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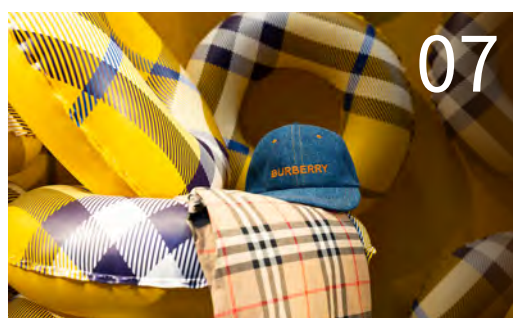
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Contents

06	NEWS	<ul style="list-style-type: none">• Top fund managers continue to back the UK consumer amid record wage growth• Two potential UK winners from the Tapestry-Capri luxury mega-merger• Fresh 'Spot The Dog' research reveals big increase in funds failing to deliver for investors• Big breakthroughs on obesity and Alzheimer's make Eli Lilly world's largest pharma firm• Pod Point powers down but hopes change at the top can recharge the shares
12	GREAT IDEAS	New: Secure Trust Bank / AG Barr Updates: EMIS
18	FEATURE	You favourite funds: Are they reliant on just a few holdings for their returns?
26	FEATURE	Smith & Nephew management under big pressure to deliver on their promises
30	FEATURE	How to analyse Greggs in five easy steps
36	EDITOR'S VIEW	Watch out: Chinese real estate worries are stalking the market once again
37	PERSONAL FINANCE	Lessons from a decade of AIM shares being allowed in an ISA
39	FEATURE	Why investors in US shares may have to lower their growth expectations
41	ASK TOM	Why do ex-pats in some countries see their state pension frozen when others don't?
42	INDEX	Shares, funds, ETFs and investment trusts in this issue



07



14

18



26




41



Three important things in this week's magazine


1



How reliant are your favourite funds on their top holdings

We examine concentration risk from a stock and sector point of view at some of the most popular UK investment products


2



Analysing Greggs

Five easy steps to understand the investment case behind the food-on-the-go leader encompassing like-for-like sales, profit, cash flow and valuation

3



Investors in US stocks may have to lower their growth expectations

A long-running tailwind from lower borrowing costs and falling taxes may be about to reverse

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:



YouGov mulling US listing another blow for London stock market



Krispy Kreme shares fall nearly 14% despite positive second quarter earnings



What to expect from technology picks and shovels giant Cisco in Q4



Directors deals: Babcock boss sells £298,000 shares while Mitie chief's purchase signals confidence

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- **Spot** interesting funds and investment trusts
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Top fund managers continue to back the UK consumer amid record wage growth



Recent indicators suggest the UK could avoid a 2023 recession but wage growth surprise revives interest rate fears

Recent weeks have seen a couple of encouraging economic data points for investors betting on the resilience of the UK consumer.

Second-quarter GDP (gross domestic product) grew at a faster rate than expected, even as interest rates have risen, pushing up mortgage costs on top of rising food and energy bills.

Wage growth also surprised to the upside at 8.2% in the second quarter, a new record and well above the Bank of England's forecast of 7.6%, although the unemployment rate crept up to 4.2% as the labour market starts to slacken. The wage growth number led to market volatility as it prompted fears inflation is becoming more entrenched, forcing the Bank to take a harder line on rates.

Meanwhile, despite the travails of Wilko, which were mostly self-inflicted, homewares

seem to be enjoying a revival in sales even if the weather in July meant footfall on the high street was disappointing.

In an unsheduled trading update, **Marks & Spencer (MKS)** reported a 6% increase in like-for-like sales in its clothing and home division in the 19 weeks to 12 August, while homewares producer **UP Global Sourcing (UPGS)** posted a 15% increase in sales in the six months to 31 July, despite not raising prices, with online sales booming.

Mark Barnett, fund manager at Tellworth Investments, began increasing his exposure to consumer stocks in September 2022 on the basis valuations were 'far too low' and spending looked like holding up.

'Despite much press commentary highlighting the wage squeeze combined with the pessimistic forecasts from the Bank of England and the IMF, the UK consumer has continued to spend and, actually is fundamentally in pretty good shape with strong cash balances, low levels of debt and, high levels of employment' says Barnett.

'These buffers have provided a cushion against the recent shocks and will act as a springboard for the eventual recovery. As I expect headline inflation to ease over the course of 2023, some growth in real wages is to be expected which in turn will fund increases in consumption and GDP.'

Barnett's holdings include **Dunelm (DNLM)**, **Howden (HWDN)**, **Next (NXT)** and **Whitbread (WTB)**.

Ken Wotton, managing director of public equities at Gresham House, agrees: 'Concerns about the UK economy and understandable worries about the outlook for consumer discretionary spending in the face of inflation and increasing interest rates have driven consumer stocks to almost unprecedented lows.

Low ticket value-for-money experiential leisure and some areas of e-commerce look particularly good value.'

Wotton's holdings include **Angling Direct (ANG:AIM)**, **Moonpig (MOON)** and **Ten Entertainment (TEG)**. [IC]

Average weekly earnings annual growth rates in Great Britain, seasonally adjusted, January to March 2001 to April to June 2023

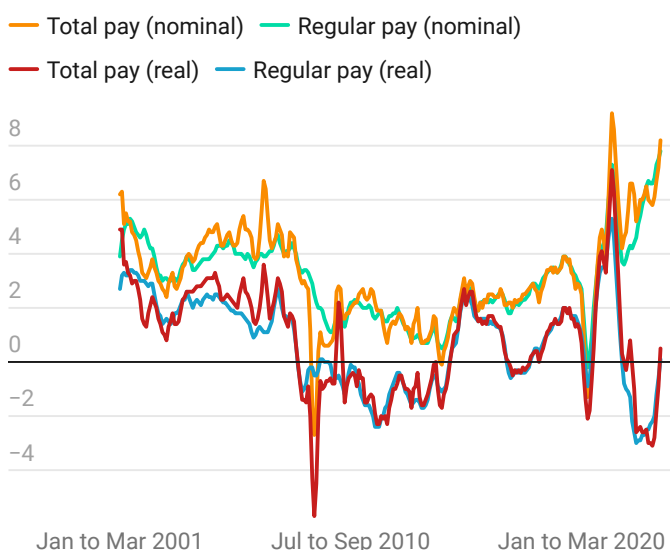


Chart: Shares magazine • Source: Office for National Statistics

Two potential UK winners from the Tapestry-Capri luxury mega-merger

Whether the US combination can disrupt the dominance of European conglomerates is debatable

Coach, Kate Spade and Stuart Weitzman brands owner **Tapestry (TPR:NYSE)** has agreed to buy Versace, Michael Kors and Jimmy Choo parent **Capri (CPRI:NYSE)** in an \$8.5 billion (£6.7 billion) tie-up between the two American fashion houses.

Slated to close by the end of 2024, the mega-merger should create a stronger rival for the likes of **Burberry (BRBY)** and is an attempt to better compete with European luxury conglomerates including **LVMH (MC:EPA)**, **Hermès (RMS:EPA)**, **Kering (KER:EPA)** and **Richemont (CFR:SWX)**.

Whether Tapestry's purchase of Capri can create a serious rival to LVMH is questionable however, judging by the plunge in the share price since the deal was announced (10 August).

Though the timing of the merger seems counterintuitive given recent worries over luxury spending in the US and China, the deal may have merit on a long-term view. Both businesses are looking to overseas markets to help boost growth and according to Tapestry and Capri, the combined business will consist of 'six highly complementary brands with global reach'.

Interestingly, Shore Capital highlights the enlarged company's strategic focus on the entry level of the luxury space. And the broker believes this strategic positioning could 'potentially create a unique value proposition, appealing to a broader consumer base that aspires to enter the world of luxury brands without the exclusivity and high price tags associated with traditional luxury names'.

Tapestry's approach to targeting the entry level of luxury could disrupt the large European players by offering this wider customer base 'a blend of American style and accessibility'. And with inflation cooling stateside, the new entity could 'potentially benefit from a more stable economic



environment, allowing it to focus on expanding its market presence and leveraging the appeal of affordable luxury,' says the broker.

Shore Capital highlights two UK retailers with 'strategic alignment with emerging trends in the luxury sector,' namely high-end timepieces and jewellery purveyor **Watches of Switzerland (WOSG)** and Mike Ashley-controlled **Frasers (FRAS)**, the FTSE 100 conglomerate behind Flannels and House of Fraser besides Sports Direct.

According to analysts Eleonora Dani and Clive Black, Watches of Switzerland's robust sales growth in the US in a tougher first quarter to 30 July 2023 underscores the Rolex retailer's 'momentum and the aspirational nature of luxury timepieces'. Black and Dani also stress that Frasers could stand to gain from Tapestry's strategy of focusing on the entry level of luxury.

'A stronger entry-level offer aligns with Frasers' Flannels stores' positioning, potentially drawing more footfall and enhancing the overall shopping experience.' [JC]



Fresh 'Spot The Dog' research reveals big increase in funds failing to deliver for investors



The Global sector saw the highest number of dog funds overall

Newly published research names and shames the funds which have failed to deliver for investors over three consecutive 12-month periods.

The latest 'Spot The Dog' report has identified 56 equity funds as serious and persistent underperformers – a 27% increase on 44 dog funds exposed in the last report in January 2023.

The amount of assets held in dog funds has more

than doubled from £19.1 billion in the last report to £46.2 billion.

St James's Place (STJ) dominates with six entries and no single fund manager came close to the wealth manager, which accounted 63% of the overall assets in dog funds. However, Artemis also holds £2.66 billion in dog funds, Scottish Widows has £2.1 billion, Columbia Threadneedle £1.92 billion and **Abrdn (ABDN)** £1.67 billion.

'If there is a theme across the companies and strategies that have struggled, it is a quality bias.

This has been a tough area of the market over the past three years, having fallen between the cracks of the various rotations between growth and value,' noted the report, which is produced by Bestinvest.

The Global sector saw the highest number of dog funds overall, with 24 relegated to the doghouse, up from just 11 funds last time, representing 15% of overall assets in the sector.

There are a few funds, however, which have 'turned the corner' since the last report and avoid the list this time round. Invesco has overcome problems with its UK equity franchise, for example, and **Fidelity American (B8GPC42)** has also improved its showing.

