dividends) two thirds of the time. An impressive feat.

Figures until the end of 2021 show total returns for Berkshire annualised at 20.1% a year, double the 10.5% return delivered by the S&P 500. Compounded over 65 years that means the lucky investors in at the start have done 120 times better than the index.

HOW HAVE THE STOCK HOLDINGS PERFORMED IN 2022?

Investors won't know how well Berkshire's wholly owned businesses have performed in 2022 until the full year results are released next year. But the conglomerate also owns a stock portfolio worth around \$300 billion.

Berkshire holds close to 50 companies but the top five account for over two thirds of the value of the portfolio. **Apple (APPL:NASDAQ)** is by far the largest holding accounting for close to 40% of the total.

Despite a torrid time for technology stocks, Apple shares have held up relatively well, falling by 20%. That may seem a large decline, but it's nothing compared to the 48% decline in **Amazon (AMZN:NASDAQ)** and the 56% slump in **Tesla (TSLA:NASDAQ)** this year.

Part of the attraction for Buffett is Apple's relentless repurchasing of its own shares which has

Berkshire Hathaway top 10 stock portfolio

Name	Value (\$bn)	% Portfolio
Apple	\$123.7	41.8%
Bank of America	\$30.5	10.3%
Chevron Corp	\$23.7	8.0%
Coca Cola	\$22.4	7.6%
American Express	\$20.5	6.9%
Occidental Petroleum	\$11.9	4.0%
Kraft Heinz	\$10.9	3.7%
Moody's Corp	\$5.9	2.0%
Activision Blizzard	\$4.5	1.5%
Taiwan Semiconductor	\$4.1	1.4%
Total	\$258.1	87.2%

Data at 30 September as reported to the SEC (Securities and Exchange Commission)

Table: Shares magazine • Source: Buffett.Online

totalled \$554 billion over the last decade.

Bank of America (BAC:NYSE) is the second largest holding for Berkshire Hathaway at around a tenth of the portfolio. Aggressive interest rate tightening by the US Federal Reserve has provided a good tailwind for banks this year. Theoretically they make a bigger spread on loans when rates rise.

However, analysts see Bank of America's earnings dropping around 10% in 2022. The shares have lost 30% year-to-date.

ENERGY BOOST

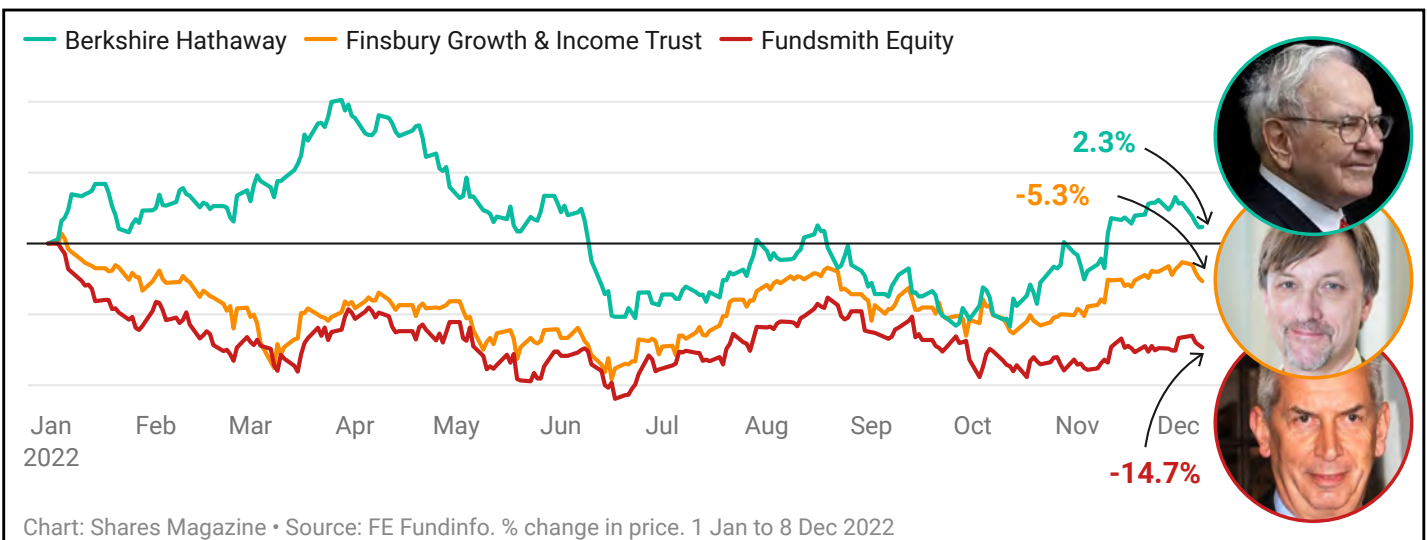
One bright spot in the portfolio is integrated oil company **Chevron (CVX:NYSE)** whose shares have surged 50% on higher energy prices. The holding accounts for 8% of the portfolio.

Oil and gas company **Occidental Petroleum (OXY:NYSE)** has done even better with the shares more than doubling in value this year. It accounts for 4% of Berkshire's stock portfolio.

The latest purchase to make the top 10 holdings is Taiwanese semiconductor maker **TSMC (TSM:NASDAQ)**.

Disclaimer: The author (Ian Conway) owns shares in Finsbury Growth & Income. The author and editor (Daniel Coatsworth) own units in Fundsmith Equity

By Ian Conway, Daniel Coatsworth, Martin Gamble



We reveal the best performing UK stocks in 2022: large and small

Some of the companies have delivered in excess of 200% share price gains



Most investors will remember 2022 as being one of the toughest years for stock markets around the world in a long time. However, plenty of stocks have delivered positive returns.

In this feature we look at the best performing London-listed stocks spread across four different parts of the market, covering small, medium and large sized companies.

£5 BILLION+ MARKET CAP

Ireland has been one of the standout economies of 2022 with forecasts for growth as high as 10% for the full year. Exports have been driven by the technology and pharmaceutical sectors, while domestic demand has been supported by household spending.

Bank of Ireland (BIRG) has benefited from strong credit demand with net interest income expected to rise by 6% to 7% this year, and in the first nine months the bank opened 245,000 new current and deposit accounts, a 90% increase on 2021.

A strong capital position, growing income and tight cost control will come in handy if there is a slowdown in economic growth next year. Its shares are up 57% since the start of 2022.

Educational publishing group **Pearson's (PSON)** shares powered 53% higher with a boost from

takeover offers, which it rebuffed, from US private equity group Apollo, as well as the positive momentum and margin improvement in the business as new CEO Andy Bird's strategy began to take hold.

A beneficiary of global learning spend, Pearson

£5 billion+ market cap

STOCK	SHARE PRICE CHANGE (%)
Bank of Ireland	57%
Pearson	53%
BAE Systems	51%
Glencore	49%
AIB	49%
Shell	43%
BP	43%
Centrica	33%
Standard Chartered	33%
Imperial Brands	30%

Table: Shares magazine • Source: SharePad. Data 1 Jan to 6 Dec 2022



is emerging from years of turbulence caused by the US education sector shifting online and is now having success selling direct to consumers.

In a year where war raged in the Ukraine and had repercussions around the world, it's no wonder that investors flocked for opportunities in the defence sector. As one of the largest players in this space, **BAE Systems (BA.)** was a magnet for investors looking to buy shares in a company that could see a big uplift in future earnings.

During the year, BAE was among the elite to show confidence in trading and improved profit margins. In November, BAE said many countries where it operates have either announced increases or are making plans to increase defence spending. These factors explain why analysts steadily upgraded 2022 and 2023 earnings forecasts throughout the year, helping to drive a 51% rise in the share price.

British Gas owner **Centrica (CNA)** has been a beneficiary of rising energy prices throughout 2022, helping to power a 33% gain in the shares. Earnings per share estimates have risen by a mighty 200% since the start of the year according to Refinitiv data.



A strong performance from the firm's electricity and gas production businesses and its energy trading arm prompted Centrica to raise profit guidance on 10 November towards the top end of market expectations.

The strong showing for **BP (BP.)** and **Shell (SHEL)** reflects the surge in energy prices caused by the conflict in Ukraine. What's perhaps more impressive is both companies have largely held on to their gains despite recent oil price weakness. On Shell, Berenberg analyst Henry Tarr says: 'Ongoing capital discipline combined with high commodity prices point to attractive free cash flow generation, enabling further material buybacks into 2023.'



Shares in **Imperial Brands (IMB)** advanced 30% during the period, outperforming the FTSE 100 with investors drawn to the cigarettes-to-vaping company's cash generation and pricing power during uncertain times for equity markets and the global economy.

Steered by chief executive Stefan Bomhard, the company behind Davidoff, Gauloises and Lambert & Butler cigarettes as well the blu vape brand delivered market share gains in its top five priority tobacco markets, while its five-year strategy generated an improved operational performance.

Also lighting up the investment case was the start of an 'ongoing, multi-year' share buyback programme on top of the ordinary dividend and continued investment in the competitive positioning of the business.

£2 BILLION TO £5 BILLION MARKET CAP

US oil producer **Kosmos Energy (KOS)**, which has a secondary listing in London to go with its primary listing in New York, enjoyed a strong 2022 thanks to rising energy prices and robust operational progress across its portfolio assets in West Africa, Latin America and the US.

A big development over the 12 months has been a reduction in the group's debt pile, down from \$2.5 billion at the start of the year to \$2.1 billion by the end of October, funded by strong cash flows from the Jubilee and TEN fields offshore Ghana.

£2 billion to £5 billion market cap

STOCK	SHARE PRICE CHANGE (%)
Kosmos Energy	93%
Mediclinic	56%
Energiean	54%
Yamana Gold	47%
Beazley	37%
Homeserve	36%
Qinetiq	32%
Indivior	32%
Investec	23%
Hiscox	19%

Table: Shares magazine • Source: SharePad. Data 1 Jan to 6 Dec 2022

The company has signalled this might enable it to commence a new shareholder return programme in the second half of 2023, with investment bank Berenberg implying it has a preference for share buybacks over dividends.

Shares in diversified international private healthcare services company **Mediclinic International (MDC)** advanced 56% in the year, making it one of the best mid-cap gainers. The rise follows a sweetened takeover offer from a consortium led by the Johannesburg-listed investment firm Remgro pitched at a 35% premium.

The consortium had previously made an unsolicited cash offer at 463p per share which Mediclinic rebuffed on the basis it undervalued the company.

Drug addiction and mental illness treatment company **Indivior (INDV)** had a stellar year with the



shares rising by a third in value. Gains were driven by the rollout of its lead drug Sublocade, used to treat severe opioid use disorder.

Analysts have steadily increased their earnings estimates throughout the year as the company beat expectations and increased full year guidance.

The company is also building a pipeline of drugs to treat adjacent disorders such as alcohol abuse and schizophrenia. In 2023 Indivior plans an additional stock market listing on the US Nasdaq index alongside a five-for-one share consolidation.



Other takeover activities in the mid and large cap space included **Homeserve (HSV)** which received a £4.1 billion bid from Brookfield Infrastructure. The deal is expected to complete by early 2023 at the latest. **Yamana Gold (AUY)** received several takeover bids, with a joint offer from Agnico Eagle and Pan America Silver set to seal the deal. A shareholder vote is scheduled for 31 January 2023 and if approved the stock could delist from the London Stock Exchange soon after.

Shares in UK defence company **QinetiQ (QQ.)** advanced by a third in value, buoyed by positive sentiment towards the sector and increased growth prospects.

In April, QinetiQ set out its ambitions to reach £2.3 billion of revenues by 2027 and double the size of its US and Australian businesses. In August, the company took a huge stride towards its goals after a transformational deal to buy Avantus, a US cyber, data analytics and software development company which doubled the size of its US business.

