STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

POPULAR FUNDS: BIG CHANGES?

We reveal how their portfolios have adapted to shifting market dynamics

TIPS OF THE YEAR We are up 23% against a flat market

Contents

Three important things in this week's magazine

1

Only 38% of actively managed equity funds outperformed the market over the past 10 years

New research by AJ Bell shows many investors who opt for passive tracker funds are coming out on top

2

Investors have been flocking to gilts with the hope of locking in decent income and making a capital gain

We explain how to buy gilts and reasons for doing so

3

By and large, popular funds and trusts haven't fiddled with their portfolios much as market dynamics shift

Most have stuck to the same investment process even though the market environment has radically changed

Visit our website for more articles

Did you know that we publish daily news stories on our website as bonus content? These articles do not appear in the magazine so make sure you keep abreast of market activities by visiting our website on a regular basis.

Over the past week we've written a variety of news stories online that do not appear in this magazine, including:

Games Workshop delivers eighth consecutive year of growth and boosts dividend

How India could be the next investment superstar state

S4 Capital warns on full year profit after slowdown in tech spending

Netflix shares fall as revenue and outlook disappoint

A unique investment philosophy

Nearly four decades of bottom-up fundamental investing.

Asset Value Investors (AVI) has managed the c.£1.1* bn AVI Global Trust since 1985. Our strategy has remained consistent for this period: to buy quality companies held through unconventional structures, trading at a discount. 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 world is filled with challenges and volatility, with a war on European soil and rising interest rates alongside high levels of inflation. Despite the challenging market conditions, we continue to find good investment opportunities.

Our proprietary research process with a focus on mispriced assets that trade at a discount to net asset value enables us to filter through the numerous companies, to distil the market down to a more manageable universe.

AVI's well-defined, robust investment philosophy helps 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; and (3) an identifiable catalyst for value realisation. A concentrated high conviction core portfolio of c. 30± investments 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, other key shareholders. Our aim is to be a constructive, stable partner and to bring our expertise - garnered over almost four decades of investing in asset backed companies - for the benefit of all. The approach is benchmark-agnostic, with no preference for a particular geography or sector which allows us to seek out the best opportunities anywhere in the world.

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 continue to find plenty of exciting opportunities in which to deploy the trust's capital.

Discover AGT at www.aviglobal.co.uk

'Gross Assets at 31 January 2023
±As at 31 January 2023, holdings >1% of NAV

Asset Value Investors

Revealed: the shares which shone as the FTSE 100 has bumper week

Housebuilders and retail stocks were among the top performers

The FTSE 100 enjoyed its best week in four months between 17 and 21 July, gaining nearly 3% across the course of five trading sessions. This followed up on a decent performance in the previous week and helped put the index in positive territory for the year.

The main driver of positive sentiment has been lower than expected inflation numbers on both sides of the Atlantic. First on 12 July US CPI came in at 3% versus the forecast 3.1% and then on 19 July UK CPI at 7.9% was below the anticipated rate of 8.2%.

This prompted an immediate drop in gilt yields, which reflect the borrowing costs of businesses and consumers, on the assumption easing inflation will mean the Bank of England does not need to raise rates as far or as fast as previously thought.

FTSE 100 best performers between 17-21 July

Company	Performance
Ocado	15.6%
Barratt Developments	11.3%
Taylor Wimpey	10.7%
Persimmon	10.7%
Hargreaves Lansdown	9.7%
Berkeley	7.6%
Admiral	7.5%
Land Securities	7.5%
Haleon	7.3%
Melrose Industries	6.9%
Rolls-Royce	6.3%
Segro	6.1%

Table: Shares magazine • Source: SharePad

FTSE 100

Chart: Shares magazine • Source: Refinitiv

In this context, it is no great surprise to see housebuilders and property stocks among the top FTSE 100 performers. As well as being sectors whose fortunes are closely tied to the UK economy, they also have correlation with interest rates.

Berenberg chief economist Holger Schmieding observed that market expectations (based on overnight index swaps) for the peak Bank of England interest rate topped out in early July at 6.5% by March 2024.

He adds: 'Although we emphasise the risks stemming from the Bank of England's damaged credibility, we also thought that market pricing had gone too far. In our base case, we look for the bank rate to peak at 5.5% in September with risks skewed towards a 5.75% peak rate.'

Interestingly, Schmieding believes longer-term expectations for rates are pitched too high at 4.4% by the end of 2025. 'That is well above our own call of 3% by end-2025 – which is based on the historical observation that the Bank of England generally undertakes sizeable and rapid cuts soon after the bank rate has peaked.

'Over the past 50 years, the average cutting cycle lasted around 12 months, during which the policymakers reduced the bank rate by around 350 basis points.' The next Bank of England base rate decision will be made on 3 August. [TS]

Wildfires and strikes cause investors to worry about airlines and holiday companies

These events could cause new disruption to the travel industry

Shares in airlines and holiday companies including **EasyJet (EZJ)**, **Jet2 (JET2:AIM)**, **TUI (TUI)** and **International Consolidated Airlines (IAG)** suffered losses on 24 July as wildfires took hold in the popular Greek holiday destinations of Corfu and Rhodes and a 'extreme fire risk' warning was made for Crete.

Danni Hewson, head of financial analysis at AJ Bell, said: 'Falling share prices for the likes of Jet2, EasyJet and TUI suggest investors are worried that they won't achieve near-term earnings forecasts and they will potentially incur extra costs for having to run repatriation flights to bring customers home.'

As a result of these wildfires some airlines had to cancel flights to certain Greek islands and begin a holidaymakers' rescue mission instead. Jet2 and TUI have cancelled all flights to Rhodes until 28 July, while approximately 2,500 people have already been evacuated from Corfu, according to reports.

EasyJet cancelled package holidays departing for Rhodes between 23 and 25 July, while those who were booked on its flights to or from the Greek island up to 29 July were given the option to stick with their plans as it continued to fly to the destination, transfer to a different date or get a credit voucher from the airline.

Compounding the situation is the threat of strike action across the summer. European air traffic control workers are protesting at being short-staffed, management behaviour and an imposed roster system. EasyJet has already cancelled 1,700 summer flights as a pre-emptive measure, while also scrapping 350 flights earlier in July as cabin staff in Portugal held strikes over pay and working conditions.

The first phase of strike action by ground handling staff at London's Gatwick airport this summer looks to have been averted but the second phase could still go ahead in August.

Back in April, EasyJet raised its full year profit forecast and said its holidays were 80% sold for summer 2023 despite higher fuel and operating costs.

In early July, Jet2 reported a 48% rise in group pre-tax profit of £390.8 million for the year ending 31 March 2023, compared to a £376.2 million loss a year earlier.

Airlines will have to adopt a 'wait and see' approach regarding how the Greek wildfire disaster pans out for holidaymakers and future bookings.

'Reports of holidaymakers having to leave hotels and sleep in sports halls or on the street could cause others to think twice about booking last-minute breaks, for fear they too could get caught up in the chaos,' added Hewson. [SG]

DISCLAIMER: AJ Bell is the owner of Shares magazine. The author (Sabuhi Gard) and editor (Daniel Coatsworth) own shares in AJ Bell.

Unilever flexes its pricing power muscles, but market share losses are a concern

There are limits to its pricing power and there are plenty of challenges for the new CEO

Consumer packaged goods powerhouse **Unilever (ULVR)** topped the FTSE 100 leader board on 25 July after the Marmite-to-Magnum ice cream maker's second quarter sales beat expectations.

Investors were delighted as the Dove soap-to-TRESemmé maker raised full year sales guidance to 'above 5%', ahead of its multi-year range, forecast that underlying price growth will continue to moderate through the year and reported a return to positive emerging markets volume growth.

But closer inspection of the results showed there is much work for new chief executive Hein Schumacher to do with high costs keeping the Sunsilk-to-Vaseline supplier's gross margins below pre-pandemic levels and Unilever having to fend off hungry competitors.

In Schumacher's first set of results since taking over from Alan Jope as CEO, Unilever reported a forecast-beating 7.9% rise in second quarter underlying sales which took growth in first half underlying sales to 9.1%.

Prices rose by a significant 9.4% in the six-month period, which did lead to volume declines in both the first and second quarters, demonstrating there are limits to Unilever's pricing power.

Yet these volume declines were very modest and Unilever's formidably strong portfolio of brands continues to attract a loyal following, with the company calling out strong showings from 'billion+ Euro brands' including Rexona, Hellmann's, OMO, Sunsilk and Lux.

In a worrying section of the statement, Unilever conceded the percentage of its business winning market share on a rolling 12-month basis has reduced to 41%. That implies almost 60% of its portfolio is maintaining or losing market share to competitors, a trend Schumacher will need to reverse during a cost-of-living crisis which is forcing many hard-pressed consumers to trade down to cheaper own-label brands.

Chart: Shares magazine • Source: Refinitiv

Unilever pinned the blame on a 17% reduction in stock-keeping units as well as pricing dynamics and consumer shifts in certain markets, including the tea and laundry value segments in India and Brazil respectively, and super-premium segments in personal care North America.

'We continue to focus on the longer-term health and competitiveness of the business while developing the portfolio into high-growth spaces and channels,' explained Unilever, which recently sold the Suave brand in North America and snapped up the Yasso premium frozen Greek yogurt brand in the US.

Schumacher insisted Unilever's first half performance highlighted 'the qualities that attracted me to the business: an unmatched global footprint, a portfolio of great brands and a team of talented people.'

He said the task ahead is to 'leverage these core strengths – supported by our simplified operating model – to drive improved performance and competitiveness.'

This is Schumacher's 'absolute priority' and will mean bringing 'greater focus and sharper execution, with science-backed innovations and investment behind our brands.' [JC]

Ocado's technology arm gets investors excited again

Grocery delivery and warehouse automation company surges nearly 35% in wake of half-year figures

The **Ocado (OCDO)** believers have been out in force again as the grocery delivery and warehouse automation company returned to an underlying profit in the six months to 28 May 2023, and confirmed its full year earnings guidance on 18 July.

Since then, the stock has soared nearly 35% to 781p, making it one of the best performers among FTSE 350 companies.

Driving the performance was the technology solutions business, seen as the engine of growth. But not everyone is convinced.

Clive Black of Shore Capital, a long-standing sceptic of the company, continues to highlight limited progress in opening new centres for existing customers **Coles (COL:ASX)** and **Kroger (KR:NYSE)**.

Still, that life isn't getting any worse for the company seems to be enough to satisfy investors, for now, although what matters to many will be if Ocado continues to be linked as a takeover target.

Rumours that **Amazon (AMZN:NASDAQ)** wanted to buy the business in a speculated 800p per share deal gave the stock a bump higher in June before several analysts rained on the parade. [SF]

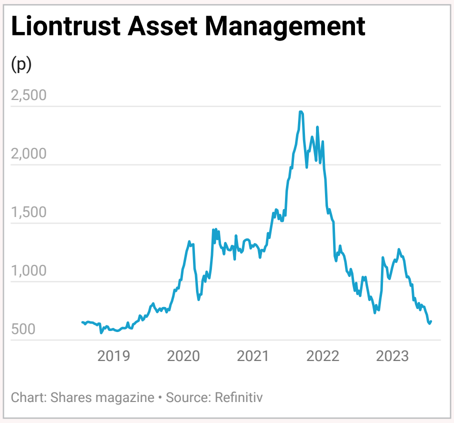
Liontrust shares remain in the doldrums as GAM takeover sees new twist

The UK asset manager has extended the acceptance period to 28 July 2023

Fund manager **Liontrust Asset Management (LIO)** has seen its shares halve in the last six months, which is providing a headwind for its proposed takeover of struggling Swiss asset manager **GAM (GAM:SWX)**.

Liontrust's offer is based on issuing 9.4 million shares to GAM's shareholders which on the day of the original takeover offer (4 May) valued GAM at CHF 107 million (£96 million), equivalent to CHF 0.67 per share. Liontrust's shares have subsequently dropped, lowering the value of the proposed offer to CHF 0.45 per share.

Investors seem unconvinced the proposed deal is a great one which partly explains weakness in the shares. Meanwhile NewGAMe, controlled by French billionaire



Xavier Niel, is urging shareholders to hold off voting the deal through.

NewGAMe and Geneva wealth manager Bruellan own 9.6% of GAM and have offered CHG 0.55 per share in cash to buy up to a further 17.5% of GAM, representing a chunky premium to Liontrust's proposed offer.

Liontrust remains resolute, insisting its offer is full and final, arguing it is the best way to give GAM's shareholders a positive outcome. [MG]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS
1 August: Filtronic
2 August: The Works

HALF-YEAR RESULTS
28 July: AstraZeneca, IMI, Intertek, NatWest, Rightmove
31 July: Haleon, Hutchmed, Quartix Technologies, Spectris
1 August: Domino's Pizza, Fresnillo, Greggs, Robert Walters, Staffline, Travis Perkins
2 August: Convatec, Endeavour Mining, Ferrexpo, Haleon, IP Group, Man Group, Smurfit Kappa, Spirent Communications
3 August: Helios Towers, Hikma Pharmaceuticals, London Stock Exchange, Mears, Morgan Sindall, Quilter, Rolls-Royce, Shaftesbury, Serco, Smith & Nephew

TRADING ANNOUNCEMENTS
28 July: Glencore, Paragon Banking
3 August: Next, Wizz Air

Can the new Rolls-Royce CEO back up his big rhetoric by delivering with first-half results?