Japan, Smaller Companies and Emerging Markets are fund sectors with just one or two dogs, suggesting active fund managers can often do best in the less widely followed parts of the market. There were also no Global Equity Income funds on the list this year. [SG]

Selection of Spot The Dog underperforming funds

	Fund	IA Sector	Size (£bn)	Value of £100 invested after 3 years	Three-year under performance (%)
1	St. James's Place Global Quality	Global	11.47	114	-24%
2	St. James's Place Global Growth	Global	7.49	109	-28%
3	St. James's Place International Equity	Global	7.09	101	-36%
4	St. James's Place Growth European Progress	Europe Excluding UK	1.85	113	-17%
5	Scottish Widows UK Growth	UK All Companies	1.82	120	-14%
6	Artemis US Select	North America	1.53	125	-17%
7	Columbia Threadneedle Responsible Global Equity	Global	1.41	120	-17%
8	abrdn UK Smaller Companies	UK Smaller Companies	1.11	90	-18%
9	Troy Asset Management Trojan Income	UK All Companies	1.00	105	-29%
10	St. James's Global Emerging Market	Global Emerging Markets	0.87	85	-20%

Table: Shares magazine • Source: Spot The Dog, Bestinvest August 2023

Big breakthroughs on obesity and Alzheimer's make Eli Lilly world's largest pharma firm

Shares are up more than 70% over the last 12 months as two new treatments capture market's imagination

Shares in pharmaceutical giant **Eli Lilly (LLY:NYSE)** have put in an outstanding performance over the last 12 months rising 71.4% to the \$539 mark to become the world's largest drugmaker by market value.

Much of the excitement around the stock has been driven by new treatments for two of the globe's biggest public health issues in obesity

and Alzheimer's. The company announced results in July from a late-stage trial showing its Alzheimer's treatment Donanemab had a big impact on memory loss and cognitive decline.

Diabetes and weight loss treatment Mounjaro is also capturing the market's imagination.

Having been approved to treat diabetes in 2022, a trial in April revealed it also cut body weight significantly and it is expected to be greenlit as an obesity treatment later in the year.

Momentum has been



Eli Lilly



sustained by its recent second-quarter results. On 8 August, the company raised its full-year revenue guidance to between \$33.4 billion and \$33.9 billion, up from the previous forecast of \$31.2 billion to £31.7 billion.

The company posted an 85% jump in second-quarter earnings year-on-year in part supported by strong sales in breast cancer pill Verzenio and type-two diabetes drug Jardiance. [SG]

Pod Point powers down but hopes change at the top can recharge the shares

Company has fallen more than 80% on its 2021 IPO price and is down 45% year-to-date

There was some excitement when EV (electric vehicle) charging play **Pod Point (PODP)** joined the stock market in 2021.

At the time *Shares* expressed concerns about a lofty valuation, limited visibility on its road to profit and a competitive marketplace. These reservations have proved to be prescient despite its leading 15% market share in home



EV charging units.

Pod Point will hope a change of leadership can prompt a change of fortunes after seeing its shares career lower from the 225p IPO price to just 35p today. In July founder Erik Fairbairn was replaced at the top on an interim basis by former **Aston Martin Lagonda (AML)** CEO Andy Palmer, who had previously served as the company's senior



Pod Point



independent director.

Results for the six months to 30 June (31 July) suggested the company is no closer to achieving profitability. Pod Point posted a drop in revenue of 26% to £30.6 million and saw its net loss widen by 337% to £33 million with cash on the balance sheet falling from £74.1 million at the start of 2023 to £58.8 million. A planned investor day in the fourth quarter looks like a crunch moment. [TS]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

August 24:

Cropper (James)

HALF-YEAR RESULTS

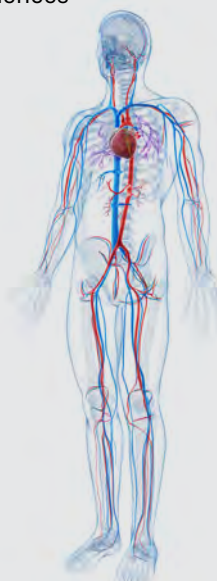
August 22: Wood Group, Empresaria, Anexo

August 24: Macfarlane, CRH, Hunting, Tribal



TRADING ANNOUNCEMENTS

August 22: RUA Life Sciences



Wood Group needs to show big progress after collapse of Apollo deal

Private equity firm walked away from a £1.6 billion bid in May



Energy services firm **Wood Group (WG.)** is under pressure to deliver after ultimately unrealised takeover interest from private equity firm Apollo Global Management earlier this year.

In May Apollo said it would not proceed with a takeover, despite Wood finally opening its books to the firm at the fifth time of asking in response to a bid of 240p per share. With no reasoning given for Apollo's stance, it's no surprise investor confidence was shaken.

Having collapsed, the stock has recovered some ground but still trades substantially below this bid price at 164.9p.

The company has been beset by restructuring and legacy issues since its 2017 merger with Amec Foster Wheeler, such that,

despite some underlying progress, Berenberg does not anticipate positive free cash flow until 2024. Cash flow and margin performance will likely be in focus when the company reports its results for the six-month period ended 30 June on 22 August.

Management may also be expected to provide some colour on a recent multi-year framework agreement struck with **Shell (SHEL)** to continue providing services on the energy giant's global projects. No financial terms have been disclosed on the three-year agreement which has options for two one-year extensions. [TS]

What the market expects of Wood Group

	EPS (p)	Revenue (£bn)
Forecast for 2023	12.4	5.7
Forecast for 2024	17.9	6.1

Table: Shares magazine • Source: Stockopedia

Wood Group



Chart: Shares magazine • Source: Refinitiv

Nvidia earnings report will determine if its superb run can continue

Shares are up more than 180% year-to-date but have stalled in recent weeks

The rapid acceleration in the AI (artificial intelligence) story has lit a fire under the shares of semiconductor designer **Nvidia (NVDA:NASDAQ)** in 2023, making it among the best performers on the US market.

However, in recent weeks the stock has stalled and its near-term trajectory is likely to be dictated by second quarter earnings out on 23 August.

Nvidia stands to benefit from the development of AI because its chips are used to develop machine learning software. The company calls its DGX system an 'AI supercomputer' and 'the blueprint of AI factories' being built across the globe.

As major tech companies invest heavily in AI, this will be expected

to translate into significant earnings growth for Nvidia.

For the year to January 2024 EPS (earnings per share) is expected to more than treble to \$7.94 and for the three-month quarter just gone, \$2.06 is anticipated on revenue of \$11.1 billion.

In the first quarter Nvidia handily beat estimates, with EPS of \$1.09 versus the forecast \$0.92 on revenue of \$7.19 billion against the anticipated \$6.5 billion. The one big weak spot was the gaming division which was hit by the weaker macro-economic backdrop. [TS]

What the market expects of Nvidia

	EPS (\$)	Revenue (\$bn)
Q2 forecast	2.06	11.10

Table: Shares magazine • Source: Yahoo Finance

Nvidia



Chart: Shares magazine • Source: Refinitiv

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

August 18: Deere & Company, Palo Alto Networks, Estee Lauder



August 21: Nordson

August 22: Lowe's, Medtronic, Zoom Video

August 23: Nvidia, Salesforce, Analog Devices, Autodesk, NetApp, Bath & Body Works, Advance Auto Parts



August 24: Intuit, PDD Holdings, Workday, Dollar Tree, Ulta Beauty, JM Smucker

Irn-Bru maker AG Barr deserves more credit for its sales momentum

The Irn-Bru, Rubicon and Boost drinks maker is strategically well-placed for growth

AG Barr

(BAG)

Price: 484.5p

Market cap: £547.3 million

Investors seeking a high-quality pick in the beverages sector should buy **AG Barr (BAG)**, the Irn-Bru and Rubicon drinks maker that deserves more credit for delivering positive sales momentum despite headwinds from the inflation squeezing consumers' spending power and its own operating margins.

The FTSE 250 company offers scope for further forecast upgrades due its demonstrably strong brand momentum and with commodity costs in decline. Considered one of the soft drinks industry's best operators, canny CEO Roger White will retire in the next 12 months after a long and successful tenure at AG Barr.

He leaves the business in great shape, having transformed the company from a regional soft drinks maker into a branded multi-beverage business that is strategically well-placed for growth. Recent downpours won't have helped the soft drinks maker's sales of late, but the incoming heatwave forecast at the time of writing should provide a boost.

For the uninitiated, AG Barr manufactures market-leading UK drinks brands including iconic Scottish tipple Irn-Bru as well as the Rubicon, Barr and Tizer fizzy drinks and take home cocktail offering FUNKIN. AG Barr has also increased its exposure to high-growth categories through the acquisitions of challenger oat milk maker MOMA Foods – oat milk is outperforming other plant-based

alternatives – and Boost, the profitable energy, sport, iced coffee and protein drinks company.

AG Barr's world-class manufacturing sites, considerable marketing clout, track record of generating high returns on capital and net cash balance sheet represent a cocktail of competitive strengths.

The £547.3 million cap recently (1 August) upgraded pre-tax profit guidance for the year to January 2024, now seen coming in 'marginally above the top end' of analyst expectations.

This upwards earnings revision reflected positive trading across the company's soft drinks divisions in the half to July as well as the removal of the cost and uncertainty of the now delayed Scottish deposit return scheme and high hopes for a number of brand launches planned for the second half.

On Shore Capital's current year estimates, AG Barr trades on a forward multiple of 15.2, well below the 10-year average and grudging given the group's defensiveness and earnings growth potential. The shares also offer a near-3% yield based on Shore's 13.7p current year dividend forecast.

Liberum Capital sees 'significant potential for growth and margin expansion' once the transitional impacts of inflation pass, which should drive 'significant earnings growth and a rerating' of the stock. [JC]



AG Barr

(p)

800

600

400

2019

2020

2021

2022

2023

Chart: Shares magazine • Source: Refinitiv

Secure Trust Bank is cashing in helping consumers get what they want



Despite its strengths this specialist lender remains deeply unloved and undervalued

Secure Trust Bank

(STB)

Price: 662p

Market cap: £127 million

Investors who are risk-averse and prefer to avoid small-cap stocks may want to stop reading here, but for those with a nose for value and an appetite for contrarianism we think there is a lot to like about specialist lender **Secure Trust Bank (STB)**.

To say the stock is unloved is an understatement, as one look at the share price performance over the last five years demonstrates.

Secure Trust Bank provides retail finance and vehicle finance for consumers as well as property and commercial finance.

Its retail finance arm arranges and administers finance and loans for well-known national brands

and retail partners across the UK, helping shoppers buy the things they want.

In the first half of this year, the bank grew its retail loan book by 12% or £614 million and increased its market share to 12.9% from 11.4% six months earlier.

In vehicle finance its V12 'product hub' allows dealers to buy, sell and finance used vehicles, while its Moneyway finance arm has hundreds of thousands of happy customers across the UK.

Lending increased by 18% or £250 million in the first half as the used car market soared and the bank grew its dealer and broker relationships.