Property and casualty insurer **Hiscox (HSX)** performed well this year due to a combination of a better underlying performance, a higher investment yield on its bond portfolio, smaller than feared losses from Hurricane Ian and the prospect of higher insurance rates in 2023.

Losses from Hurricane Ian were \$135 million, at the low end of estimates, while the rise in rates due to the weather event means the company can deploy more of its capital in catastrophe reinsurance next year, generating more income.

£500 MILLION TO £2 BILLION MARKET CAP

Coal producer **Thungela (TGA)** was so out of favour when it was first spun off from **Anglo American (AAL)** in 2021 that it traded on a rock-bottom valuation. ESG (environmental, social and governance) considerations held sway at the time.

It then saw a spectacular rally in 2022 as the world worried less about reducing emissions and more about keeping the lights on, sending

£500 million to £2 billion market cap

STOCK	SHARE PRICE CHANGE (%)
Thungela Resources	248%
Bank of Cyprus	78%
RPS	77%
Bank of Georgia	56%
Devro	50%
Telecom Plus	48%
4imprint	47%
Ienergizer	46%
FBD	45%
EMIS	38%

Table: Shares magazine • Source: SharePad. Data 1 Jan to 6 Dec 2022



Thungela's share price up 248%.

Earnings have been continually upgraded thanks to stronger coal prices and so the shares still trade on less than two times earnings and yield an astonishing 49.3% based on consensus forecasts for 2023. Liberum's forecast year end net cash of \$938 million accounts for more than 40% of the current market cap.

The soaring dollar this year is no secret and that has made UK companies look even cheaper to overseas buyers, and takeovers have been plentiful this year across all parts of the market cap spectrum. Many investors see a takeout premium as a great solution for many stocks, especially smaller ones, but the knockdown valuation of some stocks led to eye-watering premiums being offered for some companies. This applied to healthcare software firm **EMIS (EMIS:AIM)**, sausage maker **Devro (DVO)** and consultancy **RPS (RPS)**, prompting cheers from investors.



This year's energy crisis has been bleak for consumers, but it played well for multi-utility **Telecom Plus (TEP)**, which trades as Utility Warehouse. Its gas, electricity, home and mobile phone and other service packages saw it pick up customers as under-funded energy suppliers like Bulb, Orbit and Igloo went to the wall.

Lesser-known financial stocks including **Bank of Cyprus (BOCH)**, **Bank of Georgia (BGEO)** and Irish insurer **FBD Holdings (FBH)** have been among the best-performing smaller companies this year.

The banks have benefited from higher interest rates, which have boosted their net interest margins significantly after years of famine.

Bank of Cyprus reduced its bad loan book, putting it on a firmer footing, while Bank of Georgia was helped by a domestic economy

which is growing at a double-digit rate. Meanwhile, FBD delivered strong underwriting profits and kept costs down to record a 79% combined operating ratio.

£10 MILLION TO £500 MILLION MARKET CAP



The top performer from the small cap ranks of the London market in 2022 was artificial intelligence-led bank **Tintra (TNT:AIM)**, up 367% according to data from SharePad. It aims to remove the barriers of moving money between developing and emerging markets, in its own words allowing clients to 'send money directly without human inaccuracies'.

Tintra is something of an outlier with the other

spots in the list of best smaller company stocks taken by resources firms.

South African coal miner **Bisichi (BISI)** has been in the doldrums for the best part of a decade, not helped by coal falling out of favour due to mounting concerns about associated pollution. Coal has this year soared in value amid the disruption to the energy market caused by Russia's invasion of Ukraine. That saw Bisichi's shares trade at their highest levels since 2008.

In the first half of 2022 the company posted pre-tax profit of £21.2 million compared with a loss of £700,000 for the same period a year earlier and unveiled a 10p per share dividend.

Lithium explorer **Premier African Minerals (PREM:AIM)** is poised to capitalise on strong prices for the element as it gears up for pilot production from its Zulu project in Zimbabwe.



Oil and gas outfit **Prospex Energy (PXEN:AIM)** has enjoyed a strong second half of the year in share price terms as it builds towards first gas from the Podere Maiar project in Italy's Po Valley. Another stock in demand with investors in recent months was **Angus Energy (ANGS:AIM)** as it drills for gas in the UK.

In something of a blast from the past **Borders & Southern Petroleum (BOR:AIM)** has seen its shares rebound strongly in 2022 as the possibility of finally exploiting the potential for hydrocarbons off the Falkland Islands moved a bit closer thanks to strong demand for oil and gas.

£10 million to £500 million market cap

STOCK	SHARE PRICE CHANGE (%)
Tintra	367%
Bisichi	244%
Prospex Energy	238%
Premier African Minerals	196%
Angus Energy	188%
MC Mining	184%
Southern Energy	183%
Alkemy Capital	177%
Greenx Metals	174%
Borders & Southern Petroleum	165%

Table: Shares magazine • Source: SharePad. Data 1 Jan to 6 Dec 2022

By the **Shares Team**



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WHAT TO EXPECT IN 2023

THE OUTLOOK FOR STOCKS, BONDS, GOLD AND MORE

After a tough year for markets, is all the potential bad news priced? Investors are certainly hopeful that 2023 will be more prosperous but in typical fashion it won't be a smooth ride to making money.

In this article we debate some of the issues and how you might want to position your portfolio.

By The Shares Team



WHAT WILL HAPPEN TO INFLATION, INTEREST RATES AND RECESSION IN 2023?

Central bankers risk sending the world into recession to tame inflation. The only comfort is that economic contractions are disinflationary.

As we approach year-end, there is some debate among academics for the word of 2022. Among economists, 'polycrisis' – which refers to a combination of overlapping crises, such as a pandemic and a war – is the current frontrunner, for obvious reasons.

However, we would suggest the word of the year has to be 'inflation' as it has dominated everything from global energy prices and central bank policy to how we shop for groceries. As we look to 2023, we suspect it will subside of its own

accord, for three reasons.

First, global supply chain imbalances are clearly easing which is important as this time round inflation has been caused by supply-side constraints rather than demand-side issues, i.e. not enough stuff where it was needed.

Second, in six to nine months' time we will start lapping the double-digit price increases we experienced earlier this year. Third, economic activity is already contracting thanks to higher interest rates.

The JPMorgan Global Composite Output index fell for the fourth month in a row in November, and at the fastest rate since June 2020, while new orders also fell for the fourth month running with the rate of contraction the fastest in two and a half years.

Despite concerns about rising wages keeping inflation high, the global labour market saw a downturn last month with barely any new job creation while service sector activity is already signalling a contraction.

However, the US Federal Reserve is singularly obsessed with jobs and in particular the JOLTS (Job Openings and Labor Turnover Survey) data published by the Bureau of Labor Statistics.

Despite a clear slowing of the economy, monthly job openings are still running at more than 10 million or roughly two jobs for every applicant, which is anathema to the central bank.

Fed chairman Powell has vowed time and again to stick to his planned rate rise trajectory regardless of how badly it impacts the economy.

In his view, and that of other regional Fed chairs, the risk of not doing enough to slow inflation is greater than the risk of doing too much.

Job Openings and Labor Turnover Survey

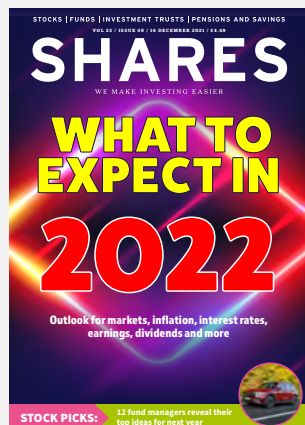
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Chart: Shares magazine • Source: Bureau of Labor Statistics

WHAT DID WE GET RIGHT AND WRONG WITH OUR OUTLOOK FOR 2022?

In many respects 2022 was defined by the war in Ukraine and the markets are no exception. Anyone who read our outlook article in December 2021 would have been forewarned of the risk of conflict.



We observed at the time that 'speculation is growing that Russian troops are ready to invade the country, possibly as soon as January'. Sadly, it proved correct.

We underestimated how persistent inflation would prove and, as a result, underestimated how far central banks would go on interest rates. Both areas were influenced by the impact of a grinding Ukrainian conflict which shows few signs of winding down.

We were right to suggest companies with quality credentials and lots of cash flow would be prized in 2022 and our warning that unprofitable technology stocks would be out of favour proved prescient.

However, our call that UK mid-caps would outperform the FTSE 100 was off the mark as a mix of commodities exposure, generous dividends and attractive valuations helped the UK's flagship index outperform its global counterparts. We did at least point to the importance of dividends as capital gains from stocks would prove harder to come by.

Hopes for an M&A boom proved forlorn and our confidence in the continuing prominence of ESG (environmental, social and governance) factors was misplaced as focus turned from the energy transition to energy security. Our balanced perspective on emerging markets was the right one as some countries like Brazil and India shone but China and Russia had a shocker. [TS]

In their 2023 investment outlook, multi-asset strategist Peter van der Welle and head of multi-asset strategies Colin Graham at Dutch bank Robeco argue a 'hard landing' is now inevitable.

'Having ended up behind the curve in 2021, central banks in Western economies this year swiftly morphed into dedicated inflation fighters. To regain their credibility, they now risk tightening monetary policy excessively into 2023, creating downside risks to the consensus soft-landing scenario,' say van der Welle and Graham.

They add: 'The culprit here is the lagged response of inflation, housing and the real economy to central bank policy tightening. However, once the ball gets rolling, it rolls fast.'

If there is any silver lining to this scenario, it is that recessions tend to be highly disinflationary. [IC]



WHAT HAPPENS TO STOCKS AND GOLD WHEN THE FEDERAL RESERVE STOPS RAISING INTEREST RATES?

Everyone is waiting for the US central bank to 'pivot' as this could trigger a new market rally.

There is a lot riding on the path of US interest rates and inflation in 2023. Economists have been talking about a US recession since the spring and if it happens it will probably be the most anticipated recession in history.

The popular narrative is also reflected in the behaviour of the US yield curve which briefly inverted in March before moving deeply inverted from June to its widest in over 40 years.

When the two-year yield moves above the 10-year, this is known as curve inversion, and historically it has presaged recessions.

The consensus view is that the economy will experience a short and shallow recession in 2023, which will bring inflation down and allow the Fed to 'pivot' and reduce interest rates from the current restrictive territory. Confirmation of the pivot is expected to trigger a big rally in the markets.

Swiss bank UBS says: 'In our projection the central bank interest rate committee starts cutting interest rates in the third quarter of 2023.'

The problem for the consensus view is that economic data remains strong, especially wage inflation which came in above expectations again in November at 0.6%.

This leaves the Fed no option but to keep its foot on the brakes and yet again disappoint equity bulls looking for that elusive pivot. The idea that stocks will suddenly soar in the second half of 2023 is not a given – yet if it does happen then expect the rally to be fast and hard, meaning it might pay to be fully invested now rather than wait for confirmation of the strategy change.

'We think attempting to time the market is a precarious exercise,' says Kelly Bogdanova, portfolio analyst at RBC Wealth Management. 'There is no bell that rings when a new bull market cycle begins. Missing the biggest rally days can have detrimental long-term performance consequences, and such rallies often occur unpredictably before all of the obstacles are out of the road.'

As an aside, it's worth noting the strength of the US dollar which gained nearly 20% against a basket of currencies at its peak in 2022 reflecting higher interest rates in the US. A change in direction or pace of hikes for rates and easing inflation could therefore put the dollar into reverse.