Investors will be focusing on cash flow performance when the aircraft engine manufacturer updates

First-half results from aircraft engine maker Rolls-Royce (RR.) on 3 August will be an opportunity for its new boss Tufan Erginbilgic to add to this week's positive trading update that demonstrated that his tough talk around reviving the fortunes of the company is yielding early results.

Erginbilgic was certainly in no mood to sugar coat the company's problems when he started his tenure in January 2023, describing the business as a 'burning platform' in an address to staff.

The former **BP (BP.)** man poached some of his ex-colleagues from the oil company to help lead the transformation process at Rolls-Royce – Nicola Grady-Smith as chief transformation officer and Helen McCabe as chief financial officer.

While the shares had stalled in recent months, after Erginbilgic's initial rhetoric drove a big rerating at the start of the year, a big jump on 26 July in the wake of the trading update, means Rolls remains one of the best performing FTSE 100 stocks year-to-date, up more than 80%.

Rolls-Royce is reliant on lucrative spares and repairs revenue on an installed base of aircraft engines. This revenue stream is directly linked to the number of hours planes are in the air. Areas of focus when the company reports will include engine flight hours and cash flow – an area where Rolls was underperforming even before the pandemic.

Investors may also be looking for a flavour of the wider strategic direction in which Erginbilgic intends to take the company – including potential disposals of businesses which are not delivering strong enough returns. [TS]

What the market expects of Rolls-Royce

	EPS (p)	Revenue (£bn)
Forecast for 2023	4.98	£13.86
Forecast for 2024	7.53	£15.02

Table: Shares magazine • Source: Yahoo Finance

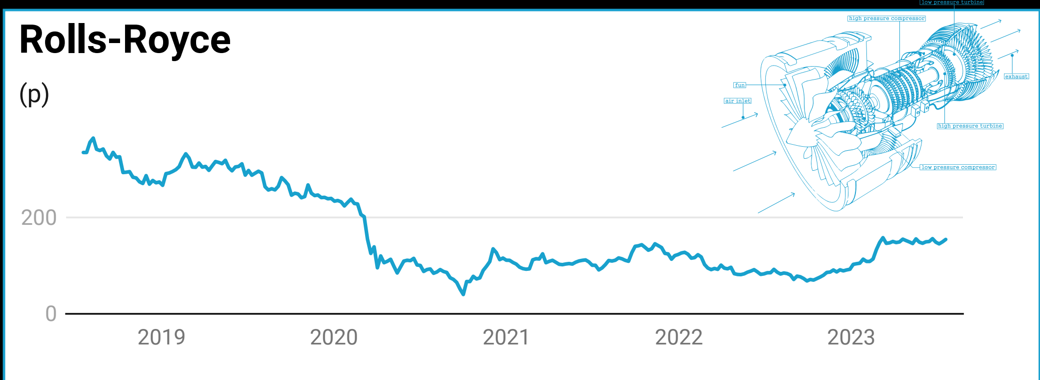


Chart: Shares magazine • Source: Refinitiv

Will fears over slowing orders at Caterpillar prove justified?

The company has consistently beaten expectations in recent quarters

US industrials outfit **Caterpillar (CAT:NYSE)** is a big, globally diversified business which operates across several economically sensitive markets.

As such, its quarterly update on 1 August will not only be a marker for the health of the company itself but also for the wider global economy.

Its core business areas are construction, mining, energy and transportation. Thanks in part to its own efficiencies and robust pricing the company has been able to fend off inflationary pressures and earnings have typically come in ahead of expectations. Out of the last four quarters reported, just one has fallen short.

As well as providing some wider insights, this latest update from Caterpillar may also reveal if analysts' worries expressed at the time of its first quarter numbers in April – that a flat order book, quarter-on-quarter – was a sign of a slowdown in purchases of Caterpillar's kit.

That initially led to some weakness in the shares but in the last two months they have regained momentum.

Caterpillar

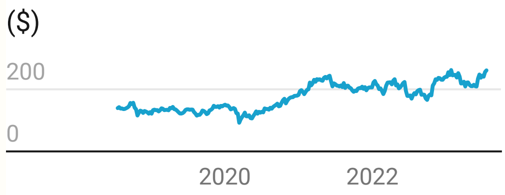


Chart: Shares magazine • Source: Refinitiv

The Q1 report was otherwise strong, with earnings per share coming in at $4.91 per share against the forecast $3.78 per share as the company benefited from infrastructure-related demand and a ramp-up in investment in the energy sector in response to higher prices. [TS]

What the market expects of Caterpillar

	EPS ($)	Revenue ($bn)
Q2 forecast	$4.58	$17.27

Table: Shares magazine • Source: Yahoo Finance

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

28 July: ExxonMobil, Procter & Gamble, Chevron, Aon, Colgate-Palmovile
31 July: Arista Networks, Republic Services, Simon Property, Global Payments, Illumina, Loews
1 August: Merck&Co, Pfizer, AMD, Starbucks, Gilead, Marriott International, Marathon Petroleum, AIG, Electronic Arts
2 August: Caterpillar, CVS Health, PayPal, Equinix, Occidental, Phillips66, MetLife, Kraft Heinz, Yum! Brands
3 August: Apple, ConocoPhillips, Amgen, Stryker, Booking, Cigna, Regeneron Pharma, Fortinet, Moderna, Warner Bros Discovery

Latest deal shows 3i Infrastructure is undervalued and investors should snap up the shares

The trust has lagged the market this year unlike stablemate 3i Group

3i Infrastructure	
(3IN)	
Price:	315p
Market cap:	£2.9 billion

News that **3i Infrastructure (3IN)** is selling its 25% stake in Attero at a significant premium to its valuation just four months ago confirms for us the market is undervaluing the shares.

The investment trust, which comes from the same stable as **3i Group (III)**, a core shareholder and one of the best performers on the FTSE 100 over the past decade, has found life harder on the stock market since interest rates started going up last year.

The sale of Attero, one of the largest waste treatment and recycling firms in the Netherlands, representing 4% of the portfolio at the end of March, is expected to net €215 million or 31% more than the most recent valuation of €164 million.

Richard Laing, chair of 3i Infrastructure, described Attero as 'a most successful investment, experiencing substantial growth' since 2018, but said while the trust aims to hold stakes for the long term it would sell where this generates significant additional value for shareholders.

While it would be a stretch to say the entire £3.6 billion portfolio is worth 30% more than its March valuation, the deal suggests the trust is fairly prudent in the way it values its assets.

'Not only does (the sale) continue management's strong track record of being able to deliver attractive exits to crystalise value from its portfolio through the cycle, but in our view, it is also suggestive of conservative valuations for wider portfolio companies, which continue to exhibit strong operational performance and growth in line with expectations,' comment analysts at Numis.

Prior to the sale of Attero, the portfolio consisted of 13 assets across five 'megatrends' which the managers believe are shaping the world around us: energy transition (42% of the portfolio), digitalisation (22%), globalisation (22%), demographic change (8%) and renewing social infrastructure (6%).

In the year to March 2023, the fund generated an NAV (net asset value) total return of 14.7%, comfortably above management's target annual return of 8% to 10%. 3i Infrastructure also raised its 2023 and 2024 dividend target by 6.7%.

Liberum analyst Joseph Pepper views 3i Infrastructure as 'one of the best-placed funds to deliver attractive NAV return in a capital-constrained environment due to its active management of core-plus companies which provides a plethora of internal levers for growth, including via disposals'.

While the fund trades on a relatively narrow 5% discount to NAV, 'we do not view this as demanding given management's strong track record of delivering returns ahead of its 8% to 10% target (14% annualised NAV total return since IPO) and the attractive return potential of portfolio companies going forward,' adds Numis. [IC]

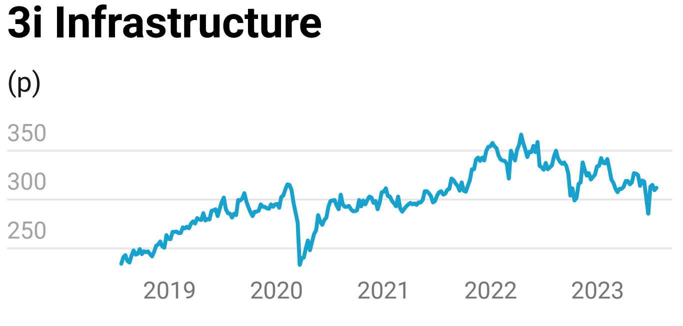


Chart: Shares magazine • Source: Refinitiv

Buy Volution: it deserves a valuation in line with high quality UK industrial peers

A modest pullback in the shares represents a great chance to gain exposure to regulatory-driven earnings

Volution	
(FAN)	
Price:	387.6p
Market cap:	£765 million

Companies with regulatory drivers underpinning their business should be highly prized, particularly in the current economic environment. A recent pullback in the share price of ventilation products maker **Volution (FAN)** has created an opportunity to invest in just such an outfit.

Volution bears resemblance to some of the UK's highest quality industrial names and Shore Capital analyst Graeme Kyle suggests there is some conservativism baked into consensus forecasts. The shares trade on an undemanding 15.2 times next 12 months' earnings estimates with a 2% dividend yield.

The company's quality is reflected in an adjusted operating margin of 21%, achieved despite inflationary pressures, and comparable with health, safety and environmental electronics equipment designer **Halma (HLMA)** which trades on a valuation of 27 times earnings.

Volution manufactures items such as extractor fans and air ducts and a big driver of investor interest in the company and its revenue in recent years has been Covid. The pandemic has led to increased focus and stricter rules around air flow and quality as countries have reacted to what was an airborne, respiratory disease.

This trend was reflected in a strong year-end trading update covering the 12 months to 31 July 2023, with robust demand in the UK repair, maintenance and improvement market supported by investment to improve indoor air quality in local authority and housing association properties.

Energy efficiency is another driver and thanks to a mix of organic and acquisitive growth, Volution has become a larger and more geographically diversified business in recent years.

In the six months to 31 January 2023 the company generated 45% of its revenue from the UK, 40% from continental Europe and 15% from Australasia. A net debt to earnings ratio of around one-times implies there is headroom for further deals to augment growth.

M&A expenditure in 2023 so far totals £39 million, its most active year on this metric apart from 2017 when it spent £44 million.

As Berenberg analyst Robert Chantry observes Volution has not just been a beneficiary of external factors, it has also helped itself. 'We feel the backdrop of regulatory drivers has been helping, but strong market service and product availability have also helped Volution gain share,' he says.

Further product innovation should help bolster its competitive position and we see big potential for the business and its share price. [TS]

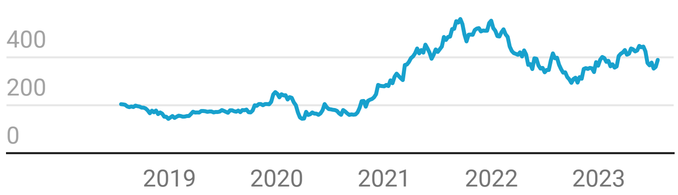


Chart: Shares magazine • Source: Refinitiv

Invesco

INVESTING IN ASIA **BEYOND CHINA**

Author: Fiona Yang

While China is our largest geographical allocation for many of our portfolios, we believe there are plenty of exciting companies in the wider Asia region.

The advantages of a flexible investment approach

Over the years, different geographies have served our Henley-based Asian and Emerging Markets Equities team's portfolios well. We have invested in countries such as South Korea, Hong Kong, Taiwan, Indonesia, and opportunistically, Australia. Our investment universe is vast and flexible as we can invest in all sectors, themes, and large and smaller companies.

That flexibility paid off for us coming out of Covid when the turnover, or more simply the buying and selling, of holdings picked up as we sought to capitalise on the opportunities available. For example, we took profits from tech and internet holdings that had outperformed, rotating into more economically sensitive names that had the potential to recover strongly as economies reopened, such as Indian engineering & construction conglomerate Larsen & Toubro.

More recently we've been able to take some profits from some of those economically sensitive companies that have outperformed, and where we believe share prices now reflect our estimate of fair value. For example, we've now sold Korean steel manufacturer Posco and Indian auto conglomerate Mahindra & Mahindra. Areas we've been adding to include Korean memory chip stocks where valuations had fallen to what we believe is a particularly attractive level, and Vietnam, where market weakness has proven to be an invitation to unearth possible undervalued opportunities.

The value of "on the ground" meetings

After a long period of travel restrictions, one of the most valuable exercises we've been able to reinstate is on the ground meetings with companies we invest in, but also those we are keen to explore. A recent example is a trip to Jakarta, where the 2024 election and the national drive to grow Electric Vehicles (EV) ecosystem were hot topics for discussion.

I travelled there with Ian Hargreaves, Co-Head of the Asian and Emerging Markets equities team and my co-manager on the Invesco Asia Trust plc, and we met with some very exciting entrepreneurs in the EV and fintech industries. It's an extremely competitive sector, so a selective approach and an in-depth understanding of the whole supply chain was required.

While Indonesia has one of the most vibrant digital ecosystems in southeast Asia, with its largest internet companies having enjoyed meaningful growth in recent years, we do see some near-term challenges. We note that some internet companies may look to raise capital, given that cash levels on their balance sheets, and e-commerce companies would likely see a decline in gross merchandise value (total value of sales over a given time period) as free shipping and discount coupons are withdrawn.

There is grounds for optimism though. As Ian summarised after our trip: "Given the improved governance and risk management of the largest bank in Indonesia, Bank Negara, and busy retail areas," he says, "the vibrancy of the economy and the reforms of Joko Widodo's administration left us confident on Indonesia's long-term prospects."