The real estate finance business offers loans to experienced developers of residential and commercial schemes as well as professional landlords, and grew its loan book by 10% or £250 million in the first half, while commercial lending was flat as the bank made a strategic shift towards lower-yielding but lower-risk financing.

On the whole, therefore, the bank increased its loan book in three of four of its large addressable markets while staying disciplined in terms of risk, and reported a net interest margin of 5.4%, which the high-street giants would kill for given they are expecting to report an average margin of just 1.5% this year.

Even though it took an impairment charge of £7.2 million for non-recoverable loans in the first half, which management says is unique and relates to a long-standing commercial debt, pre-tax profit of £16.5 million was almost flat implying underlying earnings grew by 15%.

With no write-offs in the second half, profits are expected to increase 'significantly' thanks to loan book growth and a low cost-to-income ratio.

So why does STB trade on 0.4 times 2023 book value, 3.6 times earnings and a dividend yield of 7.5% with the dividend four times covered?

'The market is valuing the shares as though the company has serious balance sheet issues, which we do not agree with', says Shore Capital. We can only concur. [IC]

Secure Trust Bank

(p)



Chart: Shares magazine • Source: Refinitiv

Watchdog U-turn leads to quickfire EMIS profit of 39%

Time to sell after healthcare tech takeover greenlit and stock jumps

EMIS

(EMIS:AIM) £19.08

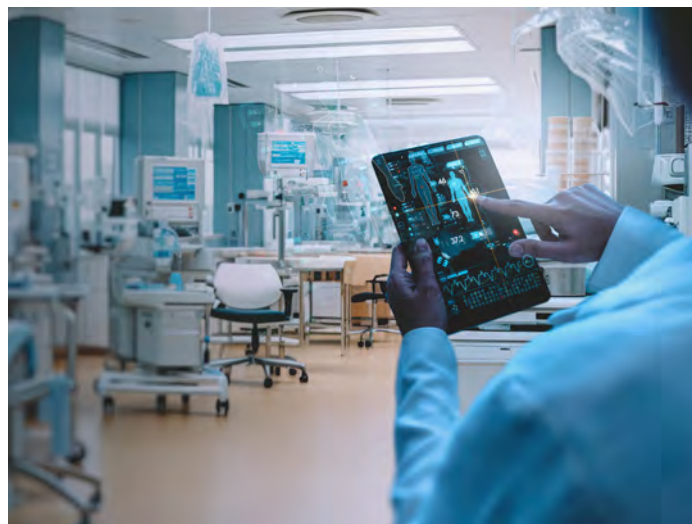
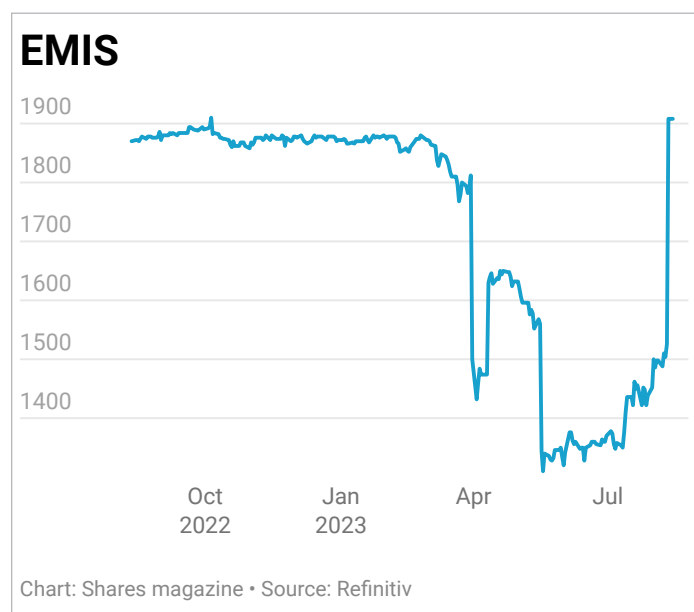
Gain to date: 39%

Readers who backed our recent arbitrage call on **EMIS (EMIS:AIM)** should be feeling pretty chuffed having banked a rough 39% in five weeks, and we called it spot on.

We said at the time (6 Jul) that this investment pitch was 'a little different to the sort of investment ideas *Shares* typically presents to readers,' but having paid-off much like we said it might, what should shareholders do now?

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

First, let's recap. NHS technology platform supplier EMIS provides vital technology to the UK's thousands of GP practices and millions of NHS users. A £1.2 billion takeover offer from US peer **UnitedHealth (UNH:NYSE)** was agreed more than a year ago, but the deal was put under investigation by the UK's Competition and Markets Authority.



EMIS is estimated to hold a UK market share of more than 50% in electronic patient records through its EMIS Web platform. The company currently integrates with several third-party systems but doing so in the future could be seeding business to rivals of Optum, UnitedHealth's UK arm.

Now the CMA has changed its mind about competition concerns in a late volte-face, largely because it thinks the NHS will be able to use its oversight role to prevent the merged business from harming the competitiveness of rivals.

Megabyte analyst Ieuan Turner says: 'Remarkably, no disposals have been deemed necessary as it all stems down to the oversight role that the NHS holds in the UK healthcare market.'

WHAT SHOULD INVESTORS DO NOW?

The CMA will conduct a public consultation on the provisional findings before it releases its final report, scheduled for October 2023, but the stock has surged, to £19.08.

That modest discount to the £19.25 agreed cash takeover price suggests some marginal doubts over the deal remain, although a spanner being thrown into the works looks very unlikely. Still, why take any risk at all?

Shares believes you're better off closing the trade now, banking your 39% profit (less costs) and moving on to something else. [SF]

Japanese shares have hit 33-year highs – but why?

With Japanese stocks scaling heights not seen since 1989, we look at what's driving them, explain why the Tokyo Stock Exchange has called on companies to enhance their corporate value and what this may mean for investors in the Schroder Japan Trust plc.

Japanese shares are flourishing so far in 2023. In recent months, the major equity indices, the Topix and the Nikkei 225, both hit their highest levels since 1989.

Gains for Japanese equities have outpaced other developed markets, albeit the weaker yen has reduced those gains for overseas investors, such as shareholders of Schroder Japan Trust, which is denominated in UK sterling.

What's behind this growing enthusiasm for

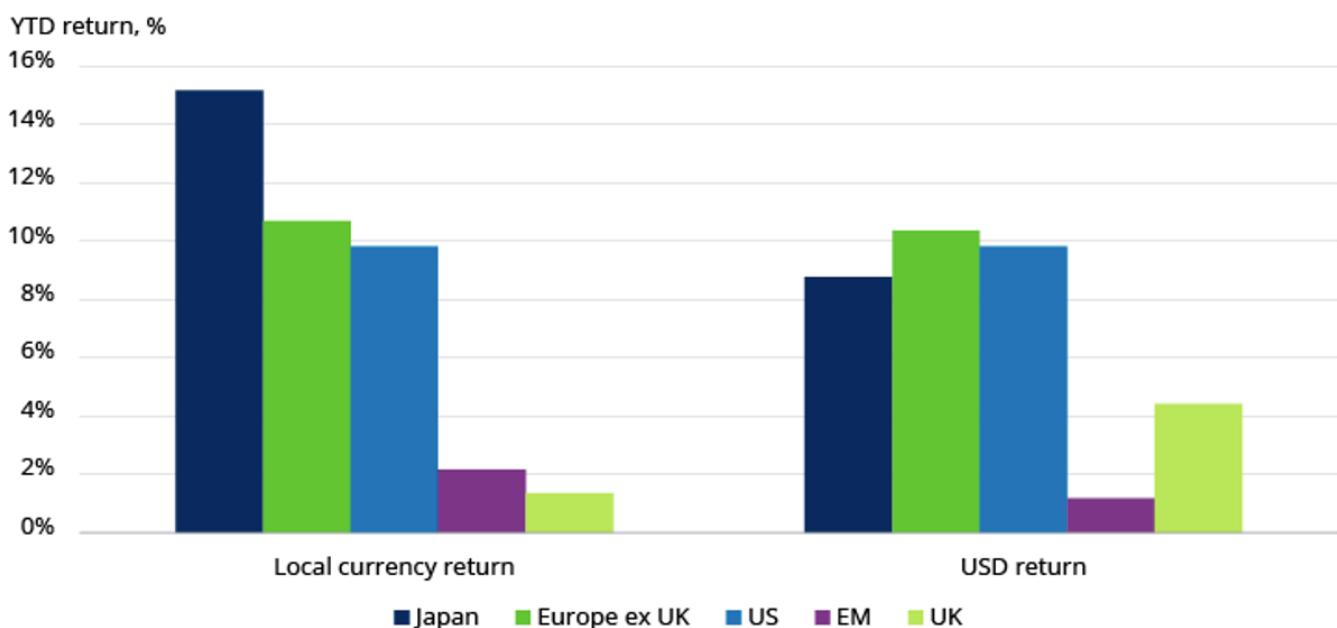


Japanese shares? We think there were two key factors driving this momentum.

One is a cyclical aspect, with the Japanese economy

Japanese stocks are surging but yen weakness has been a drag

Schroders



Past performance is not a guide to future performance and may not be repeated.

Source: Datastream Refinitiv, MSCI and Schroders Strategic Research Unit. Data to 31 May 2023. 608990

being relatively late to reopen after the Covid-19 pandemic. This gives confidence in corporate earnings growth this year, alongside attractive valuations as a whole for the Japanese stock market.

Secondly, and this is more important as a structural development for the long term, the trigger was the Tokyo Stock Exchange (TSE)'s call earlier in 2023 for companies to focus on achieving sustainable growth and enhancing corporate value. This call was particularly directed at companies with a price-to-book ratio (P/B ratio) of below one.

The price-to-book ratio (P/B ratio) is a financial metric that compares a company's stock price to its book value per share. The book value per share represents the company's assets minus its liabilities, divided by the number of outstanding shares. If a company's P/B ratio is below one, the market is valuing the company at less than its assets are worth.

There are many ways companies can try to improve their P/B ratio. The request to companies from TSE specifically mentions steps such as "pushing forward initiatives such as investment in research & development and human capital that leads to the creation of intellectual property and intangible assets that contribute to sustainable growth, investment in equipment and facilities, and business portfolio restructuring". Another method is to increase returns to shareholders, either via dividends or buybacks (whereby the company repurchases its own shares).

REOPENING POST-COVID IS ALSO BOOSTING JAPANESE SHARES

Japan was under some form of pandemic restrictions for much longer than the US or Europe. The country only reopened its borders to foreign tourists in October 2022. Domestic travel is also recovering. We think this can help benefit smaller, domestically-focused companies operating in sectors such as travel, leisure, and hospitality.