Gold could rise in value if the dollar starts to depreciate, and investors might also look more closely at emerging markets which are often beneficiaries of a weaker US currency. [MG]



WILL CHINESE STOCKS SOAR, AND WHICH OTHER PARTS OF ASIA SHOULD INVESTORS WATCH FOR 2023?

More relaxed Covid restrictions could provide a long-awaited boost to China's economy.

Investors have high hopes of a recovery in Chinese stocks in 2023 amid expectations for relaxed Covid restrictions.

Widespread protests across the country have ratcheted up the pressure for the government in Beijing to drop the zero-Covid policy, even if Chinese premier Xi Jinping will be loathed to be seen as giving in to the protestors.

Gold

\$/ounce



Chart: Shares magazine • Source: Refinitiv

Hang Seng



Chart: Shares magazine • Source: Refinitiv

The risk is that China opens too quickly and sees another significant spike in infections, leading to risks its healthcare system could be overwhelmed. If such a scenario were to play out, then we would be faced with the unhappy prospect of another full lockdown in the world's second largest economy.

Much will depend on plans to vaccinate China's older population. Assuming China reopens then the most obvious beneficiaries will be Chinese stocks themselves, with the Hang Seng index already starting to recover after large losses earlier in 2022.



A Chinese reopening would also be good news for oil companies and mining firms given it is such a rapacious consumer of commodities. Luxury goods firms are another potential beneficiary as China's middle class feels freer to travel – notably, Britain's **Burberry (BRBY)** has large exposure to the Chinese consumer.

Other parts of Asia are worth watching from an investment perspective in 2023. India is on the cusp of overtaking China as the world's most populous country and Morgan Stanley equity strategist Ridham Desai is excited about its medium-term potential.

'Many investors view India as a market that disappoints expectations, but we see it as a quintessential self-help story. The fact is that over the past five, 10, 15, 20 and 25 years, India's growth has only lagged China's among large economies, and we believe that India can deliver outperformance.

'It is one of the few countries in the world that is gaining from the disruptive global trends of demographics, digitalisation, decarbonisation and deglobalisation.' The main impediment to the Indian market performing in the short term is the already strong showing for its stock market. Elsewhere, Vietnam will be looking to build on recent years where it has attracted significant overseas investment. [TS]



WHAT'S THE OUTLOOK FOR UK STOCKS?

The FTSE 100 has been a haven in 2022 but it remains cheap and unloved by overseas investors

'UK equities offer significant value, with good earnings momentum, in a currency that is now particularly undervalued,' says Invesco's head of UK equities Martin Walker.



Truth be told, the UK stock market has been inexpensive for several years, with the FTSE 100 index currently no higher than it was in December 2017. The argument has been made repeatedly that UK equities should not be this cheap and that while they remain so, companies will be vulnerable to overseas takeovers, as the multi-billion-pound buyouts of **Aveva (AVV)**, Meggitt and **Micro Focus (MCRO)** this year attest.

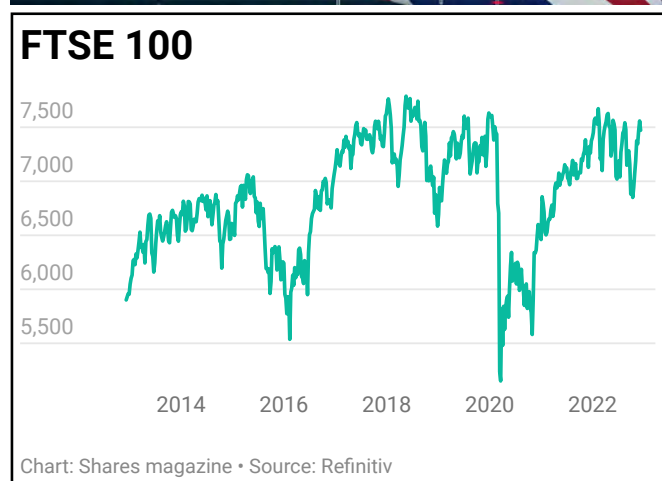
Foreign buyers had spent an estimated £52 billion on more than 500 UK companies this year (listed and private), according to data from the Office for National Statistics.

There is a theory that a broader pool of investors should see the light and buy UK shares. Some progress along that path was made through 2022, with the FTSE 100 one of the few major indices in the world to have not lost money for investors.

Abrdn Equity Income Trust's (AEI) manager Thomas Moore says Rishi Sunak becoming prime minister heralds an era of more conventional economic policies. He believes this has already calmed the markets, helping to drive a reduction in gilt yields and a recovery in sterling.

'As has been demonstrated by all the recent M&A activity in our own portfolio, some international investors are coming to the view that UK companies are now attractively priced. It would not take much for broader attitudes to the UK to improve dramatically,' adds Moore.

Invesco's Walker believes that in the fog of global and UK geopolitics, the quality of returns and the valuation opportunity on offer in the UK has been missed.



For example, the FTSE 100 currently trades on a forward price to earnings multiple of 11.4, based on Stockopedia data. The S&P 500 is on a PE of 18.4, according to research firm Birinyi Associates.

UK earnings have also been on the rise, with Invesco saying that consensus estimates for return on equity have increased by 19% this year, based on the FTSE All-Share. Despite this, valuations are down 19% in price-to-book terms.

The US equity market has derated by a similar amount to the UK (-21%), according to Invesco, but its return on equity has only increased by 3%.

The UK economy is predicted to shrink in 2023 as consumers struggle to pay soaring bills, rising rates squeeze mortgages, and widespread strikes slow recovery as workers chase pay hikes to match.

Jupiter's Richard Buxton recognises these significant threats but believes that corporate and consumer balance sheets remain robust and employment high. Even so, few doubt that the UK is in for a prolonged recession, which could make for a challenging year for investors in domestic companies. Fortunately, there are plenty of businesses on the UK stock market which make their money around the world.

'High-quality, cash-generative businesses with strong liquidity' is where investors should be positioned, says Invesco's Walker, stocks capable of emerging from market disruption and uncertainty in an 'even better competitive position than beforehand.'

Thomas McGarrity, Head of Equities at RBC Wealth Management, says UK stocks should also appeal to income-seeking investors. He notes the FTSE All-Share index has the highest dividend yield among the major equity regional markets at over 4%. [SF]

WHY ARE EXPERTS EXCITED ABOUT BONDS AGAIN?

Investors have the first chance in ages to find attractive levels of income from bonds

After one of the worst years on record for bond prices the starting point going into 2023 looks a lot more promising. After all, for the first time in decades investors can pick up a decent income from owning bonds.

One question on investors' minds is whether government bonds can provide their usual diversification benefits during bouts of market volatility.

Ashish Shah, chief investment officer of public investments for Goldman Sachs Asset Management, believes they can. Referring to the classic 60% equities/40% bonds



portfolio weighting, Shah says: ‘We expect 60/40 to work again, but we do not expect to return to the Goldilocks quantitative easing forever regime.’

The prevailing view across professional bond managers is that high quality corporate bonds and longer dated government bonds look attractive while it is too early to venture into lower quality credit.

JPMorgan strategists are in the positive camp, saying: ‘Increasingly, we believe bonds are again becoming a good risk hedge if we are correct in our expectation that inflation will eventually retrace back toward central bank targets.’

Rebecca Young, bond manager at Artemis, also sees core UK, European and US inflation approaching a peak which should remove a key headwind for bonds. Meanwhile, the repricing of bond prices has lifted yields significantly.

Young highlights the UK short-dated ‘triple B’ index which yields 6% compared with 1.7% at the start of the year. Triple B is the lowest rung on the investment grade ladder.

The positive view on bonds is tempered by market liquidity risks as explained by Megan Greene, chief economist at the Kroll Institute, who told *Bloomberg* she was concerned because around two thirds of US corporate bonds are rated on the lowest rung on the investment grade ladder.

A recession will likely induce stress on the weakest companies’ balance sheets and lead to their credit ratings being downgraded below investment grade.

This might spark forced selling by certain institutions which have restrictive investment mandates which do not allow them to invest in non-investment grade debt. [MG]

WHERE SHOULD YOU INVEST IN 2023?

Investors mustn’t assume what worked in 2022 will do so again next year.

A popular view among investment experts is that 2023 could see an equity market rally – the key unknown is when it happens.

Quite a few asset managers believe the best strategy is to stay defensive with the type of investments held in a portfolio as we move into the New Year. However, be prepared to switch to away from defensive areas once there are enough signs that the Federal Reserve is going to stop raising interest rates.

‘We do not expect a pivot until there is a meaningful deterioration in hard data, especially inflation and the labour market,’ says Salman Ahmed, Fidelity’s global head of macro and strategic asset allocation.

‘The US housing market is already showing signs of stress, as higher mortgage rates and reduced affordability stifle transactions. However, inflation and the labour market are still strong, compelling the Fed to keep going, given its focus on current spot data against the backdrop of underestimating inflationary pressures last year.’

His colleague Henk-Jan Rikkerink, global head of solutions and multi asset at Fidelity, says government bonds remain the ‘go-to’ asset for portfolio diversification in a recession. He says the time will come to increase exposure to equities, but for now, the weaker backdrop is still not fully reflected in earnings forecasts or valuations. That implies we could see more volatility on the stock market before a rally.

Sonja Laud, chief investment officer at Legal

Shell

(p)



Chart: Shares magazine • Source: Refinitiv

& General Investment Management, shares this opinion and remains cautious about equity markets near-term. 'Investors need to think about timing. We're watching the market carefully, once there is significantly negativity priced into earnings revisions, you'll have a much better entry point for equities.'

Asset manager Amundi also prefers a defensive stance with investments for now, favouring gold and investment grade bonds. However, it sees the second half of the year as being the point where equities become more appealing.

Once markets turn, investors may take profits in what's done well such as energy and look at the more sold-off areas. European and Chinese

stocks had a miserable time earlier in 2022 so they might be beneficiaries of a market rally in 2023 once investor sentiment improves as valuations have become more attractive.

On the UK market, housebuilders, retailers, property investment trusts and chemicals are among the worst performers in 2022 and so they might enjoy a relief rally if markets turn upwards next year.

The key risk to consider is that the US doesn't experience a deep recession in 2023 and so the Federal Reserve continues to raise interest rates to get inflation back towards its 2% target. Without that 'pivot' from the central bank, we may not see a market rally – and that applies around the world, not just in the US. [DC]

DON'T MISS NEXT WEEK'S ISSUE

Our top stock picks for 2023

Out on Thursday
22 December



City of London Investment Trust – 56 years of consistent income growth

Despite the volatile backdrop the City of London Investment Trust has grown its dividend every year since 1966. This 56-year-old record is the longest of any investment trust. Here, we look at how this record has been achieved and how portfolio manager Job Curtis is poised to navigate the looming recession.

Consistency is key

Often, when top-performing athletes are asked about the key ingredients to their success, the answer is rarely attributed to one thing, but rather a combination of factors successfully executed with an objective in mind. One attribute that ranks amongst the highest is consistency. Like athletics, music, or art, it is the same in investing. It is the constant grind of pushing yourself towards an objective. It is a slow and arduous process, and you may not see results every day. The only thing keeping you in the game is your belief in the strategy and the end goal.

In an era of instant gratification, consistency lacks the allure of excitement and is often dubbed as boring. As we all know, every dog has its day, but consistency is about turning up day after day, month after month, and decade after decade – that is how household names are made.

It is a characteristic that comes to mind when one thinks of The City of London Investment Trust, managed by portfolio manager Job Curtis. It has grown its dividend every year since 1966, the last time England won the World Cup! This 56-year-old record is the longest of any investment company. While Job has only been at the helm for 31 years, the investment company not missed a beat in terms of dividends under his tenure. So how has this record been achieved, and as the global economy faces a recession, how is the portfolio positioned for dividend growth going forward?