Investors need to consider many things when investing in Asia or emerging markets. While becoming hotbeds of consumption and innovation following decades of rapid industrialisation, one must still be mindful of geopolitical risks and the global economic cycle – think trade and exports.

But as economies such as China re-open and governments across the region get behind industry with pro-growth reforms and supporting measures, we are optimistic about what the region can offer investors.

Want to find out more?

Fiona Yang is a fund manager within the Henley-based Asian & Emerging Markets Equity team. Click the links below to find out more about the investment trust she manages:

Invesco Asia Trust PLC (LSE:IAT) - Share price | AJ Bell

Invesco Asia Trust plc

Investment risks

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

The Invesco Asia Trust plc invests in emerging and developing markets, where difficulties in relation to market liquidity, dealing, settlement and custody problems could arise.

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

The Invesco Asia Trust plc uses derivatives for efficient portfolio management which may result in increased volatility in the NAV. In addition, some companies are suspending, lowering or postponing their dividend payments, which may affect the income received by the product during this period and in the future.

Important information

Data as at 7 July 2023 unless otherwise stated.

This is marketing material and not financial advice. It is not intended as a recommendation to buy or sell any particular asset class, security or strategy. Regulatory requirements that require impartiality of investment/investment strategy recommendations are therefore not applicable nor are any prohibitions to trade before publication.

Views and opinions are based on current market conditions and are subject to change.

For the most up to date information on our investment trusts, please refer to the relevant Key Information Document (KID), Alternative Investment Fund Managers Directive document (AIFMD), and the latest Annual or Half-Yearly Financial Reports. This information is available on the website.

If investors are unsure if this product is suitable for them, they should seek advice from a financial adviser.

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Our 2023 share picks have absolutely smashed it: up 23% against a flat market

Gains across our portfolio have been broad-based unlike in the wider market

Given how hard it has been to pick winning stocks this year, due to the outsized gains enjoyed by a narrow collection of stocks in the US in particular, we are delighted with the performance of our 2023 Tips of The Year.

Against a FTSE All-Share index which has basically gone nowhere, eking out just a 0.5% positive return at this stage, our basket of 10 stocks has returned an average of 23.3% on an equally-weighted basis so far this year.

OUR TIPS UP 23% VERSUS 0.5% FOR THE FTSE ALL-SHARE

A BROAD SPREAD OF WINNERS

Just as pleasing, the performance isn't all down to one or two stocks – eight of our chosen shares have generated double-digit returns and of the other two only one is in negative territory.

We deliberately avoided too much concentration on any one sector, so our selection included consumer stocks, a pharmaceutical major, a China-focused financial, a semiconductor equipment-maker and a gold miner, giving us a good mix of 'growth' and 'value'.

Similarly we didn't just stick to UK names but included European and US stocks with a global revenue base, which has undoubtedly helped since the UK market has been decidedly lacklustre.

The selection also included a range of market

Shares' 2023 stock portfolio

Company	Currency	Entry price	Latest price	Market cap	Share price change (%)
Apple	$	132.37	194	$3,000bn	46.6%
ME International	p	113	162	£613m	43.4%
JD Sports*	p	114.6	161.45^	£8.4bn	40.9%
Shanta Gold**	p	9.02	11.85^	£124m	31.4%
Walt Disney***	$	85.78	108.1^	£197bn	26.0%
ASML	€	534.5	668	€270bn	25.0%
Premier Foods	p	107.6	123.5	£1.1bn	14.8%
Compass	p	1908	2116	£36.6bn	10.9%
Prudential	p	1049	1056	£29.1bn	0.7%
GSK	p	1418	1322	£54.2bn	-6.8%
TOTAL					**23.3%**

**Profit taken 19 Jan 2023. **Profit taken 23 March 2023. ***Profit taken 16 Feb 2023*

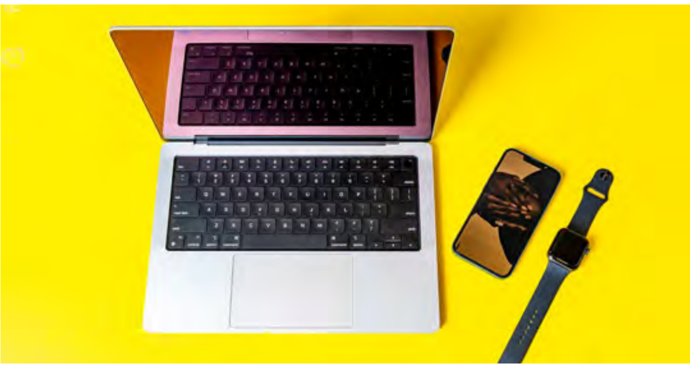
Table: Shares magazine • Source: Shares, Google Finance. Entry prices taken 20 Dec 2022. Latest prices taken 18 July 2023. ^: Price at which profit taken caps, and while our average return is perfectly respectable calculated on an equally-weighted basis, if we had adopted a market-cap weighted approach like our chosen benchmark, the FTSE All-Share index, our return would have been even stronger given the weighting and performance of one of our star stocks, **Apple (AAPL:NASDAQ)**, which started the year valued at over $2 trillion and is now worth close to $3 trillion.

Finally, while we aren't paid to be fund managers, we also didn't want to simply leave our stocks untended so we booked gains early on three of our positions – rightly it turns out, since all three have given back a fair chunk of their outperformance since we said to take profits.

THIS YEAR'S TOP PERFORMERS

Top of the tree so far this year, and defying 'law of big numbers' which says when a company gets too large it can no longer grow, is consumer electronics behemoth Apple with a gain of 46.6%.

Our investment case was based on the firm's ability to continue growing its sales not just of products but services such as Apple TV and its App Store, helped by its strong balance sheet, while at the same time expanding its margins by raising selling prices.



We were comforted by the fact the shares had derated from 48 times earnings in 2020 to a more reasonable 21 times by the start of 2023 and it was the biggest single holding for **Berkshire Hathaway (BRK.A:NYSE)**, managed by legendary investor Warren Buffett.

Pleasingly, first-half earnings were solid, and expectations are high for the third quarter following the release of the new MacBook Air and MacBook Pro, which is still the firm's biggest sales driver despite the popularity of the iPhone.

Given how well the shares have already performed we will be keeping a close eye on Apple's next quarterly update on 3 August and be alive to the implication of that earnings report.

Snapping at Apple's heels is photo booth-to-laundromat operator **ME Group International (MEGP)**, up 43.4% despite having already enjoyed an index-thumping 71% gain in 2022 thanks to pandemic-driven demand for its services.

We thought rather than being a flash-in-the-pan the company could continue to surprise this year in terms of sales and profits based on its strong customer relationships, which translate into reliable long-term contracts meaning good visibility of cash flow and earnings.

Moreover, the firm was set to invest in the next generation of photo booth machinery while continuing the roll-out of its smaller laundry and vending equipment operations, giving it a more balanced income stream.

At the beginning of June the firm raised its sales and profit guidance for the year ending in October due to better-than-expected first-half trading, leading analysts to raise their earnings estimates and spurring a strong rally in the shares.

BANKING OUR PROFITS

Our next three best-performing positions were closed out early due to the unexpectedly sharp rally at the beginning of the year which generated gains of between 20% and 40% in an unusually short time-frame.

After its shares had lost over 40% in 2022, putting them on a single-digit price to earnings multiple, we added athletic footwear retailer **JD Sports Fashion (JD.)** to our tips list for its proven ability to execute even in difficult times.

As it transpired, in early January the 'King of Trainers' reported bumper sales for the Christmas period and guided profit expectations towards the top end of market forecasts, sending its stock price soaring.

As we said at the time, a quick-fire 41% gain was more than we reasonably expected in 12 months let alone a few weeks given the pressures facing retailers, so we advised selling shares to the value of the original investment, leaving a reduced holding to capitalise on any further gains.

It was a similar story with our next-best performer, African miner **Shanta Gold (SHG:AIM)**, which we picked for its promise of operational progress as well as its direct exposure to the yellow metal.

In the event both parts of our investment case came off, with gold prices rallying and the firm publishing a positive update on its reserves and resources.

With a 31.2% gain in less than three months we banked our profit in late March and moved on.

The third position we closed early was **Walt Disney (DIS:NYSE)** after the shares had run ahead of the fundamentals.

Having lost 45% of its value in 2022, the stock looked outstanding value especially with the return to the hot seat last November of former chief executive Bob Iger who was expected to reinvigorate the brand.

Earnings for the final quarter of 2022 significantly beat market expectations with subscriber numbers holding up despite a price hike in streaming services and the theme parks performing particularly well.

After a 26% gain in six weeks, we felt the shares had priced in a lot of positive news while the streaming business still faced challenges so we cashed in.

MORE UPSIDE TO COME

As last week's second-quarter results demonstrated, Dutch semiconductor equipment maker **ASML (ASML:AMS)** is not only delivering what it promised at the start of 2023 but actually exceeding market expectations.

Sales, earnings and new orders were all above forecasts, and the firm raised its full year revenue growth target from 25% to 30% due to strong demand from Chinese customers who can only buy older equipment due to restrictions on technology exports to the country.

ASML is the undisputed global leader in lithography systems, machines which can cost up to $200 million apiece, supplying just about every major computer chip maker, and it is having to expand production as it cannot keep up with customer demand.

Grocery and sweet treats purveyor **Premier Foods (PFD)** has repaid our faith with a return of nearly 15% so far this year, underscored by an upbeat first-quarter trading update.

Group sales climbed 21% in the three months to the beginning of July led by a 'very strong performance' in grocery items, up 27%, with core brands like Batchelors, Bisto and Oxo taking further market share as consumers cook more at home to keep costs down.

Sweet treats, including Mr Kipling cakes and

Cadbury-branded goods, saw sales rise 7% although most of the growth came from the group's non-branded products thanks to contract gains in pies and tarts.

Significantly, the firm said it believed recent high input cost inflation was 'past its peak' meaning it had no need to raise prices again this year, yet with the first quarter's strong sales momentum set to continue it saw full-year trading profit towards the top end of its expectations.

Food services and catering group **Compass (CPG)**, up 11% so far this year, has raised its profit outlook and unveiled a new share buyback programme in May following a stronger-than-expected first half performance.

Underlying sales grew by almost 25% in the six months to March with the firm reporting 'balanced growth across all regions' and a 'very strong' performance in Europe.

The trend towards first-time outsourcing – where companies close their own in-house catering services and bring in outside providers like Compass – looks to be accelerating with 45% of new business coming from first-time customers.

'Net new business continued to be excellent, and significantly higher than our historical rate,' commented chief executive Dominic Blakemore.

On the back of its stronger-than-anticipated first half the group raised its full-year organic revenue growth target from 15% to 18% and forecast operating profit growth 'towards 30%' against a previous target of 'above 20%', while increasing its first-half dividend by 15% and announcing a new share £750 million buyback. We still like the shares.

CATCH-UP POTENTIAL

While we didn't expect life insurer and asset manager **Prudential (PRU)** to shoot the lights out on the reopening of the Chinese economy, it's fair to say we're disappointed with its performance so far even though it's in line with the FTSE 100 average.

First-quarter results, published last month, showed a strong bounce-back in sales with annual premium equivalent up 29% across the group and double-digit growth in 10 out of 13 Asian markets with Hong Kong premiums up almost threefold.

Analyst Philip Kett at Jefferies says 'it is difficult to overstate the magnitude, or the materiality, of the sales reported by the largest life insurers in China and Hong Kong'.

'With pandemic-related restrictions being removed and the border between Mainland China and Hong Kong now open, we believe that a unique opportunity to step-change sales growth has arrived,' argues Kett.

For now, it seems the market is oblivious to Prudential's charms, but we suspect once sentiment towards China improves there is a good chance the shares will rerate, so we're happy to wait.

Bringing up the rear is global pharmaceutical-maker **GSK (GSK)**, which has delivered operationally this year with consecutive quarterly earnings 'beats' but still seems to be under a cloud as far as litigation over heartburn drug Zantac is concerned.

GSK, along with French firm **Sanofi (SAN:EPA)** and US firm **Pfizer (PFE:NYSE)** who helped co-develop the drug, has seen billions of pounds wiped off its market value over concerns it could face a barrage of claims and a huge legal bill after the US FDA (Food and Drug Administration) said Zantac appeared to produce unacceptably high levels of NDMA, a carcinogen, when exposed to heat.

In December, the three companies won a significant court case dismissing thousands of US claims, but they still face cases in California and until these are settled the shares could continue to drift.

Analysts are growing more positive on the stock, however, revising up their earnings expectations, and as *Shares* went to press GSK was about to report its third-quarter results so we retain a constructive stance in the hope of another positive surprise.

By **Ian Conway** Companies Editor

Editor's View: Daniel Coatsworth

Reasons why investors would pay more to own a particular stock

Understanding the power of re-ratings and the catalysts to drive them

On 30 May, investment bank Berenberg published a research note on legal group **DWF (DWF)** saying it should eventually see a 'significant re-rating' as the company continued to deliver organic growth with improving margins. At the time, the shares traded on five times forecast earnings for the year to April 2024.

Eight weeks later, Berenberg's prediction has come true and the shares have gone up more than 50%. The stock now trades on 7.8 times forward earnings.

A re-rating is when investors are prepared to pay a higher multiple of earnings for a stock. DWF's re-rating was the result of a takeover offer from private equity group Inflexion which spotted an opportunity to buy a company at a cheap price.