Another important point is that China's lifting of pandemic restrictions was even later than Japan's. Trade with China is important for Japanese companies, and Chinese tourists were a sizeable proportion of total visitors to Japan (making up a third of the total in 2019). China's belated post-Covid reopening is another positive influence for Japanese shares this year.

WELCOME RETURN OF INFLATION

After three decades of low inflation, and even deflation, the current return of mild inflation is very welcome in Japan. Deflation leads companies and consumers to delay investment and put off purchases; there's little point buying something now if it will be cheaper tomorrow. By contrast, moderate inflation gives companies the confidence to invest for the future, and also spurs consumers to spend.

Rather than facing a downward deflationary spiral, Japan may now be entering a sustained period of higher corporate investment, wage growth, and increased consumer spending.

Japan's inflation rate (Consumer price index)

Schroders



Sources: Trading Economics, Ministry of Internal Affairs & Communications, May 2023. 608990

The challenge for consumers will be whether wages keep pace with this higher inflation, otherwise their purchasing power will be eroded. There were, however, positive signs from this year's spring wage negotiations, with major firms agreeing a near 4% pay rise for employees, the highest pace over the last 30 years. This only affects a limited number of companies but is still encouraging because companies need to be confident about the business outlook if they are going to commit to pay rises.

Another factor is that, even after the rally so far this year, Japanese shares look attractively valued when compared to their own history and to other regional equity markets making it an attractive hunting ground for foreign investors.

SMALL CAPS POISED TO BENEFIT

We would highlight small companies in particular as the likely winners. This is partly because of their exposure to domestic services sectors that will benefit from reopening.

The unwinding of pandemic investment trends is also a factor. The uncertainty caused by the pandemic tended to see equity investors retreat to the safety of larger companies. However, the improved economic backdrop and renewed investor enthusiasm for Japan will bring higher liquidity, which is beneficial for smaller companies as it makes them easier to trade.

An existing valuation gap has widened of late, given the fact that Japan's recent rally was very much driven by large cap stocks. This was mainly

due to overseas investors buying index futures and liquid large cap stocks. Smaller companies remain attractively undervalued.

WHAT DOES THIS MEAN FOR SHAREHOLDERS OF THE SCHRODER JAPAN TRUST?

We believe the environment described above is very positive for shareholders in the Schroder Japan Trust. Indeed, it should be positive for all shareholders in Japan because the TSE's recent focus on enhancing corporate value should ultimately deliver higher returns from Japanese businesses. In turn, after decades of dwindling international demand, this should generate more interest in Japan from global investors.

In particular, the Schroder Japan Trust portfolio is well-placed to benefit from these long-term trends, because of its focus on smaller companies and those sectors which are poised to most benefit from the return of inflation and the end of covid restrictions. Meanwhile, our focus on investing in attractively valued businesses, where the opportunity for improved returns and valuations is greatest, is also potentially meaningfully beneficial for shareholders.

All in all, we think the mix of short-term cyclical factors, plus long-term structural changes, adds up to an encouraging outlook for the Schroder Japan Trust and Japanese shares.

[Click here](#) to find out more about the Schroder Japan Trust

IMPORTANT INFORMATION

This is a marketing communication.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

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[illegible]

The recent decision by the Nasdaq stock exchange to reduce the weighting of the biggest tech stocks has once again raised the question, can you have too much of a good thing?

In terms of diversification, funds and investments trusts can be a smart way to spread risk in a portfolio, but is it possible that without realising it you can still end up with more exposure to some parts of the market than you bargained for?

The good news is help is at hand in the form of tools like the 'portfolio x-ray analysis', which is free for customers of financial services firm AJ Bell, the owner of *Shares* magazine.



The 'x-ray' tool, powered by Morningstar software, not only calculates the spread of your investments in individual stocks but can 'look into' trusts, funds and ETFs (exchange-traded funds) and work out your exposure from the list of their holdings to give you a full picture.

In this case, the portfolio is well balanced between diverse types of businesses, albeit the underlying sector weightings are vastly different from say the FTSE 100 or the FTSE All-Share index.

AJ BELL PORTFOLIO X-RAY ANALYSIS

Example portfolio

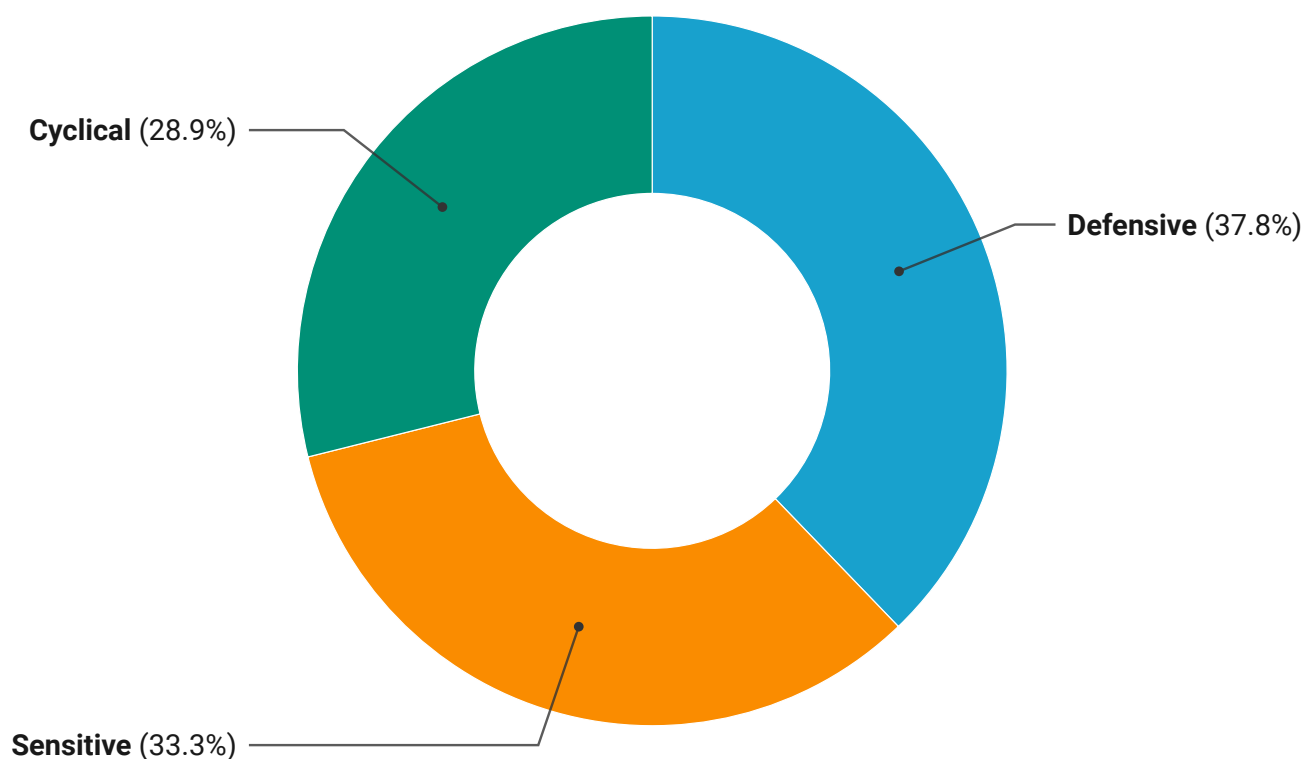


Chart: Shares magazine • Source: AJ Bell, Shares

Sensitive

Sector	Weighting
Technology	18.3%
Energy	6.8%
Industrials	4.3%
Communications	3.9%

Cyclical

Sector	Weighting
Basic Materials	8.1%
Consumer cyclical	7.8%
Real estate	6.7%
Financial services	6.3%

Defensive

Sector	Weighting
Consumer defensive	24.2%
Health care	10.4%
Utilities	3.2%

TOP MANAGERS MAKE BIG BETS

As American market guru and writer Howard Marks often reminds us in his investor letters, if you want to beat the market you have to do something different to the market.

As investors it is our job 'to intelligently bear risk for profit - doing it well is what separates the best from the rest,' says Marks.

Taking concentrated bets – and by association greater risk – is one way to generate better returns than the market, assuming you can identify great companies and buy them well.

If we look at **Fundsmith Equity (B41YBW71)**, one of the largest and most widely owned funds among retail investors, the portfolio is made up of just 26 holdings with a strong bias towards consumer stocks and healthcare, and little exposure to technology or financial companies.

Fundsmith Equity

Consumer (44%) Health care (25%)
Technology (10%) Communications (8%)
Industrial (6%) Financial (4%)

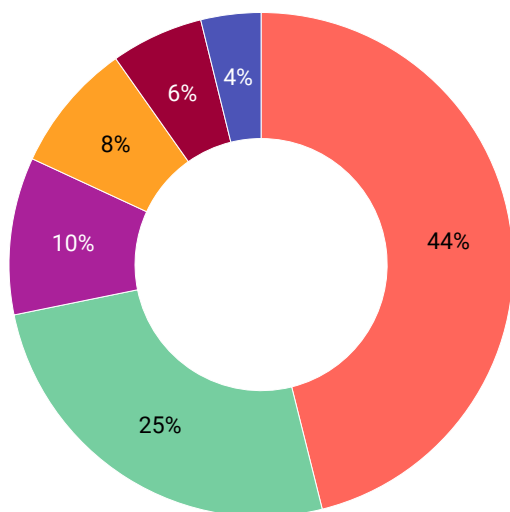


Chart: Shares magazine • Source: Portfolio, Morningstar 31 May 2023; Sector weights, Fundsmith 31 July 2023

The firm lists its top 10 stocks on its website but does not reveal their weightings or tell us how much of the portfolio they make up, just that they are 'high quality, resilient, global growth companies that are good value and which we intend to hold for a long time'.

However, Morningstar reports that as of the end of May the top five holdings – **Microsoft (MSFT:NASDAQ)**, **Novo Nordisk (NOVO-B:CPH)**, **L'Oréal (OR:EPA)**, **LVMH (MS:EPA)** and **Philip Morris International (PM:NYSE)** – accounted for

Fundsmith Equity - Top Stocks

Stock	Sector	Weighting
Microsoft	Technology	8.3%
Novo Nordisk	Health care	8.0%
L'Oreal	Consumer	6.6%
LVMH	Consumer	5.4%
Philip Morris Intl	Consumer	5.2%
Total		33.5%

Table: Shares magazine • Source: Portfolio, Morningstar 31 May 2023; Sector weights, Fundsmith 31 July 2023

exactly a third of the portfolio, so it would seem a reasonable guess that the top 10 account for more than half the fund.