The building blocks

Before we dissect the results, it's essential to look at some of the building blocks that have led to such an achievement. The first, is the quality of the company. At its core, the City of London seeks to have quality companies that consistently grow their profits and dividends. The aim is to find companies that cover their dividends with

KEY TAKEAWAYS

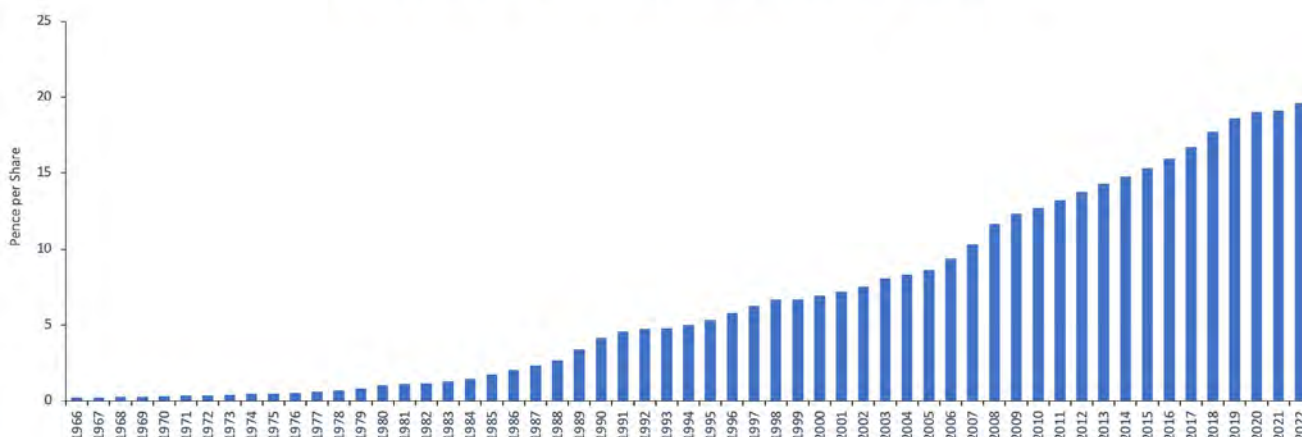
- The City of London has grown its dividend every year since 1966, the last time England won the World Cup. This 56-year-old record is the longest investment company.¹ While Job has been at the helm for 31 years, the Trust has not missed a beat in terms of dividends under his tenure.
- The portfolio is always prudently diversified from a sector and stock perspective. Underlying revenues are also sufficiently diversified to ensure that volatility within one market is offset by revenues from different regions: only 31% of the portfolios revenues come from the UK, while 69% comes from outside the UK.
- Job focuses on high-quality larger companies with solid balance sheets, strong cash-flows, and can cover their dividends while squirreling away enough cash to invest for long-term growth.

¹Source: The City of London Annual Report 2022

cash flow and profits and can squirrel away enough to invest for long-term growth. Of course, different industries and companies have varying investment needs. For example, those in a high-growth phase may need to retain a lot of cash for investment, whilst more mature companies may be able to hand back a more significant proportion of their retained profits to shareholders as dividends. The latter is what City of London focuses on.

However, not all dividends are created equal. Just because two companies yield 5%, it does not mean they have the same valuation. For example, if company A has its dividend covered twice

56 YEARS OF CONTINUOUS DIVIDEND GROWTH

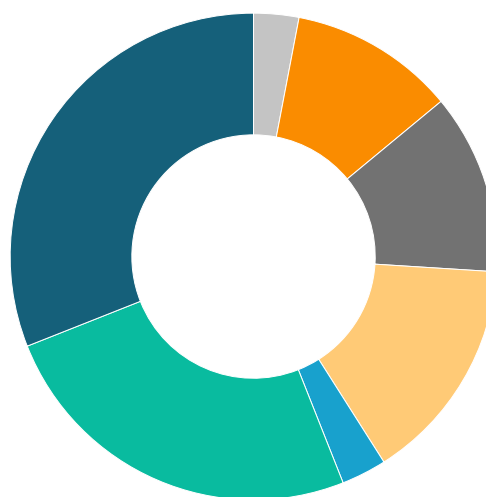
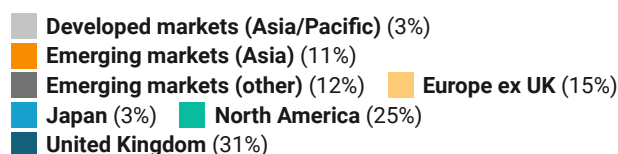


Source: The City of London Annual Report 2022

by cashflows, its prospects are very different to company B whose dividend is covered just once. This leads us to the second pillar, strong financials. It's all very well and good for a business to yield 7%, but is that number going to be the same in 5 years' time? That is why a solid balance sheet and strong free cash flow are amongst the key characteristics that Job looks for in a business. There is also another layer that rarely gets attention when it comes to dividend payers. Job believes that paying and growing a dividend helps to bring fiscal discipline on corporate management teams. As soon as a company starts paying a dividend, shareholders come to expect it. And knowing that you are expected to send a cheque to your owners every three or six months has a way of focusing the mind.

Another key pillar of City of London is diversification. Job believes that diversification across sectors and stocks can help provide consistent dividend growth as well as capital gains. The old adage 'don't put your eggs in one basket' comes to mind. While it might be tempting to have definite biases within a portfolio, too extreme a position can lead to volatile performance – a truism most highly levered growth portfolios can attest to today. As such, the portfolio is always prudently diversified from a sector and stock perspective but with a bias towards larger international companies. Taking it a step further, the underlying revenues of the portfolio also need to be sufficiently diversified to ensure that volatility within one market is offset by revenues from different regions. For example, only 31% of the City of London's revenues come from the UK, while 69% comes from outside the UK.

Revenue exposure (%)



Source: The City of London Investment Trust, Annual Report 2022

Lastly, it would be remiss not to mention the investment trust structure. It has been a key advantage in delivering consistent dividend growth. While open ended funds have to distribute all of their income once a year, investment trusts can retain up to 15% which is added to the revenue reserve. The revenue reserve can be drawn down during difficult years for dividends in the equity market enabling an investment trust's dividend to continue growing.

Since Job has managed the City of London, he has used revenue reserves only nine times to keep dividend growing.

Balance is key

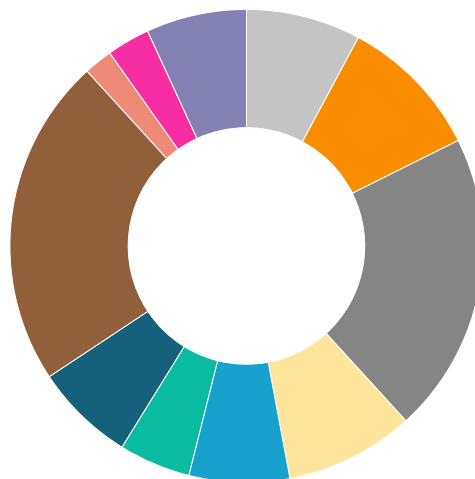
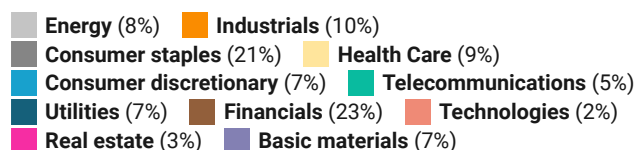
So how has this played out in practice, and how is the portfolio positioned going forward?

The portfolio has a balance in key areas with the aim of generating long-term income and capital. The first is financials, representing 23% of the portfolio. Companies within this industry group have, in general, performed well as rising interest rates have provided a helpful tailwind. For example, banks find it easier to make their net interest margin with improved rates for deposits. Within the sector, there is a smattering of exposure from more traditional banks (HSBC and Lloyds) to financial services (M&G), life insurance (Phoenix) and private equity (3i). Such exposure to different types of businesses helps Job retain the attractive combination of dividend yield and growth.

The second, consumer staples (20% of the portfolio), consists mainly of global companies that have strong profitability. These companies sell essential, everyday items. Due to the cost-of-living crisis, a staggering 83% of consumers are said to have changed their purchasing habits, with most cutting spending on non-essential items and switching to cheaper supermarket-branded products. In such an environment, companies that can offer consumers good value have performed well. Among the City of London's largest holdings are British American Tobacco, Diageo, Tesco, and Unilever. While these companies provide value to consumers, they also have strong pricing power. As a result, they have been better able to cope with higher cost pressures whilst protecting their margins and profitability. Such a characteristic will be key if inflation is to remain elevated for some time.

Other areas are oil (energy) and healthcare, which represent 8% and 9% of the portfolio, respectively. Oil companies have benefitted from elevated oil prices, which Job believes will likely persist over the next two years given the imbalance between demand and supply in the global market. While the volatility in oil prices is very much the short-term play, he also has an eye on the longer-term picture. How these companies perform longer term will depend on how well they execute ambitious plans to achieve "Net Zero". They will need to cut their fossil fuel exposure while investing in renewable energy (wind and solar) and develop carbon capture.

Sector allocation (%)



Source: The City of London, Annual Report 2022

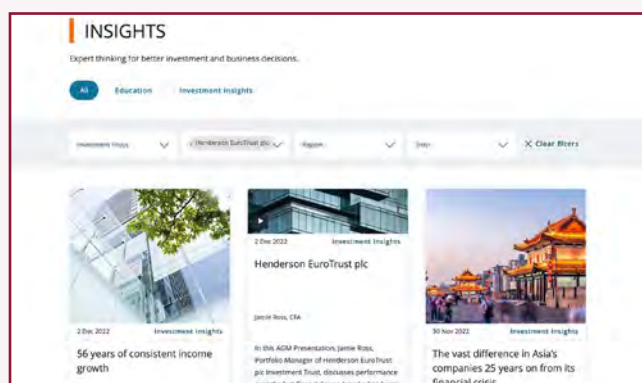
Looking at healthcare, the City of London has exposure to companies such as AstraZeneca and GlaxoSmithKline. In what has been a volatile market environment, companies within the sector benefitted from their defensive characteristics. Successful companies in this sector have a strong record of bringing to the market medicines and vaccines that improve health, prolong, and save lives. Given its importance and large-scale funding from governments, healthcare spending is relatively resilient in a period of slowing growth.

Navigating an uncertain future

There is no doubt, that the macro-economic outlook is paved with uncertainty. Inflation expectations have increased to levels not seen since the 1980s, the cost-of-living crisis is intensifying as consumers and businesses get to grips with higher energy prices, and the global economy is now headed for a recession. That being said, the building blocks that made City of London what it is today, are still firmly in place. Consistency of approach remains the bedrock on which portfolio manager Job Curtis continues to run the portfolio. And by continuing to look for high quality companies that can pay a sustainable and growing dividend, City of London's record looks set to continue.

Visit the website for more information about the [The City of London Investment Trust plc](#).

For more insights, research and commentary on the range of Janus Henderson Investment Trusts, visit the [Insights Hub](#).



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Discover what the yield curve is telling investors right now

A key indicator is ringing alarm bells about the economy



America's S&P 500 is up by 11% in the last two months and the UK's FTSE All-Share by 10% from the bottoms seen in early October. This may seem counter-intuitive, as the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and Office for Budget Responsibility (OBR), to name but three, all pile on with forecasts of recession in 2023.

And it looks ever odder at a time when one tried-and-tested recession indicator – the yield curve – is also signalling with growing conviction that a downturn is coming and possibly soon.

Yet there may be method in markets' madness, despite the apparent contradiction.