Value-style investors seek companies trading for less than they are really worth. While takeovers are one way to crystalise the hidden value, most re-ratings are triggered by other catalysts and are slow to play out.

Herein lies the problem for investors; you need to be patient and recognise what the catalyst might be to drive the re-rating and without one a stock can stay cheap permanently. This is commonly known as a value trap.

Joe Bauernfreund, manager of the **AVI Global Trust (AGT)**, runs an investment strategy based on identifying quality companies trading at a discount. He says: 'If we own businesses that are growing their profits year in, year out, it allows us to be more patient because the value of that investment is going up itself regardless of whether the discount is narrowing or widening.

'We are not buying £1 of assets for 70p in the hope that 70p becomes £1. We are buying £1 of assets in the hope that in five years' time that £1 is worth £2 and the gap in the share price and valuation has narrowed as well.'

Bauernfreund's position as an institutional investor means he can sometimes put pressure on management teams to make changes (which in turn could drive a re-rating), but retail investors do not have that weight. They need to identify the potential catalysts that would convince more investors to pay a higher multiple of earnings to own the shares.

Price comparison site **Moneysupermarket (MONY)** is the perfect example of a stock that has undergone a re-rating. In May 2022, *Shares* highlighted how it should benefit from the cost-of-living crisis as households shopped around for better deals on financial products. At 174p, it traded on 12.6 times forward earnings, a depressed rating because the energy switching market had temporarily shut down, leaving Moneysupermarket without a key source of income.

Today the shares trade at 281.8p with the stock having benefited from two key catalysts. An improvement in earnings pushed up the share price, so too did a re-rating with investors now happy to pay 16.3 times forward earnings.

Factors that can encourage investors to reassess the multiple of earnings they are prepared to pay for a company include results that consistently beat market expectations, consistent market share gains, the disposal of a business unit that had been a drag on the main group, and a more attractive cash flow profile than previously expected. Look for a company that has better prospects than suggested by the equity rating. Find the right one and it could be your ticket to decent returns.

Not all bad news: Here are 10 stocks benefiting from the cost-of-living crisis

There are plenty of companies doing well in the current environment

Although the latest UK inflation figures are easy off, the cost-of-living crisis is still alive and kicking, as food, energy and petrol costs remain stubbornly high.

This is bad news for consumers but good news for some companies who are benefiting from the doom and gloom on the high street and in households. Here are 10 names doing well.

1 SHOE ZONE

Footwear retailer **Shoe Zone (SHOE:AIM)** sells shoes at low prices and has over 400 stores across the UK.

By offering value to customers when it comes to shoe-buying it is no surprise that the company is doing well in the current environment. It recently raised its pre-tax profit forecast for the second time in five weeks after reporting 'exceptional' sales.

Year-to-date Shoe Zone shares are up 9%, and it continues to put in a solid performance as families trade down to cheap shoes, boots and trainers.

2 H&T

H&T (HAT:AIM) is the UK's biggest pawnbroker and is thriving in the current climate as cash-strapped consumers who can't get credit from banks seek short-term loans, pledging jewellery and valuables as collateral. It also makes money from selling new and used jewellery, foreign currency and trading gold.

The company delivered a strong trading update for the first six months of 2023 – H&T's pledge book closed the period at £113 million versus £85 million a year earlier, while retail sales rose 10%.

Chief executive Chris Gillespie sees demand continuing: 'I am very pleased with the progress we have made in the first half of 2023 in an environment of rising interest rates and persistent inflation. I am particularly encouraged by the growing momentum with which we enter the busy second half of the year.'

Interestingly, the shares are down 10% year-to-date, with investors perhaps nervous the current sales momentum is unsustainable.

3 MCBRIDE

Some investors might not have heard of white labelling cleaning products company **McBride (MCB)** but it is another winner of the cost-of-living crisis.

McBride supplies supermarkets with own-label products including dishwasher tablets and surface cleaners and consumers have been snapping these up to cut their weekly shopping bills, rather than opting for the more expensive branded alternatives. Its shares are up 59% year-to-date.

Earlier this month the company said its forthcoming full-year results would show a return to profit after previously suffering losses from supply chain disruption, the pandemic and the Ukraine crisis. Sales volumes were up 12.7% in the three months to 30 June 2023.

4 B&M

Discount variety retailer **B&M European Value Retail (BME)** sells everything from garden furniture, desks, kettles, and bed linen at cheap prices and is ideally positioned for cash-strapped consumers in the middle of a cost-of-living crisis.

In the past, consumers might have chosen Argos as the logical place for these items, but it feels like B&M has now superseded this brand.

B&M reported a strong first quarter, its French arm is doing well, so too is its Heron Foods retail chain. The shares are up 34% year-to-date.

5 BEGBIES TRAYNOR

Earlier this month insolvency practitioner **Begbies Traynor (BEG:AIM)** reported a strong set of full-year results, ahead of original market expectations.

With businesses increasingly becoming cash-strapped or insolvent due to cost pressures – staff, energy, raw materials, rent and more – a company like Begbies Traynor is in its element. It is paid to either oversee insolvency proceedings or help companies in administration to keep trading while a buyer is found for the business.

According to UK government figures, 22,109 companies were registered as insolvent in 2022. That was the highest number since 2009 and 57% higher than 2021.

For the year ending 30 April 2023, Begbies reported an 11% increase in revenue growth to £122 million and a strong order book of insolvency revenue, up 19% in the year. Adjusted pre-tax profit rose 16% to £20.7 million.

Although its shares are down 10% year-to-date, high interest rates continue to put pressure on companies, suggesting that corporate struggles and failures could remain elevated for at least the rest of the year which in theory creates a favourable backdrop for Begbies' earnings.

6 JD WETHERSPOON

Pubs chain **JD Wetherspoon (JDW)** says business has really picked up this year, including 12.9% like-for-like sales growth in the calendar year to 12 July 2023.

The pandemic was a torrid time for the pubs group and there was a slow recovery, not forgetting other obstacles including rail strikes and bad weather.

But the truth of the matter is people still enjoy having a pie and a pint especially if it is billed as value for money which the pubs group claims to be.

Shares in JD Wetherspoon are up 55% year-to-date.

7 CARD FACTORY

Greetings card seller **Card Factory (CARD)** raised its full-year outlook in April, before reporting an impressive set of results in early May, announcing that its revenue had returned to pre-Covid levels.

Store revenue grew by 7.6% on a like-for-like basis 'reflecting a return of customers to the high street, the success of our new ranges and strong value for money proposition' which is key for any firm during a cost-of-living crisis.

Two thirds of the like-for-like growth came from pushing up the price of its cards and related products. Even with these hikes, Card Factory's products remain significantly cheaper than cards you might find in places like WH Smith and Marks & Spencer. That's why shoppers continue to flock to its stores. Card Factory's shares are up 19% year-to-date.

8 GREGGS

With food inflation reaching a peak of 19.1% in April this year, people have been turning to more affordable food on the go, with **Greggs (GRG)** remaining one of the nation's favourites. Helping to strengthen its appeal has been menu expansion to include more hot food like pizza and chicken goujons and opening for longer hours.

Greggs has seen its shares rise 12% year-to-date. With 2,365 stores across the UK, the company plans to keep opening more outlets in places such as train stations and airports, among others.

The only fly in the ointment for Greggs is cost inflation related to energy and staff pay, however the firm has passed some of this on to consumers by raising the price of certain items, for example its sausage rolls have gone up from £1 in 2022 to £1.20 this year.

9 WARPAINT LONDON

Shares in **Warpaint London (W7L:AIM)** have been a roll this year as the cosmetics supplier shows its ongoing popularity with investors. Despite the cost-of-living crisis, Warpaint's demographic are still keen on buying 'high-quality cosmetics at an affordable price.'

It targets shoppers looking for essentials such as lipstick and eyeliner but who do not want to pay a high price. Earnings have been driven by two key factors – first, customers are coming back for more and second, its products are increasingly being stocked by more stores. Furthermore, people are trading down to its products from more expensive brands such as Rimmel and Maybelline as the cost-of-living crisis forces them to rethink their spending decisions.

Various pilots with supermarkets, retailers and pharmacies have been going well and clients have agreed to roll out Warpaint's products to more stores. The company also sells products online.

With the UK already a success for Warpaint, a lot of attention is now being paid to expansion plans in countries such as the US and China. Its shares are up 63% year-to-date.

10 MONEYSUPERMARKET

The price comparison website **Moneysupermarket (MONY)** is a beneficiary of the cost-of-living crisis as more people shop around to find the best deals for insurance, loans and credit cards when household budgets are tight.

Moneysupermarket grew its revenue from insurance, which includes home and motor policies, by 23% to £50.6 million in the first three months of 2023. There was also a 9% rise in revenue from financial products including credit cards, loans and savings sourced via Moneysupermarket's website to £26.9 million. The firm's shares are up 43% year-to-date.

By **Sabuhi Gard** Investment Writer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BING!
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Which?
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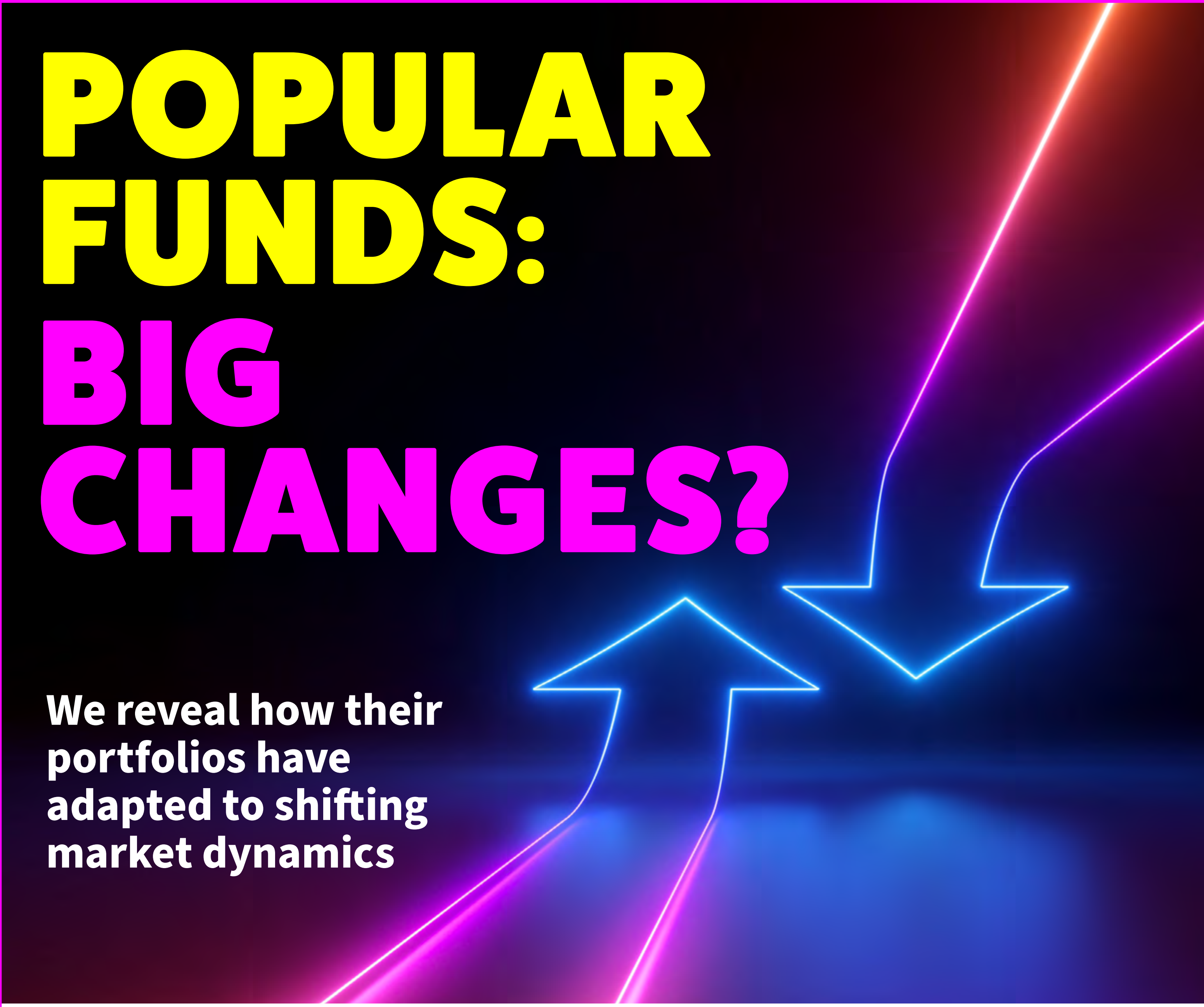
POPULAR FUNDS: BIG CHANGES?



We reveal how their portfolios have adapted to shifting market dynamics

The events of the past three years have completely altered the investment backcloth against which fund managers are trying to earn above-average returns.

Fund managers can have an investment framework to operate within, but what do they do when a 'black swan' lands? How do they adapt their strategies and reshuffle portfolios when a once-in-a-century event happens – like a global pandemic or an outbreak of war in Europe?

To shed some light, *Shares* has talked to fund managers and looked at the portfolios of popular funds and investment trusts with UK investors.

Earlier this year, markets were anticipating the economy to crumble, but the emergence of advanced AI (artificial intelligence) systems has proved to be a game changer, says Saxo's head of equity strategy, Peter Garnry. 'Now, the bulls are back in town. Stock markets in 2023 have seen some of their best first half returns on record.'