This level of concentration takes a lot of skill on the part of the managers and a lot of faith on the part of investors, but yet again Terry Smith has shown he knows his onions as his second-largest holding, Danish drugmaker Novo Nordisk, has rocketed recently following positive trial data for its *Wegovy* obesity treatment.



Just as important as knowing which individual stocks drive returns, investors should understand the sector weightings in the funds they own, which is easy enough as most provide a breakdown in their monthly fact sheets.

In the case of Fundsmith Equity, its sector exposure is vastly different to the MSCI World Index which the fund uses as its equity benchmark, with nearly 45% of its holdings in consumer sectors against less than 20% for the index, nearly 25% in health care against less than 12% for the index and just under 10% in technology against nearly 22% for the index.

It is a similar story with **Lindsell Train Global Equity (B18B9X7)**, another extremely popular fund which makes concentrated bets.

Its top 10 holdings comprised just over 60% of the portfolio at the end of July and like Fundsmith Equity it has a very high weighting in consumer stocks compared with the index.

It also has more exposure than the index to media and communications services stocks including Anglo-Dutch firm **RELX (REL)** which is the fifth-largest holding in the portfolio.

Lindsell Train Global Equity

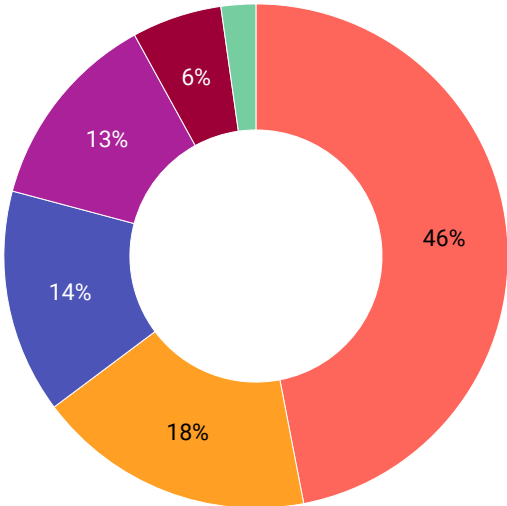
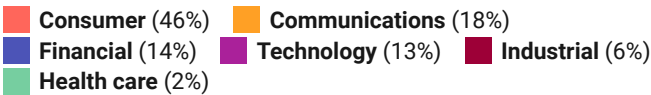


Chart: Shares magazine • Source: Source: Portfolio and sector weights, Lindsell Train 31 July 2023

Lindsell Train Global Equity - Top Stocks

Stock	Sector	Weighting
LSE Group	Financial	8.9%
Diageo	Consumer	7.9%
Nintendo	Consumer	7.9%
Heineken Holding	Consumer	6.0%
RELX	Communications	5.7%
Intuit	Technology	4.9%
Mondelez	Consumer	4.8%
PepsiCo	Consumer	4.8%
FICO	Technology	4.8%
Unilever	Consumer	4.6%
Total		60.3%

Table: Shares magazine • Source: Portfolio and sector weights, Lindsell Train 31 July 2023

HOW DO OTHER POPULAR FUNDS COMPARE?

We have done the same exercise for three of the most popular investment trusts, **Scottish Mortgage (SMT)**, managed by Edinburgh-based Baillie Gifford, **JP Morgan Growth & Income (JGGI)** and **City of London (CTY)**, managed by Janus Henderson.

Scottish Mortgage - Top Stocks

Stock	Sector	Weighting
ASML	Technology	8.3%
Moderna	Health care	6.7%
Tesla	Consumer	5.4%
Nvidia	Technology	4.5%
Mercadolibre	Consumer	4.0%
Northvolt*	Technology	3.5%
Space Expl. Tech.*	Technology	3.4%
Amazon.com	Communications	3.1%
Kering	Consumer	2.8%
Ferrari	Consumer	2.6%
Total		44.3%

Table: Shares magazine • Source: Portfolio and sector weights, Scottish Mortgage 30 June 2023. *unlisted



Scottish Mortgage

■ Consumer (39%)
 ■ Technology (29%)
 ■ Health care (20%)
 ■ Communications (9%)

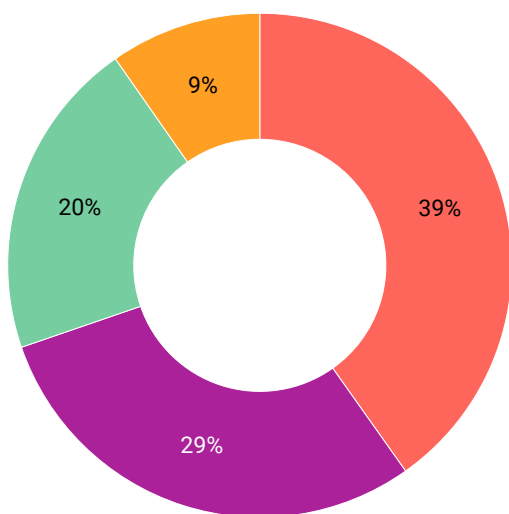


Chart: Shares magazine • Source: Portfolio and sector weights, Scottish Mortgage 30 June 2023

JPMorgan Global Growth & Income - Top Stock

Stock	Sector	Weighting
Microsoft	Technology	6.8%
Amazon.com	Consumer	5.6%
TSMC	Technology	3.2%
UnitedHealth	Health care	3.0%
Nvidia	Technology	2.8%
Coca-Cola	Consumer	2.6%
CME	Financial	2.5%
Meta Platforms	Communications	2.5%
Mastercard	Financial	2.5%
Vinci	Industrial	2.4%
Total		33.9%

Table: Shares magazine • Source: Portfolio and sector weights, JPMorgan 30 June 2023

Scottish Mortgage is less concentrated than the two open-ended funds, with the top 10 stocks making up just over 44% of the portfolio as of the end of June according to the company.

However, it is highly focused in terms of sector bets with close to a 40% weighting in consumer names, close to 30% in technology names and no exposure at all to financial, industrial, basic material, energy, utility or real estate stocks.

JP Morgan Global Growth & Income is less concentrated again in terms of top 10 holdings which make up just 34% of the portfolio, and its sector weightings are the closest to those of the MSCI World albeit with an underweight position in health care, industrial and communications stocks and no exposure to basic materials or real estate.

JPMorgan Global Growth & Income

■ Technology (22%)
 ■ Consumer (14%)
 ■ Financial (13%)
 ■ Industrial (6%)
 ■ Communications (5%)
 ■ Energy (4%)
 ■ Utilities (4%)
 ■ Health care (3%)

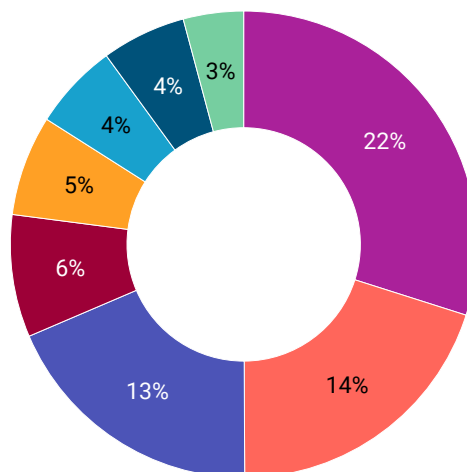


Chart: Shares magazine • Source: Portfolio and sector weights, JPMorgan 30 June 2023



City of London has a similar level of concentration with its top 10 stocks, but is the odd one out in other respects, most noticeably by having no exposure whatsoever to the technology sector and being overweight financial and energy stocks as well as consumer companies.

City of London - Top Stocks

Stock	Sector	Weighting
Shell	Energy	3.9%
BAE Systems	Industrial	3.5%
HSBC	Financial	3.4%
Unilever	Consumer	3.3%
BAT	Consumer	3.3%
RELX	Communications	3.3%
Diageo	Consumer	3.3%
AstraZeneca	Health care	3.0%
BP	Energy	2.8%
Imperial Brands	Consumer	2.5%
Total		32.3%

Table: Shares magazine • Source: Portfolio and sector weights, Janus Henderson 30 June 2023

City of London

- Consumer (26%)
- Financial (26%)
- Industrial (12%)
- Energy (9%)
- Health care (9%)
- Utilities (7%)
- Basic materials (6%)
- Communications (3%)
- Real estate (2%)

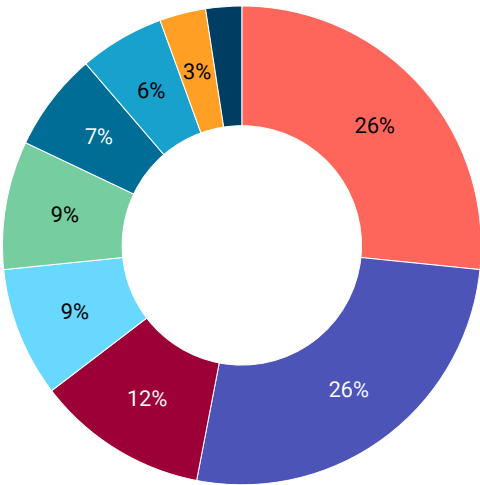


Chart: Shares magazine • Source: Portfolio and sector weights, Janus Henderson 30 June 2023



WHAT IF I OWN ALL FIVE?

If you held each of the five funds we have analysed in equal amounts, what would your exposure look like relative to the index and would you have 'too much of a good thing'?

Looking at the sector weightings of all five, the most obvious differences would be in the level of exposure to consumer and technology stocks.

We estimate the weighting to consumer stocks, both staples and discretionary, would be around 34% compared with the MSCI ACWI (All-Country World Index) weighting of 18.6%, while technology would weigh in at just 12.3% against 21.9% for the index.

This might sound like a risky bet given how well technology stocks have been performing, but it's a case of chicken and egg – the reason the weighting of tech stocks in the index is so high is precisely because they have rallied so much this year, so trying to chase them now by overweighting them could be more risky than being underweight.