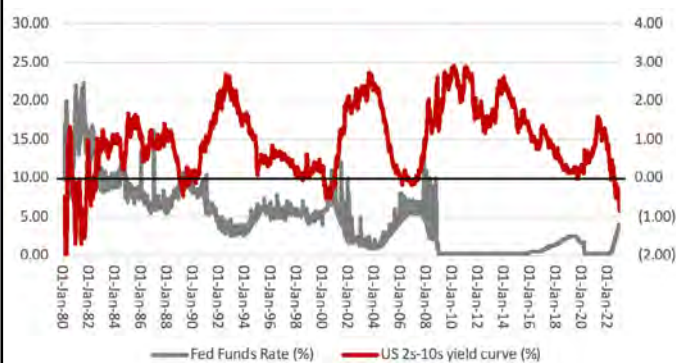
DEEPER AND DOWN

First things first: the so-called yield curve is now deeply inverted in the US and has just inverted in the UK, using the 2s-10s curve as the benchmark.

Usually, 10-year government bonds will yield more than two-year paper simply because more can go wrong in the additional eight-year period. Investors will demand a higher yield as compensation for the added risk.

But when markets sniff out a recession, they start to price in interest rate cuts. Reductions in headline borrowing rates set by central banks will usually drag down yields on government bonds in sympathy and that is what we are seeing now. Since the 12 October stock market low, the yield on US two-year treasuries is pretty much flat at 4.3% but the yield on 10-year bonds is down 41 basis points to 3.49%. As a result, the US yield curve is deeply inverted, in fact more deeply than since the twin recessions of the early 1980s when then-Fed chair Paul Volcker was also jacking up interest rates to crush inflation.

The US yield curve is deeply inverted



In the UK, the 2s-10s yield curve for gilts has just inverted. Yields have come down across the board after the panic caused by the nation's brief flirtation with Trussonomics, but since the 12 October the two-year yield is down by 70 basis points and the 10-year by 143.

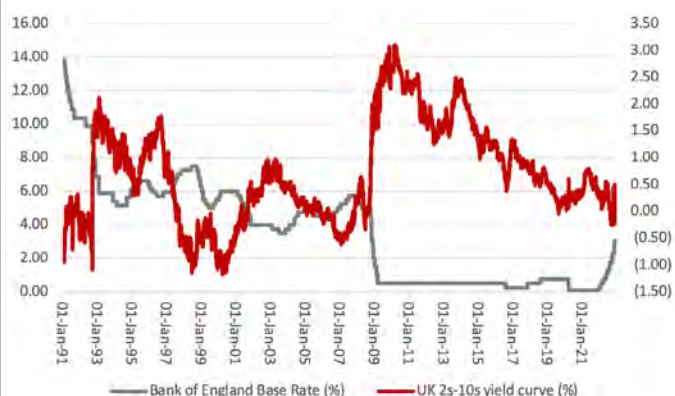
WHATEVER YOU WANT

However, both charts also make it clear that equity markets are not listening to the warnings of recession. They are focusing on the interest rate cuts instead, since they are designed to make credit cheaper, boost loans, oil the economic engine and fuel a fresh upcycle.

The theory is that central banks seem to be slowing the rate of interest rate increases, and if rate increases are slowing then they will finally stop, and the next logical step is interest rate declines. In sum, this is the argument in favour of a monetary policy pause and then pivot, with the idea being that a recession will help central banks to stop worrying about inflation and get them to focus on growth instead.



The UK yield curve has just inverted



Source: Refinitiv data

In effect, markets are calling central banks' bluff, as they continue to talk tough on inflation and interest rates. You can understand why, given that every major financial market meltdown or economic downturn since the Russian debt default and LTCM hedge fund chaos of 1998 has been met with frantic interest rate cuts and, more recently, dollops of quantitative easing.

WHAT YOU'RE PROPOSING

Stock (and bond) markets are both latching on to this narrative, making gains even as the economy apparently loses speed. This makes sense in that

the stock market and the economy are different things. The FTSE 100 derives the majority of its earnings from overseas for starters. In addition, share prices will try to price in future events, rather than wait for the economic data to come through, especially as most of this will be released with a lag, not least because of the time it takes to compile the numbers. But it might not be that simple.

The Fed and the Bank of England slashed interest rates in 2000-2002 and again in 2007-2009 and eventually their economies righted themselves and bear markets in shares came to an end – but they key word here is eventually.

Rate cutting did not initially save investors from a mauling and headline stock indices have tended to top out when the yield curve is at its most inverted and that was because the recession (as predicted by the yield curve) kicked in and took corporate earnings down with it.

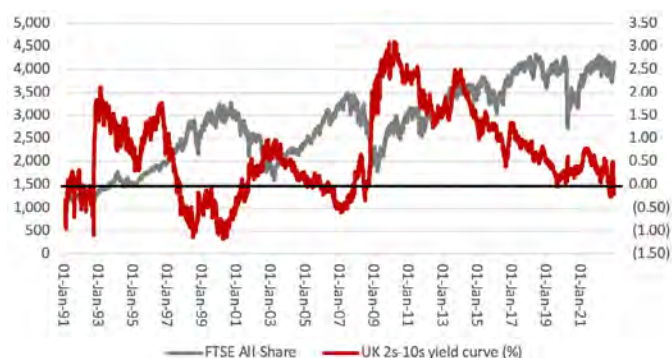
The past is no guarantee for the future, but it seems that the battle lines are set: rate cuts versus earnings downgrades. At least in the UK's case, valuation multiples and dividend yields feel like they are pricing in deeper drops in earnings than the US market is currently expecting (and analysts are still forecasting higher corporate profits in 2023 on both sides of the Pond). We shall see.

An end to yield curve inversion has often called the top in US equities



Source: Refinitiv data

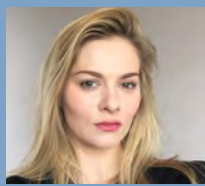
The same happened in the UK ahead of the bear markets that began in 2000 and 2007



Source: Refinitiv data

Four funds and investment trusts to buy for income and capital growth in 2023

Whether you're a cautious or adventurous investor, you'll find something of interest here



Alena Kosava, head of investment research at AJ Bell, offers a selection of fund and investment trust ideas for different types of investors.

ONE FOR CAUTIOUS INVESTORS

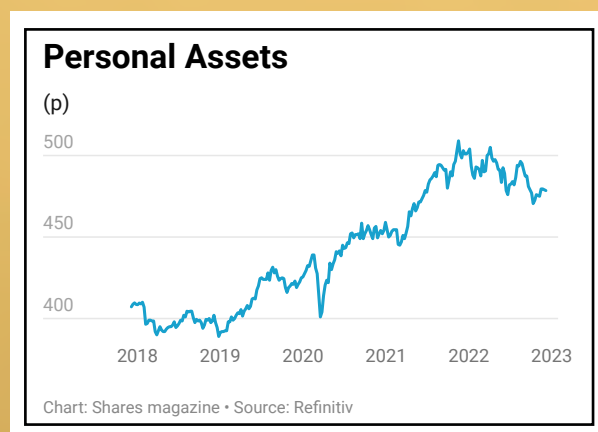
Personal Assets Investment Trust (PNL)

Personal Assets is a solid choice for investors looking to protect and increase the value of their investment over the long term. The trust has generated steady returns over the years and tends to do particularly well amid challenging market conditions and souring economic narrative.

With a heavy sell-off across equity markets and material repricing across the bond universe underpinned by fears over persistently elevated inflation for a considerable period, the defensive positioning of this trust, and in particular its exposure to inflation protecting assets such as gold and inflation-linked bonds, hold appeal.

The portfolio shape is relatively unchanged from a year ago with c.9% in gold bullion and 37% in US index-linked bonds supporting the core exposure to high quality equities.

As a result, the trust works well in providing investors with a multi-asset diversified portfolio. Given the emphasis on capital protection, it should sit comfortably with cautious investors.



ONE FOR BALANCED INVESTORS

First Sentier Global Listed Infrastructure (B24HJL4)

Following the emergence from hibernation following the Covid lockdowns of 2020 and economic reopening, we've seen an acceleration in inflationary pressures around the world as supply chains came under pressure.

Having underestimated the inflationary outlook, central banks are finally realising the realities around stubborn persistence of inflation globally. This has resulted in a steep rate hiking cycle and a precipitous rally in bond yields, weighing on economic growth.

As the prospect of recession is staring investors in the face, the importance of portfolio diversification in the form of real assets such as high-quality infrastructure has been clearly evidenced.

Whether it is through energy needs, distribution networks or communication services, infrastructure is a key part of a fully functioning economy.

Amid the ongoing war in Ukraine, the importance of energy security and independent infrastructure assets also came to the fore. The First Sentier Global Listed Infrastructure fund looks to provide exposure to these areas and more in a global portfolio of infrastructure companies.

With over 40% invested in energy related companies, it provides exposure to many who are leading on energy transformation while also giving exposure to critical distribution infrastructure such as railways and toll roads.

The portfolio is biased to the US sector (c.58% of assets) and has material exposure to electric utilities (30%), highways and rail tracks (15%) and multi-utilities (14%). It is currently yielding 2.5% and has a 0.8% ongoing charge.

The fund benefits from the experienced team at First Sentier based in Australia who have been at the forefront of infrastructure investing for many years. The fund is ahead of its benchmark index year-to-date, having kept up with the market rally from the lows in March, delivering a gain of 8.8%, relative to the index gain of 7.3%. Longer term performance is also ahead of the broader market.



ONE FOR ADVENTUROUS INVESTORS

JPM Emerging Markets Income (B5T0GN0)

While emerging market equities have suffered material underperformance over the last few years, this has largely been driven by steep losses in China.

Amid numerous challenges, including property sector rebalancing, common prosperity narrative, geopolitical risks around Taiwan and Covid lockdowns to name but a few, investors may feel nervous.

China is likely to start emerging from its zero-Covid policy in due course, as it cannot continue to pursue the regime indefinitely. Furthermore, while western central banks are fighting inflation in full force, emerging economies were swift to react and raised rates earlier, with many regions now in a position to start easing policy.

Inflation coming off from its peak in the US might also signal a change in the stance for the Fed, as it continues tightening policy, potentially at a slower pace. This might mean a pullback in the US dollar, which should also be supportive for emerging markets.

An equity income approach at the current juncture appears attractive, offering some cushioning in the form of regular dividends. JPM Emerging Markets Income fund currently yields 4.4% and offers the potential for capital gains on top.

Diversified across c.90 names, the fund offers sufficient compositional breadth, whilst ensuring diversity of drivers underpinning its dividend. It has a 1.15% ongoing charge.



ONE FOR INCOME SEEKERS

Jupiter Asian Income (BZ2YMT7)

Dividends have long played a key role in shareholder returns across Asia and the Jupiter Asian Income fund is a good way to play this theme.

Asian companies continue to be relatively well managed with low debts, helping support the fund's dividend which currently yields 4.5% from a concentrated portfolio of 28 names.

Manager Jason Pidcock is a cautious investor, seeking out high quality companies that have strong management and governance and a clear focus on the shareholder to ensure dividends are a key part of the company strategy.

The fund has historically been significantly underweight China, before fully exiting its position earlier in the year.

Political risk has been a significant concern for many investors since the Chinese government began implementing its common prosperity policies, while heightened tensions with Taiwan proved to be the final straw for the manager.

At a country level, the fund carries a material overweight to Australia (c.35% exposure) relative to the broader index (c.18%). At a sector level, the fund is overweight energy, industrials and technology.

Over the past 12 months it has returned 11.7% versus a 0.7% decline for the Asia-Pacific ex-Japan Equity Income sector, according to Morningstar. Over five years, it has generated 8.2% annualised returns versus 3.3% from the sector.

Top holdings include **Woodside Energy (WDS:ASX)** within energy and materials sectors, together with technology and consumer staples names including **Hon Hai Precision Industry (2317:TPE)** and **ITC (ITC:NSE)**. It has a 1.01% ongoing charge.