WINDING THE CLOCK BACK

The pre-pandemic world seems like eons ago, so let us remind ourselves of what analysts and economists were saying about prospects for equity markets at the end of 2019. Scanning through 2020 outlook reports reveals an undercurrent of mild optimism despite a backcloth of increasingly worrying risks, and widespread agreement that a repeat of the double-digit returns seen in 2019 was off the table.

'We think that returns from "risky" assets – equities, corporate bonds, real estate investment trusts and industrial commodities – will generally beat those from "safe" ones – government bonds and precious metals – again over the next two years, as the global economy finds its feet,' wrote

Capital Economics at the time, but 'both will be weaker than in 2019.'

Citi's economists thought global growth would settle at around 2.7% year-on-year in both 2020 and 2021 as global manufacturing activity rebounded.

Columbia Threadneedle analysts were favouring long duration assets. 'Our base case is that there is unlikely to be an acceleration in growth and we are equally unlikely to see a deep recession. In that environment, the long-duration element of markets – be that in fixed income or equities – remains relatively attractive,' the analysts said.

'History suggests that years of sharp gains (as in 2019) are not usually followed by falls, but often instead by more modest growth – so 2020 should still be worth approaching in a positive spirit,' predicted Deutsche Bank Wealth Management.

The pandemic would subsequently make a mockery of the above comments, and for fund managers to take a serious look at portfolio holdings. Ben Peters, manager of **Evenlode Global Income Fund (BF1QMV6)**, says within weeks of full-blown Covid, three stocks had been sold from his portfolio; events business **Informa (INF)**, fashion brand **Hugo Boss (BOSS:ETR)** and, perhaps surprisingly, **Disney (DIS:NYSE)**.

'We sold the fund's holding in July 2020, and while it has a formidable content portfolio in family programming and had seen success with the launch of its Disney+ streaming service, we had concerns about the long-run costs of competing with other services, notably **Netflix (NFLX)**.'

Disney shares rallied from around $120 in July 2020 to nearly $200 the following March. But the thinking behind the sale was right on a longer view, as Disney struggles to balance capital spending on film and TV production and marketing versus the fickle nature of subscribers. Disney shares are currently changing hands at $86.

TECH SUCCESS WITH A CATCH

Widespread lockdowns proved a boon for the tech space, particularly enablers of work from home and e-commerce, sending perceived winners soaring – **Zoom Communications (ZM:NASDAQ)** among the poster companies of the shift with its 700%-plus share price surge.

But work from home success came with its own problems for equity investors, eventually. 'Satya Nadella of Microsoft is quoted as saying during the pandemic they saw "two years of digital transformation in two months",' says **Blue Whale Growth Fund's (BD6PG78)** Stephen Yiu.

'This was undoubtedly beneficial for companies in their digitisation journey, and therefore beneficial for investors. However, for many companies, this also closed the gap between where the share price looked to offer good value, to starting to look like fair value – therefore losing their ability to deliver outperformance for investors.'

Towards the end of 2021, the Blue Whale team were seeing signs of what they believed was an emerging inflection point for their fund. 'We started cutting stocks from the portfolio that didn't offer the upside they once had, and in some cases faced serious headwinds in the form of inflation and unsettled geopolitics,' says Yiu.

Companies that ultimately lost their spots in the Blue Whale portfolio were **Amazon (AMZN:NASDAQ)**, **PayPal (PYPL:NASDAQ)**, **Meta Platforms (META:NASDAQ)** and **Alphabet (GOOG:NASDAQ)**, leaving the fund with none of the FAANGs, once the darlings of every growth investor.

As the world turned and economies picked up, new threats emerged; rampant inflation becoming public enemy number one, forcing central banks into a swathe of interest rates hikes not seen in a generation. This asked different but equally testing questions of fund managers and the portfolios they held.

If interest rates create a more favourable environment for value companies rather than quality or growth companies, should not we adapt our strategy to buy the companies which stand to benefit, asked Simon Barnard rhetorically, manager of **Smithson Investment Trust (SSON)**, part of Terry Smith's Fundsmith investment empire.

His answer is an emphatic no. 'Owning high quality companies with sustainable growth is a winning strategy over the long term, has been shown to work through several economic cycles, and is one which we know we can execute successfully,' he said.

'Whilst other managers may be able to run a value strategy, we believe it is inherently more difficult, as you cannot hold value companies for the long term if all you are doing is owning a poor-quality company at a low price, which you hope will re-rate in the future.

If this does happen (there is no guarantee), you then have to sell the company to find another such investment. This means that unlike our strategy, time is not your friend, because the longer you are holding the company and waiting for it to re-rate, the lower your annualised returns become, and if you are particularly unlucky, the worse the company becomes.

'On the other hand, it matters less if it takes more time for the market to appreciate the value of the type of companies we hold in our strategy, because the highest quality companies tend to get better, or at the very least bigger, owing to their growth.'

It is a belief that means the Smithson portfolio has remained free of dramatic change. Companies such as **Fevertree (FEVR:AIM)**, **Halma (HLMA)**, **VeriSign (VRSN:NASDAQ)** and **MSCI (MSCI:NYSE)** stayed towards the top of the portfolio right through the pandemic, inflation and rate rise environment.

Barnard uses an analogy to illustrate his investment beliefs. 'Imagine a dog walker crossing a field, their dog wildly zigzagging around them. We would relate the companies we own to the walker, clear in direction and making steady progress across the field, while the daily market price is like the dog, moving back and forth quite randomly.'

The fund manager believes that while current economic challenges may send the dog cowering for cover, given enough time, he believes the price and value will eventually meet again, just as the dog and walker will ultimately leave the field together.

MAKING BOLD CALLS WHERE NECESSARY

While relatively low portfolio turnover is usually a good sign of commitment to a fund's investments, managers must also not be afraid to make bold calls when the time comes. It is an area where Blue Whale sees itself standing apart from other funds.

'We are willing to make significant changes in the portfolio in search of outperformance,' says Stephen Yiu. Building its early high-performance reputation on tech names, it might surprise readers to learn that consistent stake-building in **Canadian Natural Resources (CNQ:NYSE)**, the $48 billion oil sands mines operator, now makes it one of Blue Whale's 10 biggest bets.

High quality reserves, strong management team and history of 23 consecutive years of dividend increases, gives Yiu the quality he is looking for in this previously unloved sector.

Making big calls is something **Fundsmith Equity (B41YBW7)** manager Terry Smith has never shied away from, and he continues to make cutthroat investment decisions in the name of shareholder returns. He recently revealed the sale of the fund's stake in Amazon, a move that raised eyebrows.

Smith was late to the Amazon party, having only taken an opening stake in the e-commerce giant barely two years ago. At the time, he was reassured by Andy Jassy's appointment as Jeff Bezos' replacement as chief executive, having started and run the company's hugely profitable Amazon Web Services cloud business.

Jassy's stated principles – a focus on good returns on capital, concentrate on parts of the market where consumers are not already well served, and do something different to competitors – struck a chord with Smith in 2021. However, more recent Amazon comments about expanding its low margin grocery retail operation have pulled the rug out.

'In our view, grocery retail has none of the (desired) characteristics and Amazon has already stubbed its toe in this sector with the Whole Foods acquisition,' said Smith in his 2023 half-year letter to shareholders. Amazon looks like a miss for the fund manager, albeit a rare one, but when the reasons why one invested in the first-place change, then reassess and, if necessary, sell. This is precisely what an active manager should be doing.

This is surely where active managers should have advantages over index tackers, that they can invest in the best stocks in a market and avoid owning the humdrum. A similar thought process led Fundsmith to exit **Adobe (ADBE:NASDAQ)**.

TO-DO LIST FOR ORDINARY INVESTORS

Even Warren Buffett has changed with the times, embracing companies in recent years that he never would have gone near before. Buffett previously shunned technology, airline and oil companies, either for being too hard to understand (technology) or not attractive enough.

Yet in 2023, **Apple (AAPL:NADAQ)** is the biggest holding in Buffett's **Berkshire Hathaway (BRK.B:NYSE)** investment company by a country mile, while **Chevron (CVX:NYSE)** and **Occidental (OXY:NYSE)** rank sixth and seventh.

Ordinary retail investors can also adapt their own portfolios to shifting market dynamics by doing simple things.

First, diversify across countries. Monetary policy is already starting to diverge across central banks, and this is likely to accelerate. Interest rates will move higher or lower in different countries at separate times (for example, see the US and UK), so it is wise not to only invest at home, but internationally.

Second, consider more active investing. Rather than relying solely on broad market index funds, you might want to brush up on how to pick quality companies and invest in them for yourself. With ultra-low interest rates no longer around to lift all stocks higher, you will need to find companies with strong return drivers if you want to see your portfolio expand.

Lastly, consider making room for alternatives. Higher interest rates also mean higher volatility, so look out for assets that do not necessarily rise and fall with the stock market, but that instead move to the beat of their own drum or have low beta. Alternative investments – things like real estate, commodities, infrastructure funds – can fit the bill here and could complement your allocations to stocks and bonds.

HAVE PORTFOLIOS IN POPULAR FUNDS CHANGED MUCH IN THE PAST FOUR YEARS?

In an attempt to answer this question, we selected 12 popular funds and investment trusts and used Morningstar data to analyse their full portfolios on three different dates.

We wanted to see where they invested just before the Covid pandemic struck, which we took as being the end of 2019. We then wanted to see the shape of portfolios at the end of 2021 as this was just before interest rates started to go up dramatically. And then we compared them to the most recent portfolio lists.

The goal was to see if the different market dynamics prompted a radical reshaping of portfolios. On the whole, they did not. It shows that managers have stuck to their investment strategy and not tried to chase whatever was in fashion that month.

However, we did note they changed their minds on certain stocks. That is normal – portfolio positions can be sold if the investment case changes, valuations become excessive or better ideas found. Equally, new ones made, or positions added to, as fund managers spot opportunities.

For example, software group **Autodesk (ADSK:NASDAQ)** was **Liontrust Sustainable Future Global Growth Fund's (3003006)** biggest position at the end of 2019. Now it languishes at position 26.

Rathbone Global Opportunities' (B7FQLN1) two biggest positions were Amazon and Adobe in December 2019. Adobe no longer features in the portfolio and Amazon is the third smallest holding.

JPMorgan Global Equity Income had strong conviction in **McDonald's (MCD:NYSE)** and **Procter & Gamble (PG:NYSE)** at the end of 2021. The former is now down the list in its portfolio and the latter has been sold completely.

Finally, to get an idea of how the average portfolio from the 10 funds in question has changed over the past four years, we used a scoring system to work out the shift in holdings between December 2019, December 2021 and the most recent data.

You can see the results in the accompanying table. Popular names in 2019 that have since fallen away include **Alibaba (BABA:NYSE)** and **Sage (SGE)**, whereas the likes of **L'Oreal (OR:EPA)** and **Novo Nordisk (NVO:NYSE)** have become more popular this year.

DISCLAIMER: The author (Steven Frazer) and article editor (Daniel Coatsworth) are invested in Fundsmith Equity Fund and Smithson. Steven Frazer owns units in Blue Whale and Daniel Coatsworth owns units in Evenlode Global.

Popular funds and trusts with UK investors

Alliance Trust	Fundsmith Equity	Rathbone Global Opportunties
Blue Whale Growth	JPM Gobal Equity Income	Scottish Mortgage Investment Trust
Brunner Investmen Trust	Lindsell Train Global Equity	Smithson Investment Trust
Fidelity Global Special Situations	Liontrust Sustainable Future Global Growth	TB Evenlode Global Income

Table: Shares magazine

The average of these funds and trusts' top 20 holdings

End 2019	End 2021	Now*
Microsoft	Microsoft	Microsoft
Alphabet	Alphabet	Alphabet
PayPal	Amazon	Visa
Amazon	Meta Platforms	PepsiCo
Unilever	Visa	Mastercard
Meta Platforms	PepsiCo	Diageo
PepsiCo	PayPal	Amazon
Visa	Diageo	Unilever
Intuit	Mastercard	Meta Platforms
Mastercard	Nvidia	L'Oreal
Nvidia	ASML	Nvidia
Shell	Intuit	UnitedHealth
UnitedHealth	IDEXX Laboratories	PayPal
Reckitt Benckiser	Unilever	Intuit
Sartorius	Shell	ASML
Adobe	UnitedHealth	Coca-Cola
Alibaba	Reckitt Benckiser	Estee Lauder
Automatic Data Processing	Alibaba	Novo Nordisk
Estee Lauder	Estee Lauder	Reckitt Benckiser
Sage	Sartorius	IDEXX Laboratories

Table: Shares magazine • Source: Morningstar, Shares. *Latest available

Schroders fund manager: Why the FTSE 250 offers 'growth at a ridiculous price'

It is possible to get exposure to mid-cap companies for much less than their market value

Firmly out of favour with investors since the Brexit vote seven years ago, the FTSE 250 index rallied strongly on the release of the latest UK inflation data (19 July). This showed UK CPI rising by 7.9% year-on-year in June, lower than forecasts of an 8.2% rise, theoretically reducing expectations for the scale of future interest rate hikes from the Bank of England.

Yet even after a big one-day jump, the FTSE 250 is still down 8.2% on a five-year view at the time of writing due to the overhang of the gloomy prognosis for the UK's post-Brexit economy.