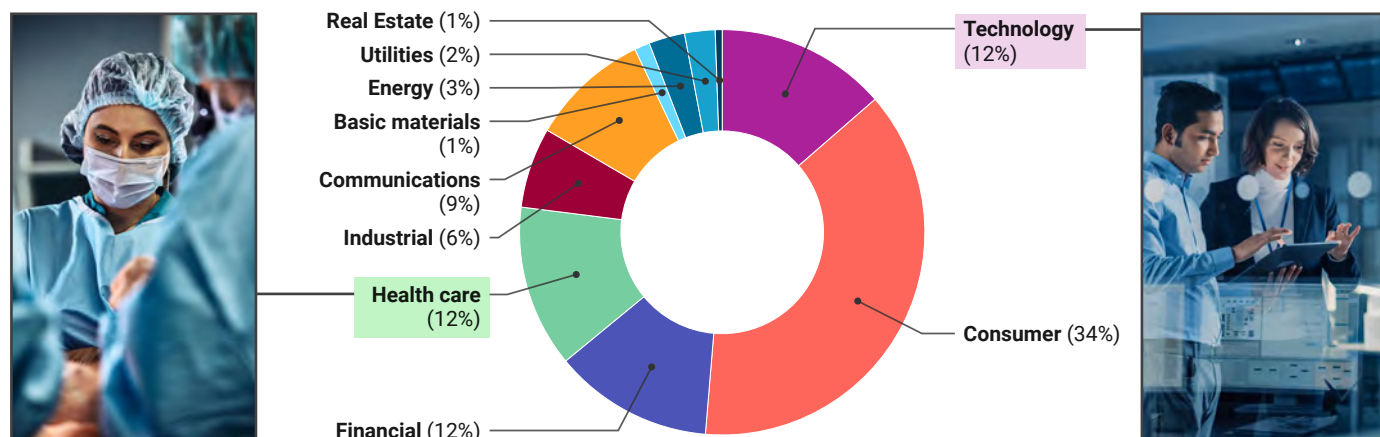
In most other respects, an equally-weighted portfolio of the five funds actually does a reasonably good job in terms of replicating the index weights when it comes to financial, health care and communication stocks, but it underweights industrials, energy and basic materials which are more cyclical in nature and which in any case will struggle in a low-growth environment.

We have not looked at the country exposure of all five funds, but apart from City of London, which invests solely in the UK, the rest have similar geographic weightings to the index, mostly through their technology, consumer and financial holdings which are predominantly US stocks.

For investors who want to explore this aspect of their holdings, each fund gives its geographic exposure on its corporate website.

DISCLAIMER: Financial services company AJ Bell referenced in this article owns *Shares magazine*. The author of this article (Ian Conway) and the editor (Tom Sieber) own shares in AJ Bell.

Overall portfolio if you invested £5,000 equally in each of these funds



MSCI ACWI Index

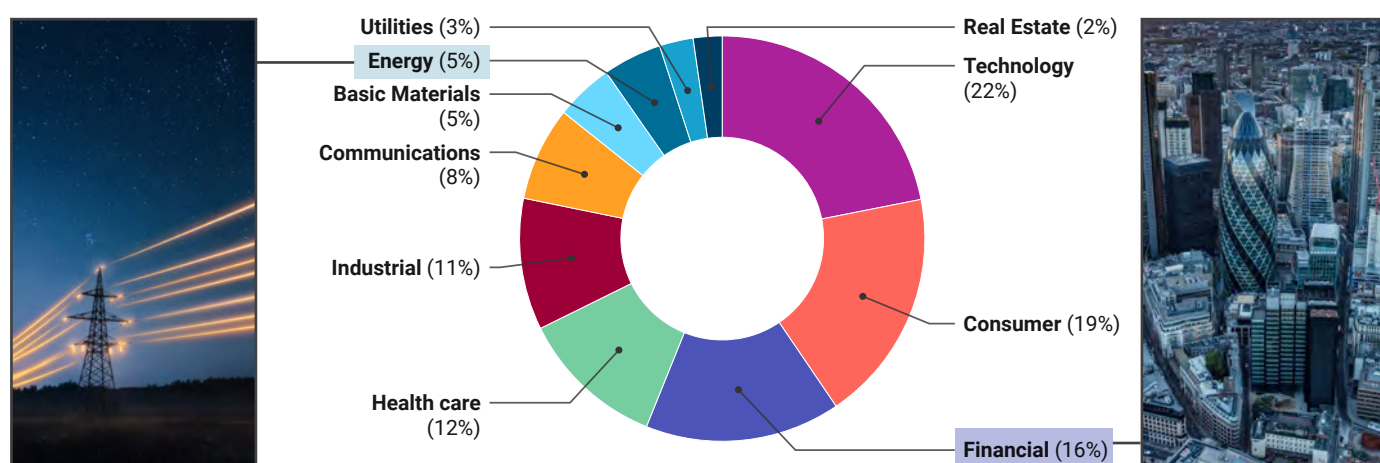


Chart: Shares magazine • Source: Shares, fund factsheets. MSCI ACWI breakdown



Invesco Bond Income Plus Limited

Investing for income in the high yield bond market

Invesco Bond Income Plus Limited (Ticker: BIPS) invests primarily in high-yielding fixed-interest securities with the aim of providing a mix of capital growth and income to shareholders.

Portfolio managers Rhys Davies and Edward Craven, supported by their team, typically invest in a diversified portfolio of bonds issued by large and medium-sized businesses across the sectors of the economy, both corporates and financials. They are also happy, to a limited degree, to invest in bonds that have come under price pressure but where they believe the companies could turn around their businesses.

BIPS has a clearly defined income provision with a **target dividend of 11.5 pence per share per year, paid quarterly***

With higher yields now available for income investors, particularly those investing in the high yield bond market, Rhys spoke to AJ Bell about his background as a credit analyst, the investment objective of BIPS and how he generates ideas and income for the BIPS portfolio.

*Dividend policies and future dividend payments are determined by the Board and are not guaranteed.



WANT TO KNOW MORE?

Rhys Davies is a fund manager and senior credit analyst in the **Henley-based Fixed Interest Team** and manages high yield credit portfolios. Click the links to find out more about the Invesco Bond Income Plus Limited:

[Invesco Bond Income Plus Limited \(LSE:BIPS\) on AJ Bell](#)

[Invesco Bond Income Plus Limited](#)

Investment risks

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

The Invesco Bond Income Plus Limited may invest in contingent convertible bonds which may result in significant risk of capital loss based on certain trigger events.

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

The Invesco Bond Income Plus Limited uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

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Smith & Nephew management under big pressure to deliver on their promises



Medical devices firm faces moment of truth after outlining turnaround goals a year ago

Medical device and prosthetics specialist **Smith & Nephew (SN.)** is one of those businesses which you think should do well because it operates in a market with demographics on its side.

An ageing population is likely to need an increasing number of knee and hip replacements, creating bigger demand for Smith & Nephew's expertise. However, the company's execution over the years has been patchy, particularly in its largest Orthopaedics division. Its other business units are Sports Medicine & ENT and Advanced Wound Management. The lack of consistent delivery is reflected in a share price which is pretty much where it was eight years ago.

In fairness the pandemic didn't help. Elective surgeries were largely off the table as all the resources of global health care systems were directed at dealing with Covid. This was compounded by the impact of broad-based supply chain issues.

A year ago, the FTSE 100 company's management team announced a 12-point improvement plan. Chief executive Deepak Nath, appointed in early 2022, outlined medium-term guidance on margins and revenue. Having been refined earlier this year, these now stand at revenue growth 'consistently above' 5% and margins of 20% by 2025.

Yet the latest set of results (3 August) from the company were decidedly mixed. Full-year revenue guidance was lifted by one percentage point to between 6% and 7%.

For the six months to 30 June the company reported a trading profit margin as a proportion of revenue which fell to 15.3% from 16.9% in 2022 due to higher marketing and input costs. A big improvement will be required to hit the guided

Smith & Nephew



Chart: Shares magazine • Source: Refinitiv

full-year margin of 17.5%.

It was also revealed the company faces the disruption of the exit of its finance director Anne-Françoise Nesmes in the second quarter of 2024.

When the turnaround programme was launched the company's senior leadership gave themselves some breathing space and said it would be a year before the market saw any tangible evidence of it working. That means there's a lot of pressure to deliver in the second half of this year.

Berenberg analyst Sam England says: 'With the company now one year into management's 12-point improvement plan, we think the business needs to move from qualitative commentary to showing tangible evidence of delivery in its numbers.'

England adds: 'Management noted at the H1 results that the plan is around 45% complete and the company's margin bridge for H2 implies 140-plus basis points of margin improvement from productivity and 12-point plan cost savings in H2. As a result, the company has reached a point where it will need to deliver these savings or else miss expectations for 2023.'



By Tom Sieber Deputy Editor

Equity income: the UK is now once again the most attractive market for the income investor

Charles Luke, Investment Manager, Murray Income Trust PLC

- ***The UK is a very international market with around half the revenues of UK-listed companies generated in the United States and Asia Pacific, with Europe also holding a major share.***
- ***The UK market trades at an approximate 20% discount to global equities.***
- ***The yield premium for the UK market is now at its highest point for the last 15 years.***

It is some years since UK equity income portfolios were the toast of the town for the core of an investment portfolio. Investors have been seduced by the charms of global income portfolios. After all, why not have the whole world at your fingertips rather than just a single market? The reality is more nuanced.

The UK is an international market. Many companies listed on the UK market draw their sales from around the world, which means they are not dependent on the UK's - admittedly sluggish - domestic economy. The United States and Asia form around half the revenues of UK companies, with Europe another significant chunk. Investors are already getting global income from their UK portfolios.

But why not just buy a global income portfolio and get the broadest possible opportunity set? The answer lies in the valuations of UK companies, which have been pushed lower by weaker confidence in the UK economy and political system. This has left UK



share prices cheap relative to their global peers.

The absolute discount to global markets sits at around 35%. However, the UK market has lighter representation in areas such as technology, which tend to trade on higher valuations. Adjusted for these sector differences, our estimates suggest the UK market is at an approximate 20% discount to global equities.

We see this in the rating of UK companies relative to their international peers. A variety of companies in the Murray Income portfolio helps to highlight this: BP trades at a price to earnings ratio around 40% below US-listed Exxon; Diageo's valuation is around two-thirds that of US distiller Brown Forman as is Rentokil compared to US peer Rollins; Convatec trades at around 19x its annual earnings, compared to 29x for Danish-listed competitor Coloplast. It is difficult to determine differences in the operations and prospects for these businesses yet there is a chasm in terms of their valuations.

Apart from the global financial crisis, the UK's market multiple is nearing its lowest point for 30 years. It is cheap

in absolute terms, relative to history and also relative to global equities. Investors are getting global income at a knock-down price by investing through the UK market.

PREMIUM DIVIDEND

The UK has a long-established and well-developed dividend culture. While other countries have improved their payouts to shareholders in recent years, few can match the track record of UK companies. The yield for the FTSE All Share is currently 3.7%, which puts it significantly ahead of most major markets. The S&P 500, for example, yields just 1.7%.

This premium has always existed, but is particularly high today as poor sentiment towards the UK has depressed share prices (yields are expressed as a percentage of the share price). The yield premium is now at its highest point for the last 15 years.