DISCLAIMER: Daniel Coatsworth who edited this article owns units in First Sentier Global Listed Infrastructure



Discover what fund managers got right and wrong in 2022

The professionals reveal the investments which paid off and those which struggled during a tricky year



It's been a tricky 2022 for global stock markets and that's made life hard for ordinary and professional investors alike. In this feature several leading fund managers explain what worked out for them over the course of the year and what went wrong.



James Harries

**Securities
Trust of
Scotland
(STS)**

WHAT WORKED?

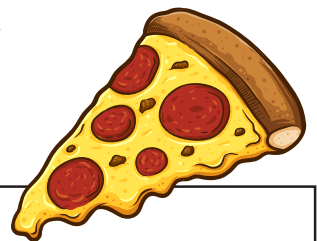
At Troy (Securities Trust of Scotland's investment manager) we seek companies that generate sustainably high returns on capital employed bolstered by identifiable competitive advantages, such as consumer staples companies. They have done well for us this year.

A good brand will conjure up in a consumer's mind a particular idea or concept about a product or company. This engenders both loyalty and a degree of price insensitivity which is especially valuable in more inflationary times. This is made more powerful still when married to a product that is bought on impulse. Examples include **Hershey (HSY:NYSE)** (chocolate) or **Pepsi (PEP:NASDAQ)** (predominantly snacks).

WHAT DIDN'T WORK?

Domino's Pizza (DOM). This is a business with extremely attractive returns on capital that had suffered from lacklustre execution and a long running quarrel between the company and the underlying franchisees.

Following engagement by us and the purchase of a significant stake by an activist investor, we were pleased to see changes in senior management including the chairman and chief executive. Unfortunately, the new CEO recently resigned and returned to be the boss of his previous employer. Further, Domino's is exposed to the cost-of-living crisis.



Domino's Pizza



Chart: Shares magazine • Source: Refinitiv



Andy Brough

**Schroder UK
Mid 250 Fund
(B76VYS2)**

WHAT WORKED?

Telecom Plus (TEP), a multi-utility group, is our second top positive contributor to relative returns this year. Offering a cheaper deal by bundling services together in an environment where consumers are getting squeezed by rising costs has resulted in an acceleration in customer growth (24% year-on-year). Adjusted pre-tax profit this financial year is expected to be £95 million, which would represent an increase of more than 50% on last year.



WHAT DIDN'T WORK?

Catalogue retailer Studio Retail (formerly Findel) sells a range of homeware, clothing and gifts and struggled as the cost-of-living rise hit consumers. The company unfortunately fell into administration, and we lost our investment.



Freddie Lait

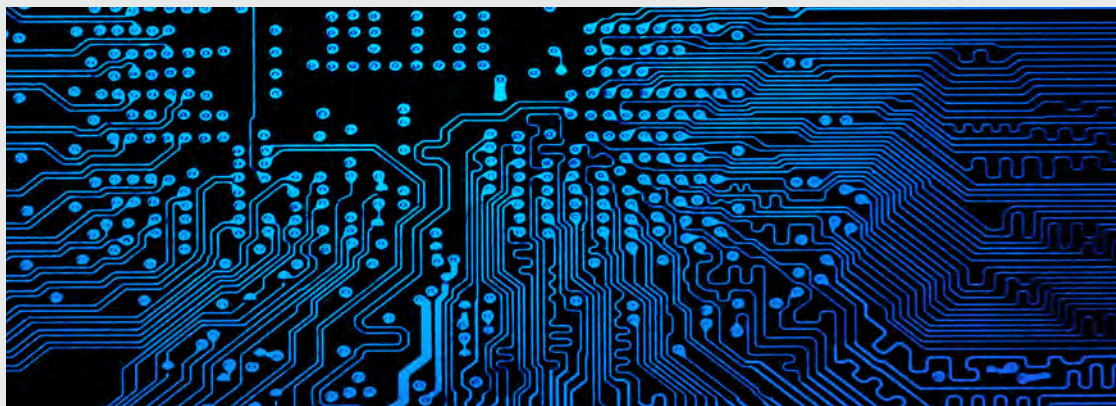
**Latitude
Horizon Fund
(BDC7CZ8)**

WHAT WORKED?

Having a portfolio of businesses which grow substantially while trading at inexpensive valuations (around 13 times earnings at the start of the year) has allowed us to generate positive returns, supported by underlying cash flow growth, despite a backdrop of falling markets.

WHAT DIDN'T WORK?

The small allocation we have to internet and technology shares suffered this year. Technology shares were the poster child of the bubble which ended in 2021, and almost all stocks in this sector have fallen meaningfully. In general, valuations remain high, and we believe there is still a risk of both a further derating and an earnings recession following the boom of 2021.





Jamie Ross

**Henderson
EuroTrust
(HNE)**

WHAT WORKED?

Over the past 24 months, we increased our exposure to financials and energy, and it is this part of the portfolio that has worked well during 2022. Positions in **Munich Re (MUV2:ETR)** (a German reinsurance business), **TotalEnergies (TTE:EPA)** (a French oil & gas company) and **Deutsche Borse (DB1:ETR)** (a German exchange business) contributed positively.

WHAT DIDN'T WORK?

Our small positions in **Delivery Hero (DHER:ETR)** (takeaway food delivery) and **HelloFresh (HFG:ETR)** (meal kits) have both been costly. We like the long-term positioning of these businesses, but both have been impacted by fears over consumer weakness and an inverse correlation between their equity valuations and interest rates.



WHAT WORKED?



Guy Anderson

**Mercantile
Investment
Trust (MRC)**

Positive contributions to portfolio performance in 2022 have been primarily driven by stock-specifics. **4imprint (FOUR)**, the branded merchandise supplier, has delivered strong profit growth, ahead of expectations, as it has capitalised on improving mobility after the pandemic while demonstrating strong market share gains.

4imprint

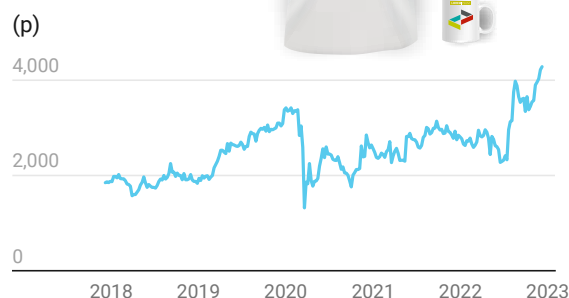


Chart: Shares magazine • Source: Refinitiv

WHAT DIDN'T WORK?

Our holdings in the consumer discretionary sector have been drags on performance this year. In particular, our holdings in retailers, which as a sub-sector represented 11% of the portfolio at the start of the year, including holdings in **Watches of Switzerland (WOSG)** and **Dunelm (DNLM)**, have been disappointing.



Stuart Gray

Alliance Trust (ATST)

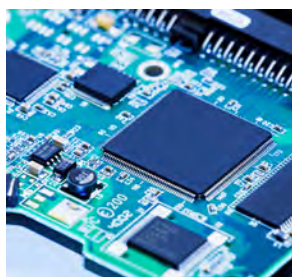
WHAT WORKED?

Remaining diversified by style and industry meant that we didn't suffer disproportionately from the sharp drawdown in growth and technology stocks, while benefiting from exposure to the gains made by energy stocks.

We also benefited from exposure to defence-related stocks such as **BAE Systems (BAE)**. The war in Ukraine likely drew greater attention to the value of these businesses that we have been invested in for some time.

WHAT DIDN'T WORK?

With the market swayed by macro considerations and near-term safety, stock selection based on longer-term company fundamentals wasn't always easy. In particular, stock selection in the communication services sector, primary in the US, was a drag on returns.



Carlos Hardenberg

Mobius Investment Trust (MMIT)

WHAT WORKED?

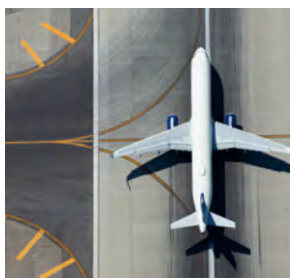
Avoiding some of the major risks in emerging markets. While our stock selection is bottom-up driven, we are very mindful about macro and regulatory risk as well as a lack of governance standards. This has meant that we had no investments in Russia at the time of its invasion into Ukraine, and that we invest very conservatively in China.

We have used the recent downturn to add some highly innovative companies to our portfolio. They have already had a positive impact on performance. Every crisis creates opportunities, and it is our task as investors to identify them.

WHAT DIDN'T WORK?

What clearly hurt performance were companies with direct exposure to the semiconductor cycle. Although we prefer asset-light businesses which are brand and margin leaders, the semiconductor companies have not been immune to the hefty cyclical downturn of the industry. We continue to have high conviction and are looking forward to the recovery in the near term.

We do not invest in sectors that we believe are not compatible with a sustainable investment approach. This includes fossil fuels and mining, sectors that have profited from the shortages and supply chain issues in the wake of the pandemic and the Russia-Ukraine war.



Kartik Kumar

Artemis Alpha Trust (ATS)

WHAT WORKED?

2022 has been a difficult year for most sectors other than energy and commodities where we have modest exposure. One company that has performed well is **Plus500 (PLUS)**, a stock we have held since 2016. As a retail trading platform, Plus500 has benefited from elevated volatility, and it has been smart with its capital allocation.

Plus500

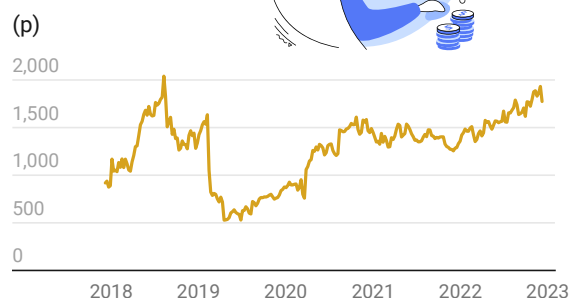


Chart: Shares magazine • Source: Refinitiv

WHAT DIDN'T WORK?

We carried a significant holding in the airline sector into this year, expecting suppressed demand to rebound strongly. Overall capacity had declined as a result of the pandemic, so we expected surviving airlines to benefit. This view played out but share prices have performed poorly, reflecting concerns over the impact of higher oil costs and uncertainty over the outlook for demand in the near term due to recession.



George Ensor

R&M UK Micro Cap (RMMC)

WHAT WORKED?

In a year dominated by a rapid increase in the cost of capital, tightening liquidity conditions and heightened economic uncertainty conditions have been ripe for non-cyclical shorter duration assets.

Our top performer in 2022 has been **Capital (CAPD)**, a business that provides production and exploration drilling services for gold miners. High fleet utilisation has driven improving return on capital and cash generation and the shares remain on a low valuation despite the strong performance.

Diversified Energy (DEC), a consolidator of traditional gas wells in the US, has benefited from European demand for LNG. **Shanta Gold (SHG:AIM)** has benefited from improving operational delivery at its core asset while its second asset is on track to contribute to production next year and exploration results from its third asset have been exceptional.

WHAT DIDN'T WORK?

Early-stage growth companies with high reinvestment rates that support organic growth but depress profitability such as **ActiveOps (AOM:AIM)**, **Kooth (KOO:AIM)** and **CMO (CMO:AIM)** have been aggressively sold off due to deteriorating risk sentiment and higher cost of capital.

Poor risk sentiment and record outflows from UK small-cap funds has driven an aversion to illiquidity. Recent surveys highlight extremely depressed consumer sentiment and our overweight to the UK consumer has been painful – the FTSE AIM retail index fell by 84% from its high in February 2021 to the low in October 2022.