Prevailing poor sentiment towards the FTSE 250 should pique the interest of bargain hunters, since investors do not buy GDP, they buy shares in individual companies. And the mid cap ranks offer a different collection of opportunities to the large caps and contain market leaders of tomorrow trading on inexpensive valuations today.

ABILITY TO GET EXPOSURE AT A DISCOUNT

Given the current negativity towards the UK, it is no surprise that the two dedicated mid cap funds in the investment trusts sector – **JPMorgan Mid Cap (JMF)** and **Schroder UK Mid Cap Fund (SCP)** – continue to trade on double digit discounts to net asset value.

The FTSE 250 has outperformed the S&P 500 and the FTSE 100 on a 25-year basis

Total return, rebased to 100

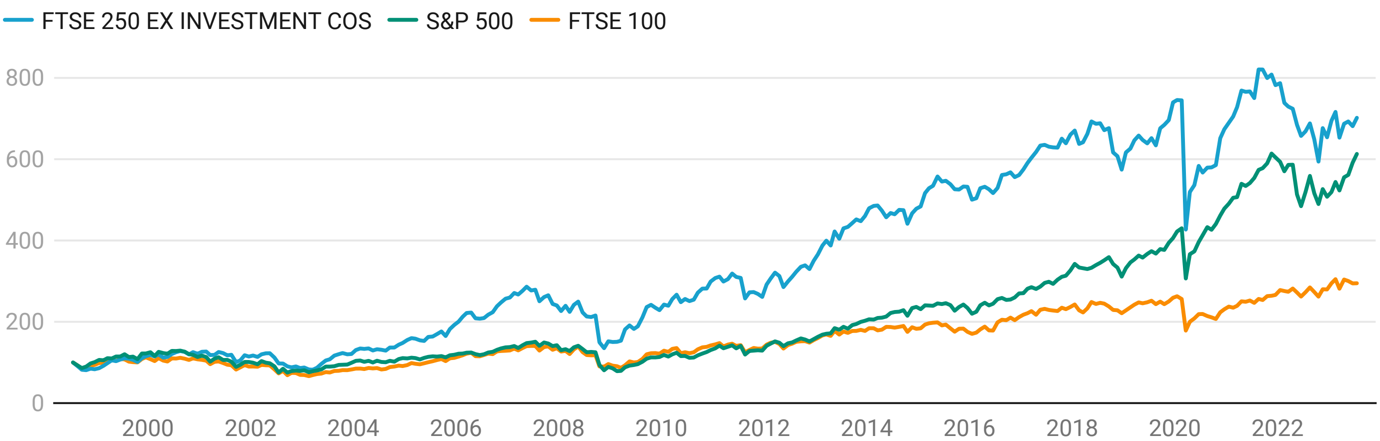


Chart: Shares magazine • Source: Refinitiv

Schroder UK Mid Cap's 11.2% discount to underlying assets looks overdone considering its outperformance of the FTSE 250 (ex-investment companies) index over the past 25 years, no mean feat since the FTSE 250 itself outperformed not only the FTSE 100 but also the S&P 500 index of US shares over the same period.

During the six months to 31 March 2023, Schroder UK Mid Cap's net asset value total return rose by 18.5%, comfortably outperforming the 15% return from the benchmark FTSE 250 (ex-investment companies).

PORTFOLIO REFRESHMENT

Steered by lead manager Jean Roche, a former analyst with a masters in mathematics and experienced co-manager Andy Brough, Schroder UK Mid Cap invests in mid cap equities with the aim of providing a total return in excess of the FTSE 250 (ex-investment companies) index.

Mid cap companies are attractive to investors for a variety of reasons; more established than smaller firms, they are considered less risky, yet they also tend to be faster growing than their larger, more mature counterparts.

Roche refers to the FTSE 250 as the 'Heineken index' since it is often refreshed by promotions, relegations, takeovers and initial public offerings (albeit IPOs have been scarce of late).

While M&A activity in the mid cap ranks has been quieter recently, Roche tells *Shares* she expects mergers and acquisitions to return as inflation slows down. 'I think inflation affects the animal spirits and the willingness to pull the trigger on things,' she says.

WHY INVEST IN MID CAPS NOW?

Roche concedes there are 'gloomy suppositions' in the valuations of FTSE 250 stocks at present, yet these are more than priced in as the premium that mid-caps have historically traded on relative to large caps has collapsed.

Roche says: 'We are expecting earnings per share growth on a consensus basis of 16.6% for the index for 2024 and as you would expect, the kind of shares that we've included in our portfolio have slightly better growth prospects than that.'

She continues: 'For 2024, the price to earnings ratio for the FTSE 250 index excluding investment trusts is 10-times, and that compares with the FTSE 100 on 9.9-times with EPS growth of 3.6%. You are getting "growth at a ridiculous price", so GARP but 'R' for ridiculously cheap (instead of 'reasonable'). It just feels overdone to me, like we are at max bearishness.'

SPOILED FOR CHOICE

The FTSE 250 is the domain of a wealth of companies operating in high growth niches and with sustainable and well-covered dividends.

Roche says broadly half of the revenues from her fund's underlying companies come from international sources.

'After the Brexit vote, a lot of the companies with international earnings were far more highly rated than the ones that were more domestic.

Schroder UK Mid Cap: top holdings

Games Workshop	4.8%
Spectris	4.7%
Inchcape	4.2%
4imprint	4.0%
Man Group	3.9%
Dunelm	3.9%
Diploma	3.8%
Oxford Instruments	3.7%
Cranswick	3.5%
Computacenter	3.4%

Table: Shares magazine • Source: Schroders, as of 30 June 2023

But the valuations of some of those international ones have also tumbled, so you are spoiled for choice,' she comments. 'You can buy the ones with international earnings or the ones with the domestic earnings cheaply.'

Roche typically waits until a stock enters the FTSE 250 before buying, whereas promotion to the FTSE 100 offers a clear sell discipline; engineer **Weir (WEIR)** was the last stock sold on promotion to the blue-chip benchmark.

She is happy to buy 'fallen angels' back if they drop out of the FTSE 100, having done this twice with Royal Mail-owner **International Distributions Services (IDS)**. 'That fell out of the FTSE 100 twice and we bought it and then sold it when it went back in. That is part of the strategy – it can often be an attractive time to look at shares when they have fallen out of the FTSE 100 and people have decided that they don't love them anymore.'

The Schroders stock picker finds additional returns in the bottom two quartiles of the FTSE 250 index, where stocks are less covered and names that have recently entered the index pop up on her radar.

LATEST ADDITIONS TO THE SCHRODERS TRUST

Recent portfolio additions include **Tyman (TYMN)**, a supplier of components to the construction industry which was promoted to the FTSE 250 at the start of June.

Tyman is a specialist in windows, doors and seals and its products have valuable roles to play in terms of the security and sustainability of residential homes and commercial buildings.

Another recent investment for the investment trust is **ME Group International (MEGP)**, the photobooths-to-laundry machines provider. The fund manager notes founder management with an inventor mindset are still involved in the business. Blessed with a strong balance sheet, Roche highlights that Me Group generates lots of cash which it can reinvest in the business.

WHAT ELSE IS IN THE PORTFOLIO?

Other holdings in the Schroders trust include **Games Workshop (GAW)**, the fantasy miniatures maker behind the Warhammer franchise. In theory, Games Workshop could become a much bigger business in time due to its significant US opportunity and noting it has struck an agreement in principle with **Amazon (AMZN:NASDAQ)** to develop its intellectual property into film and TV productions.

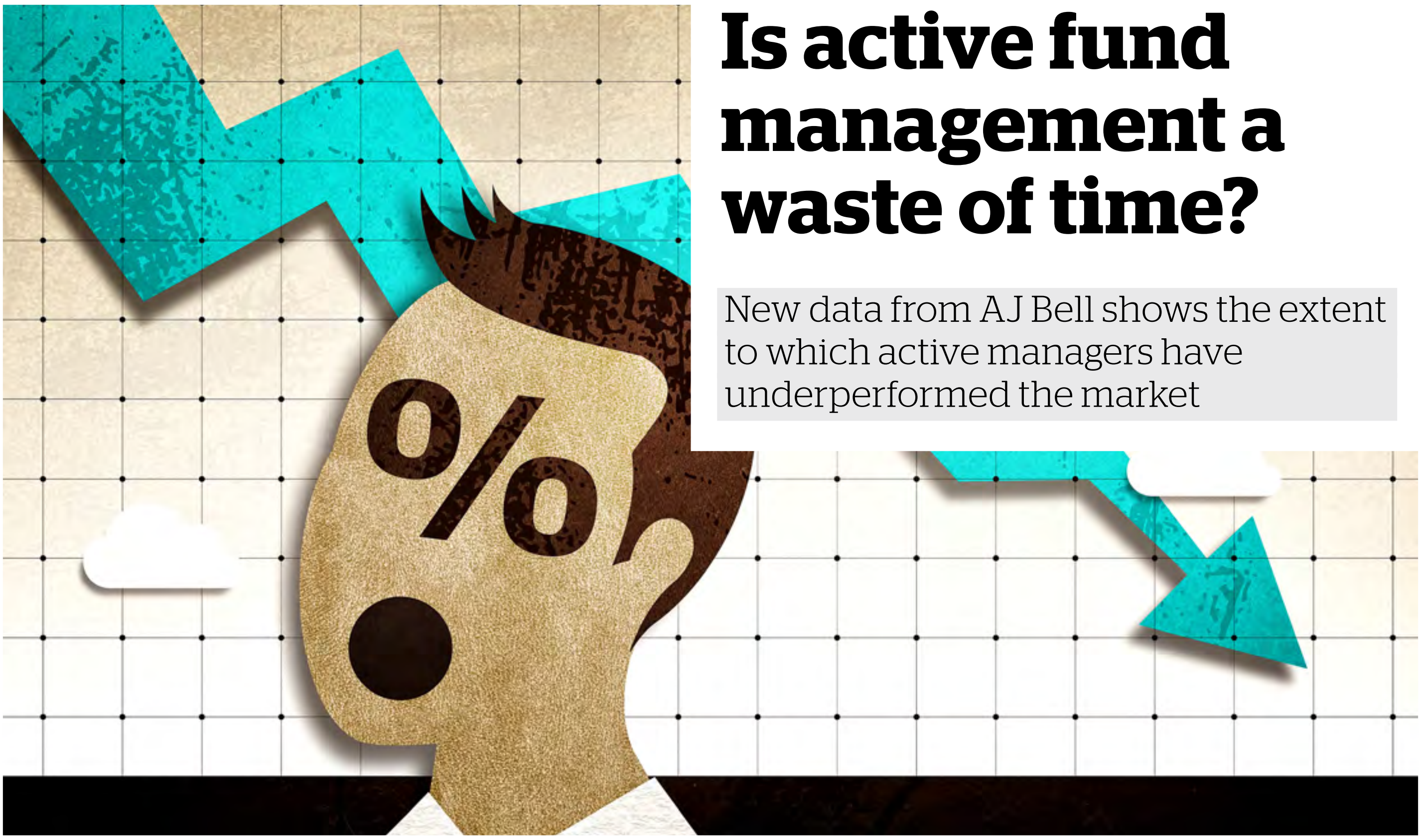
The trust also has stakes in fund manager **Man Group (EMG)**, precision measurement firm **Spectris (SXS)**, multi-utility **Telecom Plus (TEP)** and **Cranswick (CWK)**, the meat producer behind the McDonald's McCrispy burger which has delivered a 200-fold return for investors since 1991.

Roche believes sausage, bacon, cooked poultry and pet food supplier Cranswick should have resilient earnings in the cost-of-living crisis because it sells 'a cheaper protein, generates oodles of cash internally and is maintaining margins of around 7% or 8%'.

The trust also has positions in the likes of cash-generative retailer **Dunelm (DNLM)**, which continues to take share in homewares and furniture as well as **Inchcape (INCH)**, the acquisitive global automotive distributor.

Investors also get exposure to **Ecora Resources (ECOR)**, a mining royalty business that has begun to move away from being a coal-heavy business, using the supernormal profits from this commodity to pivot towards commodities that will enable the energy transition. [JC]

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



Is active fund management a waste of time?

New data from AJ Bell shows the extent to which active managers have underperformed the market

For the last 10 years active fund managers in the UK have been under the pump. In that time the amount of money held in passive index tracker funds has doubled, from 9% of UK industry assets to 21%, according to Investment Association data.

Last year retail investors withdrew £25.7 billion from all investment funds, the worst figure on record by a country mile.

But even then, tracker funds saw £11 billion of money coming in from retail investors, which implies that active funds suffered a staggering £36 billion of outflows.

To put that in some context, during 2008, which witnessed the mayhem of the Lehman Brothers collapse, retail investors still ploughed £4.8 billion into investment funds. Last year redefined what a bad 12 months meant for the active fund management industry.

The latest figures from AJ Bell's Manager versus Machine report go some way to explaining this trend. Over the last 10 years, only 38% of active equity funds outperformed the typical passive alternative across seven key investment sectors, which won't exactly put bums on seats.

WHERE DID ACTIVE MANAGERS DO BADLY?

Results were particularly poor in the widely held global sector, where only 22% of active funds have beaten the passive machines over the last decade.

The same goes for the similarly popular North American sector, where again just 22% of funds have outperformed a comparative tracker fund.

These results do not paint active managers in the best light, to say the least, but it's important to draw reasoned conclusions from the data, rather than simply characterising active managers as money-grabbing charlatans.

Indeed, there are some mitigating factors which go a long way to explaining why active managers have not done very well compared to passive competitors over the last 10 years.