Equally, dividend cover looks healthier than it has for some time. The pandemic allowed many companies to re-set their dividends to more realistic levels. Aggregate dividend cover – the amount of profit a firm makes divided by the dividend it pays out – for the FTSE 100 is now



more than 2x, having been below 1.5x as recently as 2016.

It is also worth noting that UK investors in global equity income funds will usually see a drag from withholding tax. This lowers distributable income for overseas-listed investments, but has no bearing for investments in UK-listed companies.

GLOBAL TRENDS

The UK market is often seen as old-fashioned, stuffed with yesterday's companies in mature, low-growth industries such as banking and fossil fuels. This may be true of the UK's largest companies, but looking beyond the mega-caps, there is an increasing

range of companies exposed to exciting global themes, such as digitalisation, the energy transition and emerging global wealth.

Equally, where there are gaps, these are readily plugged. At Murray Income Trust, 20% of the portfolio can be held in overseas-listed companies. This allows us to fill any holes in our exposure or diversify risk in concentrated sectors. At the moment, that exposure includes high quality companies such as Microsoft (Artificial Intelligence), Kone (elevators), Novo Nordisk (diabetes and weight loss), Accton Technology (network equipment), LVMH (luxury goods), VAT Group (semiconductors) and L'Oreal (cosmetics).

In short, if Murray Income Trust were a global income fund focused on high quality businesses, it would look extremely similar to its current make-up. In achieving the aim of a high and growing income (Murray Income Trust has just achieved 50 years of consecutive dividend growth) combined with capital growth, the UK market serves us very well.

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

Important information:

Risk factors you should consider prior to investing:

- The value of investments, and the income from them, can go down as well as up and investors may get back less than the amount invested.
- Past performance is not a guide to future results.
- Investment in the Company may not be appropriate for investors who plan to withdraw their money within 5 years.
- The Company may borrow to finance further investment (gearing). The use of gearing is likely to lead to volatility in the Net Asset Value (NAV) meaning that any movement in the value of the company's assets will result in a magnified movement in the NAV.
- The Company may accumulate investment positions which represent more than normal trading volumes which may make it difficult to realise investments and may lead to volatility in the market price of the Company's shares.
- The Company may charge expenses to capital which may erode the capital value of the investment.
- Derivatives may be used, subject to restrictions set out for the Company, in order to manage risk and generate income. The market in derivatives can be volatile and there is a higher than average risk of loss.
- There is no guarantee that the market price of the Company's shares will fully reflect their underlying Net Asset Value.

- As with all stock exchange investments the value of the Company's shares purchased will immediately fall by the difference between the buying and selling prices, the bid-offer spread. If trading volumes fall, the bid-offer spread can widen.
- Certain trusts may seek to invest in higher yielding securities such as bonds, which are subject to credit risk, market price risk and interest rate risk. Unlike income from a single bond, the level of income from an investment trust is not fixed and may fluctuate.
- Yields are estimated figures and may fluctuate, there are no guarantees that future dividends will match or exceed historic dividends and certain investors may be subject to further tax on dividends.

Other important information:

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How to analyse Greggs in five easy steps

We look at the investment merits of the Tyneside-based food-on-the-go star turn

Having analysed **Microsoft (MSFT:NASDAQ)** and **Unilever (ULVR)** in [parts one and two](#), part three of *Shares* new mini-series is an examination of the key metrics and investment merits of **Greggs (GRG)**. A more down-to-earth choice but unquestionably one of the UK's favourite options for food on the go, now guided by CEO Roisin Currie.

ANALYSING GREGGS

We will dig into the numbers at the value-for-money sausage rolls, coffees and sweet treats seller with Tyneside origins. This is a stock that has served up a tasty total return (capital growth plus dividends) since joining the stock market as a humble bakery retailer back in 1984.

To recap, the aim with this mini-series is to provide you with an easy-to-use five step framework which can be applied to many of the most popular types of company. This feature should give readers a better understanding of the performance drivers at the company behind the iconic vegan sausage roll, and some idea as to whether its stunning success is sustainable into the future.

STEP ONE

ANALYSING SALES GROWTH

Greggs sales

Year	Total sales	Like-for-like sales growth	
2022	£1.51bn		17.8%
2021	£1.23bn		52.4%
2020	£811.3m	-36.2%	
2019	£1.17bn		9.2%
2018	£1bn		2.9%
2017	£960m		3.7%
2016	£894.2m		4.2%
2015	£835.7m		4.7%
2014	£806.10		4.5%
2013	£762.40		-0.8%

Table: Shares magazine • Source: Annual reports, company accounts



First up on the analysis menu is Greggs' impressive history of revenue growth over the past decade. Total sales have doubled from £762.4 million in the year to December 2013 to £1.51 billion in the year to December 2022, a testament to Greggs' capacity to deliver appetising market share gains. Shore Capital forecasts further rises to £1.75 billion, £1.97 billion and £2.2 billion for 2023, 2024 and 2025 respectively.

Like-for-like sales is a key performance measure for Greggs, since this metric shows underlying estate sales performance excluding the impact of new shop openings and closures. Same-store sales have grown in eight of the past 10 years, save for Covid-impacted 2020 and 2013, when like-for-likes slipped 0.8% due to 'tough and competitive trading conditions'. 2013 was blighted by two bouts of extreme weather; snow in the first quarter and a heat wave in the third quarter, and the like-for-like anomaly here does demonstrate that Greggs is weather-sensitive.

The good news is Greggs has staged an impressive recovery from the coronavirus pandemic and the latest half ended 1 July 2023 confirmed ongoing market share gains. Company-managed shop like-for-likes increased 16%, albeit second quarter growth moderated slightly from a first quarter boosted by weak prior year comparatives due to the Omicron strain. Actions taken to make Greggs' products available in more channels and at more times of day have continued to grow the frequency of customer visits.

At the forefront of the food-on-the-go movement, Greggs has gorged itself on market share by continuing to offer hungry consumers exceptional value food and drink on-the-go and moving beyond its core offering of pasties and sausage rolls.

Present-day Greggs sells everything from fresh sandwiches and savouries to affordable coffees, breakfasts and confectionery to pizza slices and chicken goujons and has moved with the times to

offer healthier options including gluten-free, vegan-friendly and lower calorie products including the now-iconic vegan sausage roll.

The retailer has also expanded its evening trade, successfully developed its digital channels and fostered great customer loyalty with the Greggs App. As of 1 July 2023, Greggs had 2,378 shops trading of which 466 are franchised and has big ambitions to have significantly more than 3,000 shops, which are a key volume growth driver.

'Our confidence in this opportunity is underpinned by recent success in catchments where Greggs is underrepresented such as retail parks, railway stations, airports, roadsides and supermarkets,' insists the company. 'We now have shops trading in **Tesco (TSCO)**, Asda and **Sainsbury's (SBRY)** supermarkets, with plans for further development.'

STEP TWO

HOW PROFITABLE ARE SALES?

Pre-tax profit and operating margin

Year	Profit before tax (£m)	Greggs operating margin
2022	148.3	10.2%
2021	145.6	12.5%
2020	-13.7	n/a
2019	114.2	9.8%
2018	89.8	8.7%
2017	81.8	8.6%
2016	80.3	9.0%
2015	73.0	8.7%
2014	58.3	7.2%
2013	41.3	5.4%

Table: Shares magazine • Source: Annual reports, company accounts, Greggs' preliminary results



Richard Hutton informed *Shares* in an [exclusive interview](#) in late 2022: 'We make the majority of the things that we sell ourselves. We don't have to negotiate with a supplier for the price of the products and we have the benefit of being a growing business.'

Opening more shops creates even greater demand for the products Greggs makes and enables its bakeries and manufacturing facilities to stay busy. The busier a factory, the more efficient it is and that helps keep prices as low as possible.

STEP THREE

HOW MUCH PROFIT CONVERTS INTO CASH?

Greggs EPS and free cash flow per share compared

(p)

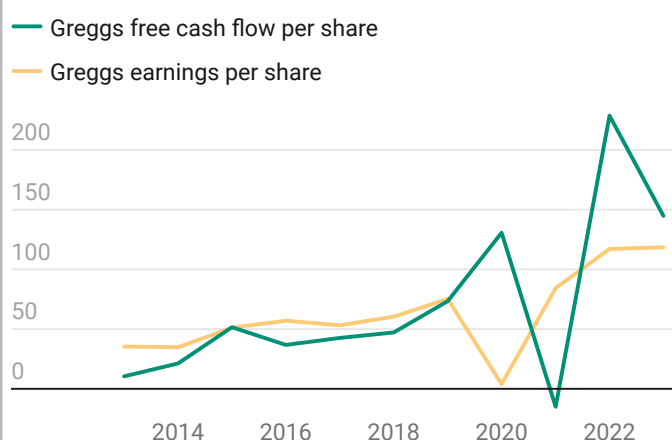


Chart: Shares magazine • Source: Refinitiv

Greggs' cash generative business model and robust balance sheet mean it has been able to fund its expansion and pay progressive and periodic special dividends to shareholders down the years.



But the key question is how profitable are Greggs' growing sales? The next metric to scrutinise is the long-run growth (or not) in pre-tax profit, a measure of the food retailer's absolute performance. As the table shows, pre-tax profits have surged from around £40 million in 2013 to the best part of £150 million last year, with Greggs' profitable growth trajectory only interrupted by the unprecedented disruption to trading caused by the pandemic.

Another key metric investors are wise to monitor is operating margin, calculated by dividing operating profit by sales and expressed as a percentage. The operating margin illustrates how much profit a company makes on each pound of sales after an array of distribution and selling costs and admin expenses but before interest and tax.

For Greggs, these costs will include everything from manufacturing and logistics costs to its shop leases and the costs of wages, food and packaging commodities. Operating margin has been maintained in high single digits over the past decade at Greggs, well ahead of rival food purveyors such as the supermarkets, in the face of rising wage, energy and ingredient costs. Greggs' 'return on sales' even crept into double digits in 2021 and 2022.

The food-to-go group's vertically integrated business model has helped to support this long-run record of profitable growth. As finance director

As the chart shows, pandemic disruption aside, Greggs has been consistently good at converting its earnings per share into copious amounts of the cash flow that is the lifeblood of any business. This cash supports its progressive dividend policy, which targets a full year ordinary dividend that is around two times covered by underlying earnings. In normal circumstances, Greggs also aims to maintain a year-end net cash position of around £50 million to allow for working capital cycle seasonality and to protect the interests of creditors.

The company says its cash position will normalise in future years as it deploys resources to support its ambitious growth plans. At the half year stage, Greggs explained that it continues to carry 'a higher-than-normal cash position in order to self-fund the multi-year investment in our significant growth programme,' having closed the period with a cash balance of £138.6 million.