Why investors can't afford to overlook Europe's growth and income champions

Cheap equity valuations reflect the region's weak economic outlook, but the continent is home to some genuinely world class businesses

Europe has world leading companies spanning most sectors of the market. Many of these businesses consistently generate high returns and have demonstrated an ability to weather economic storms.

The good news is many are currently 'on sale' after the turbulence European markets have experienced year-to-date, triggered by red hot inflation, central bank rate hikes and the potential severity of a looming global recession. Europe has been hit particularly hard thanks to its exposure to surging energy prices.

At the time of writing, the FTSE 100 is just about in positive territory year-to-date, whereas France's CAC 40 is off 7.5% and Germany's DAX is down 10.7%.

WHY EUROPEAN STOCKS ARE CHEAP

'Right now, valuations overall for Europe look pretty attractive,' says Nick Edwards, manager of the **Guinness European Equity Income (BYVHVZ9)** fund. 'At the end of September, the European market was the cheapest it had been since 2013's euro crisis and relative to the US, it is the cheapest it has been since 2008/2009.'

Edwards explains the European market structure is good for a more inflationary environment with higher rates, as Europe gives investors nearly 50% more exposure to financials than the US, double the exposure to high quality industrials focused on resource efficiency and nearly double the exposure to consumer staples.

Also weighing in on Europe is Zehrid Osmani, manager of **Martin Currie Global Portfolio (MNP)**, which as of 31 October had a regional allocation to Europe of 48.5%, up from 46.5% at the end of September.

While valuations have come down across all



global equity markets, on a cyclically adjusted price to earnings ratio basis over 10 years, Osmani says, 'Europe still has more valuation support than the US equity market. From the point of view of developed markets, we tend to find more value in European equities than in US equities.'

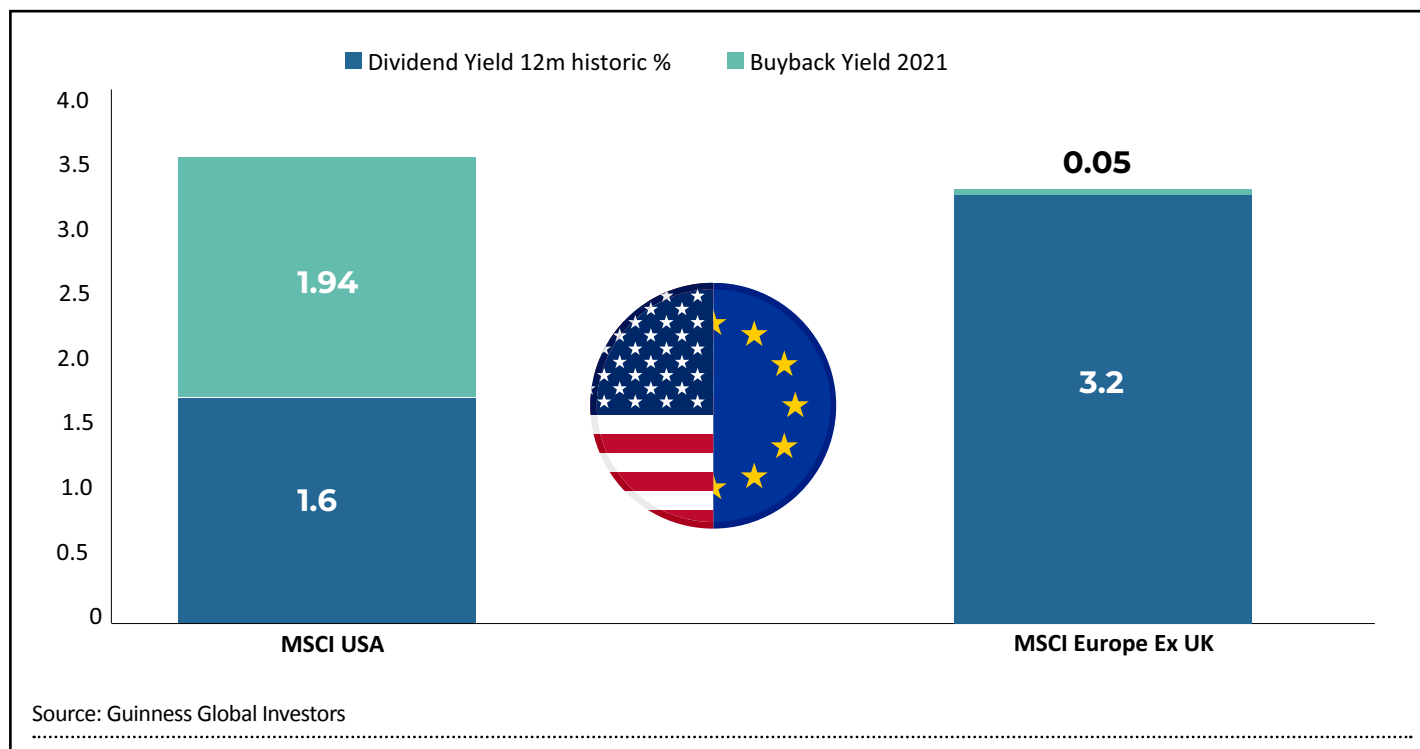
Osmani sees a higher risk of stagflation in Europe but stresses that the Europe-listed names he does own are globally exposed businesses. 'Yes, the European outlook is weak,' he concedes, 'but you can find European-listed companies that are exposed to the global cycle, and that's what we do.'

EUROPEAN STOCKS ARE GREAT FOR INCOME

Europe also has a well-established dividend paying culture dating back to the 17th century, when the Dutch East India Company became the first company to pay a dividend.

And as Nick Edwards wrote in a recent report, the Europe ex-UK region offers investors 'a

DIVIDEND YIELD VERSUS BUYBACK YIELD (%) 2021, MSCI US VS MSCI EUROPE EX UK



premium level of dividend income versus other main regions (and asset classes such as bonds), yielding significantly more in aggregate than the MSCI All Country World Index and MSCI USA indices.

'This is primarily due to the region's longstanding progressive dividend culture which contrasts with the US, where share buybacks comprise a far higher portion of capital returned to investors. The intersection of higher yields and globally leading quality across a range of sectors makes Europe a primary destination for income investors.'

Stephen Anness manages the global equity income portfolio of the multi-asset **Invesco Select Trust (IVPG)** and the portfolio he oversees had a 24% allocation to Europe as of 31 October.

Top 10 holdings include France's **Verallia (VRLA:EPA)**, a wine and spirits bottles producer blessed with pricing power which recently entered the STOXX 600, and **Zurich Insurance (ZURN:SWX)**, which offers a 'very attractive dividend yield' and is guided by 'shareholder focused' management. Anness' portfolio also owns **Universal Music (UMG:AMS)**, which has 'an extremely long duration in terms of its revenue stream' and which he likens to 'a toll road' for listening to music.

'We are quite substantially overweight Europe,'

enthuses Anness, a bottom-up stock picker whose portfolio is underweight the US. The outcome of his investment process, which is to find 'good companies on sale at a substantial discount relative to the value', has led to the portfolio having a number of holdings in Europe and some are quite big positions.

Anness says: 'Companies in aggregate are bit better in the US, particularly those mega cap growth companies that have delivered extraordinary earnings over the last 10 years. But we're not buying a market, we're buying a relatively small number of companies, many of which have overseas earnings, but are on a discount to peers because of the postcode they sit in.'

WHICH EUROPEAN FUNDS AND TRUST HAVE DONE BEST?

Investors can gain exposure to continental opportunities via some of the fund and investment trust sectors' top performers, vehicles such as **The European Smaller Companies Trust (ESCT)**, which has returned 356.3% over 10 years, or **Montanaro European Smaller Companies (MTE)**, up 253.5% over the past decade. **IFSL Marlborough European Special Situations (B90VHJ3)** has returned 249.1% over the same period.



Best performing European funds and trusts over 10 years

Fund/trust	10-year total return (%)
The European Smaller Companies Trust	356.3%
Montanaro European Smaller Companies Trust	253.5%
IFSL Marlborough European Special Situations A	249.1%
JPMorgan European Discovery Trust	223.3%
Fidelity European Trust	221.7%
SVM Continental Europe A	211.9%
BlackRock Continental European D Acc	208.7%
BlackRock European Dynamic D Acc	207.3%
Liontrust European Dynamic I Inc	205.1%
Henderson European Focus Trust	198.5%
BlackRock Greater Europe IT	189.9%
Janus Henderson Henderson Euro Trust	176.3%
Fidelity European W Acc	171.4%
Jupiter European L Inc	168.8%
Threadneedle European Assets Trust	165.4%
BlackRock Continental European Income D Acc	163.3%
LF Brook Continental European Ret Acc	161.6%
Baillie Gifford European B Acc	159.2%
Royal London European Growth Trust Inc	158.7%
Invesco European Focus (UK) Acc	158.3%

Table: Shares magazine • Source: FE Analytics, data to 8 December 2022

THREE TO BUY

FIDELITY EUROPEAN TRUST (FEV) 316.5p

DISCOUNT TO NAV – 6.3%

This trust aims to achieve growth in capital and income by identifying long term opportunities in companies with strong fundamentals and structural growth prospects. It has delivered a strong 10-year total return of 221.7%, according to data provider FE. Manager Sam Morse looks for businesses exhibiting an ability to grow their dividend sustainably over a three-to-five-year time horizon.

He co-manages the strategy with Marcel Stotzel, who was appointed in September 2020.

The portfolio is comprised of quality companies trading at reasonable valuations, best thought of as a GARP investment style. The process typically avoids more cyclical stocks and smaller companies to manage downside risk. Trading on a 6.3% NAV discount, the trust has offered protection in falling markets year-to-date, whilst outperforming the broader European equity market.

The trust carries an overweight to financials, technology and consumer discretionary, featuring some household names at the top of its portfolio, including **Nestle (NESN:SWX)**, pharmaceutical giant **Roche (RO:SWX)** and Dutch microchip kit maker **ASML (ASML:AMS)**.

MARTIN CURRIE GLOBAL PORTFOLIO (MNP) 303p

DISCOUNT TO NAV – 1.2%

Investors seeking a global vehicle offering meaningful exposure to European-listed champions should consider **Martin Currie Global Portfolio (MNP)**, which seeks to achieve long-term returns in excess of the total return from the MSCI All Country World index. Osmani focuses on buying quality growth companies which generate good returns on invested capital and boast pricing power, earnings resilience and strong balance sheets.

As of 31 October, Europe-listed holdings

included Swedish industrial group **Atlas Copco (ATCO-A:STO)** and luxury names **Kering (KER:EPA)** and **Moncler (MONC:BIT)**, two plays on an ‘emerging market middle class structural growth trend which remains very strong’.

Osmani holds a stake in sports car maker **Ferrari (RACE:BIT)**. ‘Ferrari by definition has strong pricing power and has been able to deliver steady top line momentum and good delivery on margins,’ he says. **L’Oreal (OR:EPA)** is also in the portfolio and has captured the trend for Chinese consumption of cosmetics despite the lockdown ‘because they’ve been able to service those consumers online and probably did better at doing so than **Estee Lauder (ESLA:VIE)**.’

GUINNESS EUROPEAN EQUITY INCOME FUND (BYVHWJ0) £10.81

Guinness European Equity Income (BYVHWJ0) is a concentrated portfolio equally weighted across 30 high quality, dividend paying companies with pricing power and strong balance sheets. It offers a dividend yield of 3.1% on the income share class. ‘We only look at companies that have generated high levels of persistent high cash returns over time and can sustain high cash returns over difficult periods,’ says Edwards.