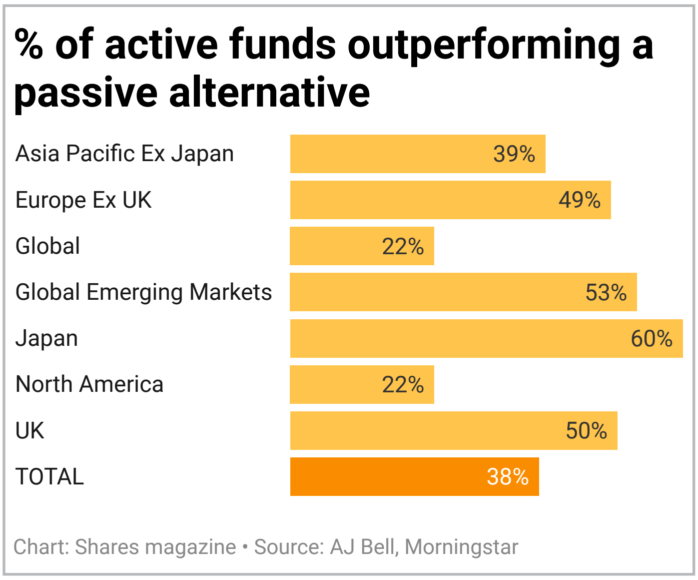
WHY HAVE SO MANY ACTIVE MANAGERS STRUGGLED?

Not all active managers can outperform the market, and by extension, passive funds tracking the market.

The market return is made up of the activity of all investors, and many of them are still active. In theory, active managers raise the overall market return in the long run by allocating capital more

efficiently, so even passive investors probably owe them some gratitude. However, when it comes to active managers' performance versus the market, there have to be some losers, and that's before charges are taken into account.

The typical active equity fund costs around 0.7% more per year than a tracker, and that's a deficit that needs to be made up before investors receive any performance benefit.

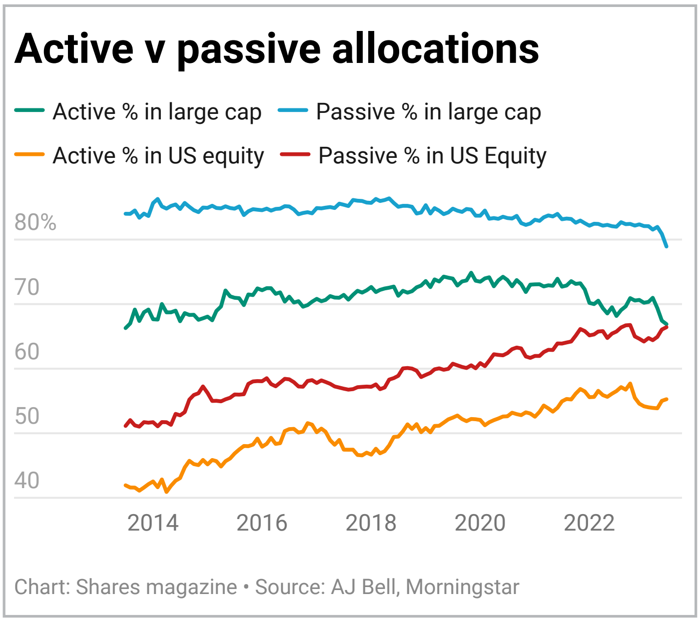


The global fund sector plays an outsized role in the poor overall showing from active managers, simply because of the sheer number of funds in this sector.

If fund managers in this area were pulling their weight, rather than just 22% of them outperforming, the overall proportion of active managers beating a passive alternative would be nudging up to a more respectable 50%, which might be viewed as a neutral position.

But in the global stock market, the last decade has been characterised by two long-running trends which have favoured a passive way of investing. Namely the dominance of US shares and large cap stocks.

Global fund managers have been underweight versus the market in these two winning areas compared to their passive peers as the chart below shows.



Outperformance from these market segments has boosted global passive funds at the expense of their active competitors, rather than it simply being a case that active managers are hopeless at picking good stocks for investment.

Bizarrely though, global fund investors might not be too miffed, even if they've got a fund that has underperformed the average passive machine. That's because performance from this sector has been so strong, that absolute returns have been pretty spectacular, as the table below shows.

Even bottom quartile global funds have doubled investors' money over the last decade, and have returned more than top quartile funds in the UK, global emerging markets and Asia Pacific ex-Japan sectors.

In theory, if you are able to pick better performing funds, preferably in the top quartile, then you have a good chance of beating a tracker.

There is no sure-fire way to do this. But investors can tilt the odds in their favour by doing some research and weeding out some of the dross.

WHAT SHOULD I LOOK FOR?

One of the most important things to look for when picking an active manager is their performance track record. This isn't a guarantee of superior returns going forward, but the longer an active manager has been able to showcase outperformance, the more this is likely to be a result of skill, rather than luck.

Unlike many disciples of passive or active investment, private investors needn't be dogmatic in their use of either strategy. It's possible to mix and match active and passive funds within a portfolio, perhaps picking active managers you have a great deal of confidence in, and then gap-filling using trackers.

It's also worth noting there are some areas that are not well-served by passive funds, or where outright performance is not the only goal, which probably favour an active approach.

For instance, looking for opportunities in smaller companies, investing for income, or reducing volatility. Either way, active and passive funds are tools at your disposal, rather than a rigid lifelong doctrine you need to cleave to.

10 Year Total Return %

	Active top quartile	Active average	Active bottom quartile	Passive average
Asia Pacific Ex Japan	118.1%	93.9%	73.8%	103.3%
Europe Ex UK	143.8%	128.8%	112.7%	131.2%
Global	189.5%	155.3%	118.8%	195.1%
Global Emerging Markets	80.8%	61.5%	45.9%	60.1%
Japan	120.5%	104.0%	88.0%	99.2%
North America	276.4%	239.4%	202.8%	277.8%
UK	88.7%	74.3%	56.8%	74.5%

Table: Shares magazine • Source: AJ Bell, Morningstar

What's the best way to use my pension tax-free lump sum?

Think about your options, what you might need the money for, and when you need it

What's the best way to use your pension tax-free lump sum? Would it be to pay off the mortgage? What about the benefits of taking it in tranches to supplement income and should it be taken as an uncrystallised lump sum each time? Or from a drawdown plan?
Harriet

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

There is no 'best way' to use your tax-free lump sum, but it's important to think carefully about what you want to do with the money, rather than simply taking it out of your retirement pot at the first opportunity. In fact, there are potential benefits to leaving your tax-free cash within your pension for as long as possible.

Firstly, any growth your fund enjoys within a pension will be completely tax-free. Second, if your fund does grow, the amount you can take as tax-free cash will grow as well, until you reach the maximum which for most people is £268,275 – although investment returns are never guaranteed and can be volatile.

Your pension fund needs to support you throughout retirement, so taking out a quarter and spending it frivolously could be problematic later on.

If you are determined to access your tax-free cash, you need to have a plan before going down this road. That will vary based on personal circumstances and preferences, but a good starting point is considering the basic principles of financial planning.

Your first port of call should usually be paying off any high-cost debts and then building a rainy-day fund in case of emergency.

If you've got both of those sorted, you can start to consider things like paying off your mortgage early, if that's a priority and you are able to, or looking at more luxury spending, like renovating your home or travelling. But make sure doing this in the early stages of retirement won't jeopardise your lifestyle later on.

You don't have to take all your tax-free cash at once – it is possible to access your pot in tranches, either through drawdown or by taking ad-hoc lump sums and using your tax-free cash as part of your annual income. This will enable you to stretch your pension pot further and will also give the tax-free cash entitlement you don't touch the opportunity to grow over the long-term.

Another important thing to consider is inheritance tax, also known as IHT. Pensions can usually be passed on completely free of IHT and are usually tax-free if you die before age 75. If you die after age 75, your pension will be taxed in the same way as income when your beneficiary (or beneficiaries) come to make a withdrawal.

If you take money out of a pension and haven't spent it before you die, it will count towards your estate for IHT purposes.

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.

Can emerging markets make the transition away from fossil fuels?

Despite some perceptions the relationship with resources is a changing and nuanced one

Emerging markets are more reliant on fossil fuels than the developed world with developing countries lagging in terms of the transition to greener forms of energy.

In research published earlier in 2023 the World Economic Forum observed: ‘By 2030, annual renewable energy investment in emerging countries needs to be multiplied by more than seven – from less than $150 billion to over $1 trillion – to put the world on track to reach net-zero emissions by 2050 and meet these countries’ energy needs.’

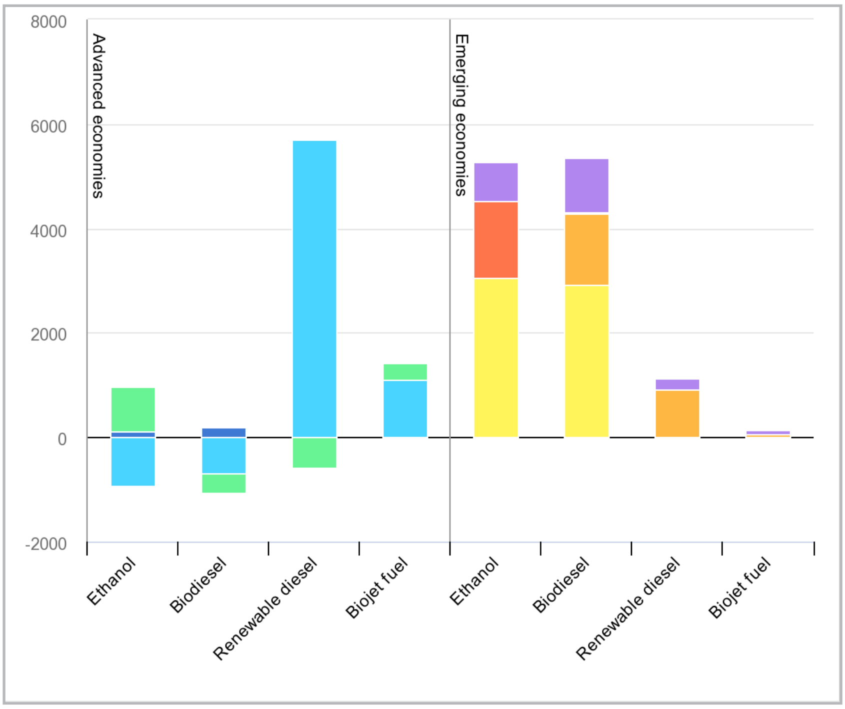
While this is a sobering thought, it also suggests there could be significant opportunities in emerging markets as governments and other participants look to shift the dial on renewables and clean energy. Significantly, the World Economic Forum notes avoiding one tonne of CO_2 emissions in emerging markets costs around 50% as much as it does in advanced economies.

Beyond environmental considerations there could be significant benefits in terms of energy cost and energy security for the developing world if it can advance its renewable sector. Particularly for those countries which are currently significant net energy importers.

One area where emerging markets are expected to be at the forefront is biofuels. According to the IEA (International Energy Agency), domestic production of biofuels in emerging markets avoided $38 billion worth of oil import costs in 2022. In 2023 and 2024 the IEA expects two-thirds of biofuel demand growth to come from developing economies.

This outlook is part of a series being sponsored by Templeton Emerging Markets Investment Trust. For more information on the trust, visit **here**

Biofuel demand growth by fuel and region, 2022-2024



Source: International Energy Agency

Emerging markets: technology at the forefront, overtaking developed world on oil consumption

Find out what the Franklin Templeton team are thinking about right now

1. Broadening market breadth. During the first half of 2023, 72% of the gains and six out of the 10 largest contributors to the gains in the MSCI Emerging Markets index were technology-related. This is a trend repeated in global equity indices, as 53% of the gains and nine of the 10 largest contributors to gains in the MSCI All Country World index came from technology-related companies. Looking ahead to the second half of the year, investors are questioning whether this trend will be repeated or if gains will be more broad-based. Technology companies are long-duration assets – more of their profits are in the distant future as opposed to the near term. This makes their performance sensitive to interest-rate expectations, with falling expectations supporting their performance in the first half-period. This implies interest-rate expectations, as well as other fundamental factors, could drive more broad-based gains in equity indices in the second half of this year.

2. Oil supply and demand. The International Energy Agency (IEA) recently updated its forecasts for world oil supply and demand, highlighting that emerging markets (EMs) are expected to overtake the Organisation for Economic Co-operation and Development (OECD) as the leading oil consumer by 2028. EMs' share of total demand is forecast to rise from 45% this year to 48% by 2028. The OECD's share of total demand is forecast to decline to 42% over the same period. Global demand for oil used in transportation is forecast to start declining after 2026, reflecting a pivot toward renewable energy and growth in electric vehicle (EV) sales. The OECD is seen as leading the way, but it is expected to start impacting EM demand toward the end of the decade as EV sales grow and emission rules are tightened.

3. El Niño impacts. The US National Oceanic and Atmospheric Administration has confirmed the formation of an El Niño, a climate phenomenon that results in tropical cyclones in the Pacific, wetter conditions in South America and drier conditions in India. During the prior El Nino in 2016, which was the strongest on record, drought conditions lowered crop yields and warmer oceans reduced fish stocks. This creates upside risks to inflation in 2024 in EMs, considering the high weight of food in the consumer price basket and the lagged effect of lower agriculture supplies on food prices.