Companies in the portfolio include consumer

staple dividend growers Nestle and **Danone (BN:EPA)**, as well as European bourse **Euronext (ENX:EPA)** and firms which generate high returns on capital like **Schneider Electric (SU:EPA)** and Atlas Copco, ‘the global market leader in air compression technologies vital for resource efficiency across different sectors from foods to semiconductors,’ says Edwards.



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

How to give your child or grandchild a financial gift at Christmas

We explore the pros and cons of cash, Premium Bonds, Junior ISAs and Junior SIPPs

This Christmas lots of parents and grandparents might decide to forgo the usual presents for the young people in their life and instead decide to give them money. But the days of tucking a £5 note into a Christmas card are largely gone now money is digital and people want to give financial gifts that last longer (and can't be splurged on sweets or magazines). So, what are the pros and cons of financial presents to give this Christmas (or at any time of the year)?

CASH

PROS

If you choose to put money in a cash account the child's parents will need to open the account. You should hunt around for the best rate possible, so you are maximising the return. The top rate at the time of writing was 3.75% from HSBC.

Just make a note to check back on the rate in a year or two, as banks have a nasty habit of slashing the interest on offer and relying on people not moving their money.

CONS

Cash rates have risen recently, but they are still miles away from inflation. This means any money you gift and leave in cash will lose value in real terms over the years. If you want a short-term option and know your grandchild will access that money in a few years that might be ok, but for longer-term savings it can really eat into your spending power.

For example, £100 saved 18 years ago would only be worth £61 today after factoring in inflation. There are tax implications if a child earns more than £100 in interest in a year and the money has been gifted by their parents, but this isn't an issue if the money has come from grandparents.



PREMIUM BONDS

PROS

Premium Bonds are a perennial favourite, and now the minimum amount is just £25 it's much easier to gift them. They are Government-backed, so couldn't be safer, and you have the bonus that they might make your grandchild a millionaire.

CONS

While the expected prize fund has improved recently, and is now the equivalent of 2.2%, they will still earn less than a cash savings account.

This 'expected rate' is also based on the average winnings, and the bonds you buy could win nothing. With inflation high that means the spending power of your gift will be eroded year on year, particularly if your grandchild doesn't cash the money in for a long time.

JUNIOR STOCKS AND SHARES ISA

PROS

Investing is the ideal long-term place for money, making it a good option for people who are gifting money to younger children, where it will go untouched for years. Generally, you should invest for five years or more, so it's ideal for younger children who have 10, 15 or even 18 years until they will access the money.

Someone who invested £25 a month for their grandchild from birth to the age of 18 would generate a pot worth £8,000, assuming growth of 4% a year. The parents of the child will need to set up the Junior ISA, and afterwards anyone can contribute. You can pay in up to £9,000 a year per child.

CONS

The downside of a Junior ISA is that the money can't be accessed until they are 18, which means if the child wanted it sooner, they wouldn't be able to get their hands on it.

Similarly, when they reach the age of 18, they take control of the money, which means they could cash it in and go on a spending spree – despite your protests. Investing is also riskier than leaving it in cash, as the value could drop too.

JUNIOR SIPP

PROS

Even non-taxpayers can pay into a pension and get tax relief, so you can put up to £2,880 into a pension each year for your child or grandchild and it will be topped up by the Government to £3,600.

If you paid in the maximum each year until they reached 18, you'd have a pot worth £96,000, assuming a 4% annual return. If you then didn't make any further contributions and left that money to grow, they would have a pension worth almost £410,000 by the age of 55. The fact the pension is locked up for so long means you can be sure they aren't going to raid the money and spend it on something frivolous.

CONS

This is a very long-term investment, and your grandchild won't be able to benefit until they are retirement age. Currently that's 55 but the minimum age level is expected to rise and so it's impossible to predict what it would be for someone who is currently a child.



By **Laura Suter**
AJ Bell Head of Personal Finance

THE TAX PERK OF GIFTING MONEY

Gifts of money is a great way to move the assets out of your estate for inheritance tax purposes. Everyone can pass on an estate worth up to £325,000 free of inheritance tax (and some people are eligible for a bigger limit if they are passing on their main home). But after that the estate will have to pay 40% tax.

If you know you're going to hit this threshold and can afford to part with

money now, moving funds out of the estate while you're alive can save tax in the future.

Anyone can gift up to £3,000 a year, as well as extra amounts when certain people in the family get married, without it being considered for inheritance tax purposes. Any gifts over that amount will be subject to the seven-year rule, which means that if you were to die inheritance tax is due on a sliding scale until seven years have passed.

How much tax relief can I claim if I'm already taking a pension?

Our expert helps with a query from a reader who is considering taking two pensions at age 55

I left school at 16 and for eight years or so I worked for a major bank. Once I left the pension was deferred. It is now worth around £3,000 per year with a small lump sum. I realise I can take this pension at 55 (and this will move to 57 in the future).

I also have a police pension which I can take in three years' time after reaching 30 years' service.

If I take either or both of these pensions together at 55 or any other age, does this impact on what I can pay into a new pension, as I will almost certainly go into new employment?

If there is any limit once I have retired from the police and taken the pension, what is the most I can pay into a scheme to gain tax relief?

Steve



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

The amount you can contribute to your pension each year while benefiting from tax relief is limited to 100% of your taxable UK earnings. If, for example, you earn £10,000 in 2022/23, then the maximum personal contributions you can make to a pension during that tax year, inclusive of tax relief, is £10,000.

There is also a separate, more general limit called the annual allowance. For 2022/23, this annual allowance – which covers personal contributions, employer contributions and tax relief – is set at £40,000.

If exceeded, you will be hit with a tax charge which effectively removes your tax relief.

If you are a very high earner then your annual allowance may be reduced, to a minimum of £4,000. [You can read more about the annual](#)



[allowance taper and how it may affect you here.](#)

Finally, if you make certain types of withdrawals from your pension, you will trigger the money purchase annual allowance (MPAA), reducing your overall annual allowance from £40,000 to £4,000. Triggering the MPAA will also prevent you from 'carrying forward' any unused allowances from the three previous tax years.

If you access a defined contribution pension flexibly – such as by taking an ad-hoc lump sum or an income via drawdown – you will trigger the MPAA. If you just take your 25% tax-free cash, however, you won't trigger the MPAA. The same is true if you use your pension pot to buy an annuity.

In addition, you are allowed to take up to three small pot lump sums in your lifetime. These lump sum withdrawals will not trigger the MPAA. In order to qualify as a small pots lump sum, the fund needs to be worth less than £10,000 and must be entirely exhausted when you access it.

Similarly, if either of the pensions you are considering accessing are defined benefit pensions, which sounds like it might be the case, taking this income also won't trigger the MPAA.

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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INTRODUCTION

Thank you to everyone who voted in the 2022 Shares Awards. We are now pleased to reveal the winners of the event in this special report.

The awards were voted by readers of Shares and by the public, making the event truly representative of the people who invest and trade the markets.

The awards cover a broad range of products and services including investment and trading platforms, ISAs and SIPPs, wealth management and investment products, as well as categories for listed companies.



Daniel Coatsworth,
Editor



BEST INVESTMENT TRUST FOR INCOME

THE LAW DEBENTURE CORPORATION

LAW DEBENTURE HAS been popular with investors for two reasons. First is a growing income stream – it has delivered 13.8% compound annual growth in dividends over the past four years. The dividend has gone up by 114.8% over the past 10 years.

Second is capital gains, with the shares having a good track record of outperforming the market. For the 10 years to 30 June 2022, it achieved a share price total return (capital growth and dividends) of 180.8% versus 94.6% from the FTSE All-Share index.

A resilient performance from the trust during the volatile market conditions of 2022 helped put the spotlight on **Law Debenture** and saw it win even more fans during the year.





www.lawdeb.com



Best Investment Trust for Income Shares Awards 2022

Law Debenture's investment objective is to achieve long term capital growth in real terms and steadily increasing income through investing in a diversified portfolio of stocks

133 years

of history with a long-term
track record of value creation
for shareholders

43 years

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increasing our dividend
payments

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BEST INVESTMENT TRUST FOR GROWTH

FIDELITY EUROPEAN TRUST

DESPITE A GLOOMY backdrop for European shares over the past year Fidelity European Trust has managed to outperform its investment trust peer group and snare the **Best Investment Trust for Growth** gong at the 2022 *Shares Awards*.

A disciplined focus on owning high-quality stocks which are trading below intrinsic value, generate consistent growth and which have the potential to pay out a steadily rising stream of dividends has been key to generating above-average returns.

That and a long-term view which enables the trust to hold onto stocks for three to five years, compounding returns for investors while keeping trading costs low in the process.



Built to stand the test of time

FIDELITY EUROPEAN TRUST PLC

This investment trust is built on companies with well-formed, long-standing foundations.

Europe is home to some of the strongest, most stable and resilient companies. These global household names are famed for standing the test of time, even through periods of economic uncertainty.

Using Fidelity's extensive research team, portfolio manager Sam Morse aims to select well-established European companies with proven business models, attractive valuations and the ability to grow dividends both now and in the future. It's these classic giants with market-beating potential that have helped the investment trust outperform the index over the long term.

PAST PERFORMANCE

	Nov 17 – Nov 18	Nov 18 – Nov 19	Nov 19 – Nov 20	Nov 20 – Nov 21	Nov 21 – Nov 22
Net Asset Value	0.3%	16.7%	9.5%	21.5%	1.0%
Share Price	-1.9%	21.7%	10.5%	19.7%	3.2%
FTSE World Europe ex-UK Total Return Index	-4.6%	13.7%	7.3%	15.7%	-2.9%

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 30.11.2022, bid-bid, net income reinvested.
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The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations.

This trust uses financial derivative instruments for investment purposes, which may expose the fund to a higher degree of risk and can cause investments to experience larger than average price fluctuations.

To find out more, scan the QR code, visit fidelity.co.uk/europe or speak to your adviser.





GROWTH COMPANY OF THE YEAR

TELECOM PLUS / UTILITY WAREHOUSE

TELECOM PLUS, WHICH trades as Utility Warehouse, saw a record number of UK households sign up to its services in the six months to 30 September 2022. Revenue jumped 51.5% to £562.4 million and pre-tax profit increased by 46.2% to £29.1 million.

In the half-year period customer numbers hit 814,684, representing an annualised growth rate of nearly 24%. The company upgraded its earnings guidance and said it was on track to deliver an additional one million customers over the next four to five years.

Shareholders have been richly rewarded with Telecom Plus's share price rising more than 40% this year.

It's no wonder that **Telecom Plus** was crowned Growth Company of the Year at the *Shares Awards* in 2022.





Thank you

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From our growing team of

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BEST INVESTMENT TRUST GROUP

ALLIANZ GLOBAL INVESTORS

ALLIANZ GLOBAL INVESTORS can trace its roots in the investment trust world back to 1889 and today it manages three companies in this part of the investment universe.

The Merchants Trust is a popular choice among investors wanting exposure to higher yielding large UK companies.

The Brunner Investment Trust is positioned as an 'all-weather' portfolio for investors who want exposure to global equities and a quarterly dividend.

It also manages Allianz Technology Trust which provides exposure to exciting companies that have the potential to be tomorrow's big names in the tech space.

Each one has carved a niche in the investment market and their success has made them well-known names in the investment trust world.

Allianz Global Investors has been recognised for its success in managing these three vehicles by winning the Best Investment Trust Group category at this year's *Shares awards*.



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Allianz Global Investors and its predecessors have been managing investment trusts since 1889. Our trusts span investor aims – from income, to growth, to the specialist sector of technology – and offer a path to investment opportunities around the world. We're delighted to have been named Best Investment Trust Group in the 2022 Shares Awards. So whatever your investment goals, please take a closer look and discover what our investment trusts could bring to your portfolio.

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