TEMPLETON EMERGING MARKETS INVESTMENT TRUST (TEMIT)

Porfolio Managers

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

Gilts are in demand: we explain how to buy and reasons for doing so

Even if interest rates rise further from here, current gilt yields looks attractive

With official interest rates spiralling higher as the Bank of England grapples with inflation, yields across fixed income markets have also exploded higher. This provides investors with a chance to earn a decent rate of return.

This article explains what gilts are, how they work, the potential returns on offer and different ways to buy them.

WHAT IS THE DIFFERENCE BETWEEN GOVERNMENT AND CORPORATE BONDS?

Broadly, there are two types of bonds, sovereign and corporate. UK sovereign or government bonds are a type of IOU issued by the government's debt management office to fund government expenditures. UK government bonds are also called gilt-edged securities or gilts for short.

Corporate bonds are issued by companies such as supermarket **Sainsbury's (SBRY)** to fund investment in the business or for general corporate purposes.

Investing in a bond is effectively lending money to a company or government until a specified date – known as the maturity or redemption date. The company or government is the 'issuer' of a bond.

In return for buying a bond (and lending money to a company or government), an interest payment is made by the issuer. This is typically known as a coupon and is usually paid once or twice a year, depending on the type of bond.

At maturity the investor also receives back the original issue price of the bond unless the issuer defaults on its debts.

It is worth remembering that bond yields move in the opposite direction to bond prices. With gilt yields moving higher over the last year-and-a-half bond prices have been moving lower.

2-Year UK gilt yield (%)

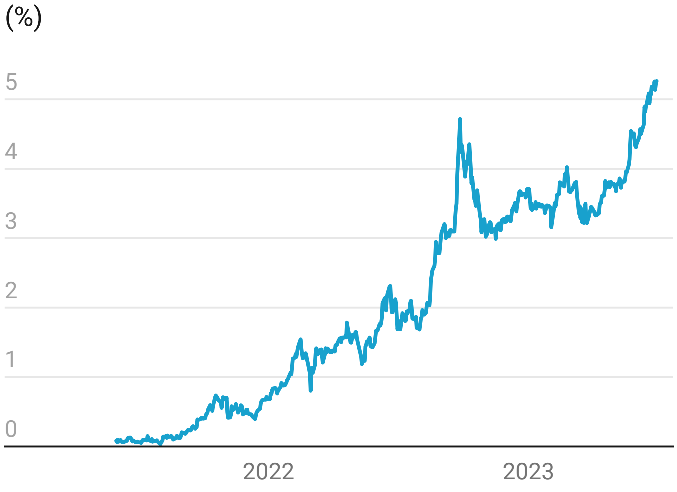

Chart: Shares magazine • Source: Refinitiv

For example, the two-year gilt has a yield of 5.1% compared with a negative yield in December 2021 just before the Bank of England starting its rate hiking cycle.

Because the two-year gilt was issued when official rates were much lower it can be purchased today for just over £92 compared with its £100 issue price. That is unwelcome news for investors who purchased at issue, but good news for future buyers who have the chance to lock-in a capital gain.

When the gilt matures on 7 June 2025 investors will receive £100, creating eight percentage points of capital gain. It is convention to quote a gilt's redemption yield which reflects capital gains/losses at maturity in addition to interest payments.

Gilts had a negative yield in December 2021. This means investors were locking in a guaranteed loss had they held to maturity because the interest payments were worth less than the capital loss incurred at maturity.

Many investors this year have been taking advantage of low gilt prices to lock in expected future capital gains.

A tax efficient account such as an ISA or SIPP which are sheltered from capital gains and income taxes can be a good vehicle for holding a gilt.

HOW TO JUDGE RISK AND RETURN

It is worth pointing out that higher returns come with higher risks.

While money in bank savings accounts is

BOND JARGON BUSTER

It is worth familiarising yourself with some bond jargon. A **clean bond price** excludes accrued interest between what are typically bi-annual coupon payments. A **dirty bond price** includes this accrued interest and is the price you will actually pay.

Let's assume a bond priced at £100 pays a 3% coupon in two separate payments across a year – so £1.50 apiece. The accrued interest per day over that six-month period is 0.82p. If the coupon is paid at the beginning of March and the bond is purchased on 30 April (61 days later) then the accrued interest would be roughly 50p.

At issue or on the coupon paid date the clean and the dirty price will be the same.

A **running yield** is the coupon multiplied by the face value divided by clean price. For example, a bond priced at £95, with a 3% coupon, maturing in three years, has a running yield of 3.16% [(3% x £100) / £95 = 3.16%].

The running yield doesn't tell you what you might earn if you hold a gilt to maturity. For that you need to calculate the **redemption yield** which also factors in capital gains/losses.

You usually need a spreadsheet to make an accurate calculation but there is a simple short cut which adjusts the running yield to reflect the difference in the price from the face value of the bond.

Redemption yield is calculated by adding the running yield to the implied gain divided by the years to maturity, multiplied by 100.

Using the above example again, it would be 3.16% + [(5/3) x 100] = 4.91%.

The short cut works for shorter duration issues while a spreadsheet is needed for longer duration gilts.

Bond duration measures the sensitivity of a gilt to a 1% move in interest rates. The price of bonds with longer to run until maturity will be more sensitive to changes in interest rates, particularly if the coupon is relatively low.

The highest duration will be found with long-dated bonds with lower coupons, and the lowest duration in shorter-dated bonds with higher coupons.

INFLATION-PROTECTED BONDS

Index-linked gilts have pay-outs linked to the rate of UK inflation, measure by the retail price index.

The regular coupon and the amount you get back at maturity is adjusted for inflation, instead of being a fixed amount – as with conventional gilts.

Index-linked bonds tend to have longer maturities than conventional bonds. So, their price can be more sensitive to changes in interest rates than conventional gilts.

ETFs for UK gilts exposure

	Fees	Weighted average YTM
Lyxor FTSE Actuaries UK Gilts ETF DIST (GILS)	0.07%	4.69%
iShares Core UK Gilts UCITS ETF DIST (IGLT)	0.07%	4.63%
Invesco UK Gilts UCITS ETF ACC (GLTA)	0.06%	4.62%
Short-term 0-5yr gilt ETFs		
iShares UK Gilts 0-5yr UCITS ETF ACC (IGL5)	0.07%	5.11%
Lyxor UK Gov Bonds 0-5yr UCITS ETF DIST (GIL5)	0.07%	4.63%
Index-linked gilts		
iShares index-linked Gilts UCITS ETF DIST (INXG)	0.10%	4.54%

Table: Shares magazine. Source: Just ETF. YTM= Yield to maturity • Source: SharePad

guaranteed up to £85,000, there are no such guarantees for bonds. However, UK government bonds are as close to being risk-free as an investor can achieve.

Unlike some savings accounts where money is tied-up for specific periods, called time deposits, investing in government bonds doesn't come with such restrictions.

Investors are free to sell bonds in the market at any time and they do not have to be held to maturity, although dealing spreads, commissions and platform fees need to be considered.

At the time of writing two-year gilts have a yield to maturity of 5.1% and 10-year gilts yield 4.4%, levels which have not been seen in decades.

Gilts represent a risk-free rate because it is unlikely that the UK government will not continue paying interest on its debts and repay the principle on maturity.

That is not true of all countries and in several emerging sovereign debt markets there have been defaults in recent history.

The risk of investing in gilts is very low compared with investing in corporate bonds or stocks and shares. It is worth reflecting on the current yields on offer despite risks the Bank of England continues to increase interest rates.

Locking in 4% to 5% risk-free may look attractive to some investors in this context. Also remember, government bonds typically provide safety during choppy markets and economic recessions, providing ballast to diversified portfolios.

HOW TO INVEST IN GOVERNMENT BONDS

Investing in specific gilts is an option for investors with the confidence and knowledge to pick the most attractive parts of the gilts market.

While there isn't a huge risk of not getting the principle back, that is not the same thing as not losing money. Think back to the negative implied yields in 2021, for example.

Picking the 'right' part of the yield curve can be tricky and requires a 'correct' view on the future path of official interest rates, inflation, and growth in the economy.

Investors can trade individual gilts on most investment platforms via the phone. The cost is typically the same as trading individual shares.

It is always worth bearing in mind that although there are no minimum trading sizes, smaller value trades may not make economic sense. For example, buying £50 worth of the two-year gilt means losing 20% in dealing charges if the cost is around £10 a trade.

Investing in individual gilts may not be for everyone and there are several passive and active fund options available. The cheapest and most straightforward to gain exposure to gilts is through exchange-traded funds – with several shown in the table.

By **Martin Gamble** Education Editor

Can I give money from my pension to charity at death?

There are some important points to note if you are planning to do this

I am thinking about how I can make bequests from my estate to my favourite charities and wondered if I can gift some of my pension in this way and whether or not this makes sense, given my estate might have to pay inheritance tax. I'm interested in the pluses and minuses around giving money to charity on death from my pension.
MT, via email.

Laura Suter, AJ Bell Head of Personal Finance, says:

Firstly, well done for thinking of charitable giving when it comes to organising your estate and affairs. Often it falls off people's to-do list or they don't think about leaving money to charity.

There are also decent tax breaks if you do leave money to charity when you die, meaning that your estate can save on inheritance tax – so let's cover that off first.

WHAT DO I NEED TO KNOW ABOUT IHT?

If you leave 10% or more of your estate to charity the estate will benefit from a lower rate of inheritance tax. The tax rate is usually 40% but this will be cut to 36% if you meet the criteria.

When working out your will it's important to note that you won't know exactly what your estate size will be when you die. For this reason, it's usually wise when leaving gifts to charity in a will to state it as a percentage of the estate, rather than a lump sum in monetary terms. That's particularly the case if you want to meet the 10% threshold for qualifying for reduced inheritance tax.

It's also worth noting that your donation to charity is only 10% of the estate that will be liable for inheritance tax – you can deduct any nil rate bands you're eligible for before calculating this number.

For example, if you had an estate worth £1 million and you were eligible for the standard nil rate band of £325,000 you would only need to leave 10% of £675,000 (£67,500) to qualify for the lower IHT rate.

DOES GIFTING MONEY FROM A PENSION COMPLICATE THINGS?

Your question is more specifically around gifting money from your pension, which sits outside the estate for IHT purposes. The good news is that there is a way to leave money from your pension directly to a charity. Called a charity lump sum death benefit, this is a sum of money paid to a registered charity on death, that will be tax-free too.

There are some rules around this though: the charity must be nominated by the person who died (in this case, yourself) rather than by your executor, for example.

The second, potentially bigger hurdle, is that the individual can't have any dependents. For the purposes of this rule a dependent is a spouse, civil partner or a child under the age of 23, and some co-habiting partners. So, it will depend on your specific circumstances whether that could apply to you.

HOW WOULD IT WORK IF I GIFTED A LUMP SUM?

Another alternative is to leave a lump sum from your pension to a charity on your death, which is allowed but potentially isn't as tax efficient as the example above.

Under current rules if you died before the age of 75 then this lump sum payment would be free of tax if it was paid from funds you had previously allocated to drawdown but not used in your lifetime. If the lump sum was from funds you had not yet accessed, as long as you have sufficient unused lifetime allowance this would also be tax free. However, if you died after the age of 75, or had unused funds above the lifetime allowance on death before age 75, it would face a 45% tax charge.

SHOULD I GIVE MONEY FROM MY PENSION BEFORE I DIE?

One other option worth considering, but not exactly what you were after, is donating money to charity from your pension while you're alive. Clearly this involves some calculations on whether you can afford to gift money when you're still alive, as you don't want to risk depleting your assets before you die.

You'll also need to be taking benefits from your pension, so be over the age of 55. But if so, you could make use of payroll giving to donate money to charity.

This is where you make a payment to charity from your gross income and the income tax you would have paid goes to the charity instead – which if you're a higher or additional rate taxpayer can really boost your donation.

The ability to do this depends on your pension provider being able to facilitate it, as there are likely some costs to them of doing so – meaning not all of them are amenable.

So, the short answer to your question is that there are some options open to you, but they each have some hurdles to jump.

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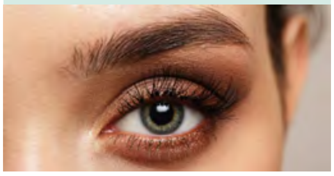

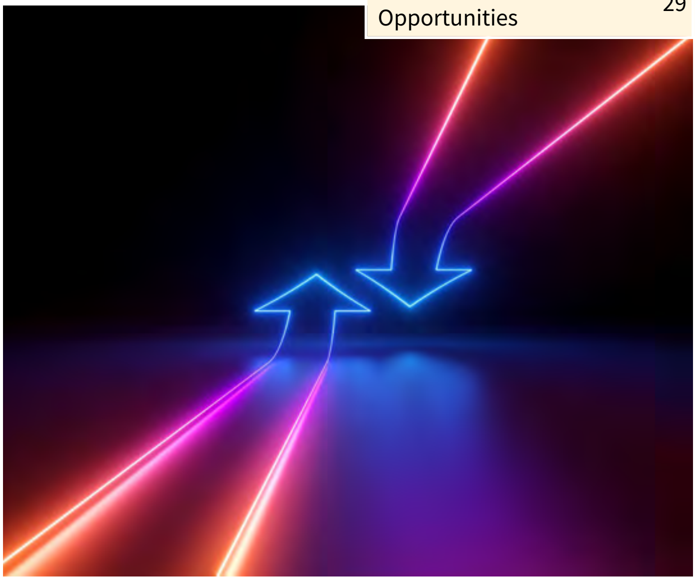

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