STEP FOUR ALLOCATION OF CAPITAL

Greggs return on capital employed (ROCE)

2022	21.0%
2021	23.0%
2020	20.0%
2019	20.0%
2018	27.4%
2017	26.9%
2016	28.1%
2015	26.8%
2014	22.4%
2013	16.4%

2020 figure before exceptional costs

Table: Shares magazine • Source: Annual reports, preliminary results



It may seem as though Greggs' iconic blue and yellow store signs are ubiquitous in the UK, but the food retailer's share of a fragmented food-on-the-go market remains modest and Greggs remains very much in growth mode. As such, it is allocating capital to new store openings and refurbishments while investing in supply chain capacity to support management's big growth ambitions.

Greggs has told investors that the level of capital expenditure will increase in coming years. In 2023 it is expected to be roughly £200 million and remain around that annual level through 2024 and 2025 as the retailer invests to increase capacity in its supply chain.

A key metric to keep on top of is return on capital employed (ROCE), which is calculated by dividing profit before tax by the average total assets less current liabilities for the year. ROCE is an indicator of efficiency since it measures a company's profitability after factoring in the capital used to achieve that profitability. Managing return on capital well is an important discipline for long-serving numbers man Hutton, allowing him to measure the return generated on capital invested in factories, new shops and store refurbishments. As the table shows, Greggs typically generates a ROCE comfortably north of 20%, edging towards the 30% mark in good years, which is well above that generated by rival food retailers.



GREGGS: A SNAPSHOT

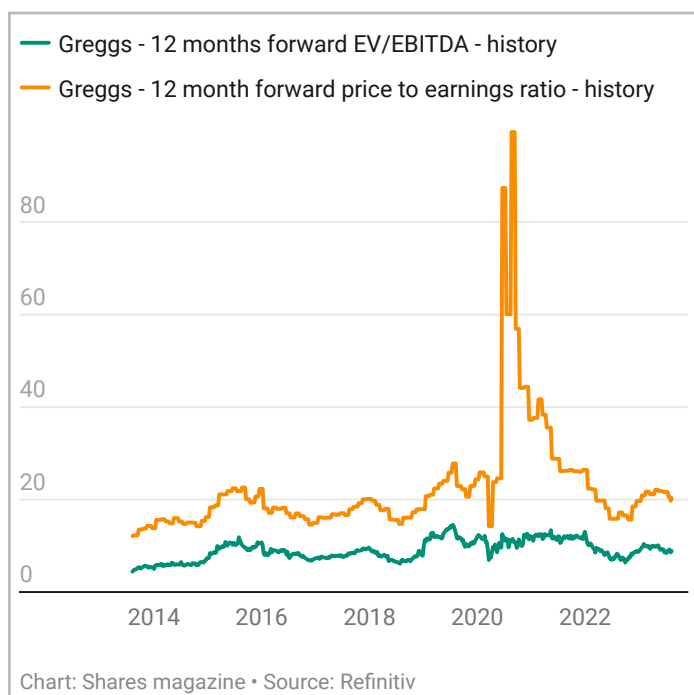
GREGGS (GRG)

Share price: £25.94

Market cap: £2.68 billion

STEP FIVE

VALUATION & INVESTMENT CASE



estimate for 2024. This rating is slightly below the 10-year average of 22.2 (a number inflated by a period when earnings were affected by the pandemic and the PE moved out to extreme levels). The progressive dividend payer also offers a 2.3% yield based on Shore Capital's forecasts for a 60.3p dividend this year rising to 67.3p next.

Shares believes this premium rating is more than merited for long-term investors seeking a high-quality compounder and a resilient growth and income stock. Greggs' reliance on the embattled UK high street has been reduced over the years as it opens shops on roadsides and in retail parks, airports, train stations and within supermarkets, while its unwavering commitment to competitively-priced food and drink, which people always need when they are out of the home, gives the business defensive attributes.

Greggs has proven it is well-equipped to cope with inflationary pressures and offers a play on consumer downtrading. Even during the dark days of the global financial crisis of 2007 to 2009, the company's like-for-like sales remained modestly positive, which was no mean feat.

At £25.94, Greggs' shares aren't cheap, trading on 21.5 times Shore Capital's 120.7p earnings per share forecast for 2023 and a PE (price to earnings) ratio of 19.3 times based on the broker's 134.5p



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



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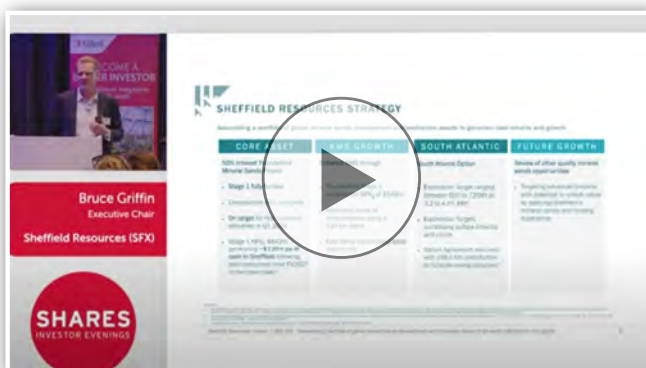
Aurora Investment Trust (ARR) Daniel Carter, Research Analyst

Aurora Investment Trust aims to be long-term value investors, known for the depth of their research. The Trust runs a concentrated portfolio, typically holding between just 12 and 20 investments, predominantly listed in London.



Invesco Bond Income Plus Limited Rhys Davies, Fund Manager and Senior Credit Analyst

In this video interview, Rhys Davies discusses his sector expertise, how he manages the investment company Invesco Bond Income Plus Limited (BIPS) and what features he looks for when generating ideas and income for the BIPS portfolio.



Sheffield Resources (SFX) Bruce Griffin, Executive Chair

Sheffield Resources is assembling a portfolio of mineral sands development and production assets. The core asset is Sheffield's 50% interest in the Thunderbird project in which is fully funded with construction over 80% complete and less than 12 months from first production.

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Watch out: Chinese real estate worries are stalking the market once again

It is worth maintaining perspective but also being alive to the risks which are bubbling up

How worried should you be about Chinese property developer Country Garden suspending trading in some bonds and potentially defaulting on payments?

To many investors the fortunes of a single real estate firm on the other side of the world might not seem that material. However, Country Garden's woes are reflective of wider issues and we have been here before with China's property market.

Eight years ago, in August 2015, at least some of the seeds of a currency and stock market crisis in the world's second largest economy, which led to widespread selling of equities across the globe, could be found in the real estate space.

To quote an oft-used phrase – history does not repeat itself, but it can rhyme – and the sharp increase in interest rates in the last 18 months or so has already created stress in the financial system, evidenced in the collapse of Silicon Valley Bank this March.

We cannot rule out further episodes and as David Jane, multi-asset manager at Premier Miton Investors, observes it could be hard to see these coming. He says: 'A further credit event, by its very nature, will be unpredictable, those with terminal financial issues do not tend to highlight the fact. We can point the finger at a number of areas of concern, such as the US commercial property market and that market's impact on the US regional banks.

'Lending to the Chinese residential developers is another obvious example. The reality is these things tend to creep up and then spiral out of control. Certainly, a further credit event is a possibility, conditions are tight, areas of the US economy are weakening and internationally, particularly in Japan, central banks seem much less in control than the past.

'The major difference from the 2008 crisis is

Problems in Chinese real estate have heralded trouble for global stocks in the past

Rebased to 100

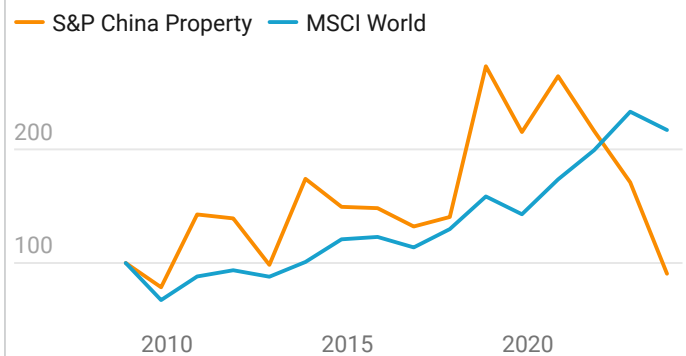


Chart: Shares magazine • Source: Refinitiv

that not only is private sector indebtedness higher, government borrowing and deficits are already very extended. The potential for a meltdown is there, but that does not make it certain or even likely. We have to be prepared to act appropriately if things materialise.'

This is a relatively gloomy take, as another difference from 2008 is big banks in the West are better capitalised than they were, but it is worth investors being aware of the risks. These can be exacerbated during the summer when trading volumes are lower as people take their annual break and a spate of selling can have an outsized impact.

If there is a period of volatility then it is important not to overreact. In the same way as you should not get carried away by market hype, you should not be swayed by market panic. So long as you have time on your side, you should stick to your long-term investment goals and try and block out the day-to-day noise.

Remember, if you sell when the market is falling you could miss out on any recovery when it comes and several studies have shown that some of the stock market's very best days come when it is rebounding after a sell-off.

Lessons from a decade of AIM shares being allowed in an ISA



There are tax advantages and some names have performed exceptionally well but you must tread carefully

It's now 10 years since the government allowed AIM shares to be held in a stocks and shares ISA, opening the door to investors protecting themselves not just from income and capital gains tax, but from inheritance tax too.

That's because many AIM companies, though not all, are free from inheritance tax (IHT) if held for two years or more, under business property relief rules that are designed to encourage entrepreneurship and investment in small companies. Tax reliefs are not to be sniffed at, but using AIM stocks to mitigate inheritance tax is a strategy that needs to be handled with care, whether it's used inside or outside an ISA.

WHAT IS AIM?

AIM is the London Stock Exchange's junior market. It doesn't have as stringent rules on listing or reporting as the main market, which leaves investors vulnerable to a greater risk that companies can provide misleading statements. It's notable that one of the most infamous accounting blunders of recent years took place at Patisserie Valerie, which was listed on the AIM market. These events are still thankfully rare, but lower levels of scrutiny and regulation on the AIM market should give investors some pause for thought.

London's junior market is also home to smaller, early stage companies, which makes them exciting and dangerous in equal measure. The market capitalisation of the average AIM stock is just £27 million, which compared to an average of £233 million amongst the constituents of the FTSE Small Cap Index of small companies listed on the main market.

That said, there are around 200 companies with a market cap of more than £100 million on AIM, roughly the size which would get them into the FTSE Small Cap index if they were on the main market, so it's possible to put together a portfolio of stocks that are simply small, rather than microscopic.

PERFORMANCE HAS BEEN MIXED

As a whole, the AIM market hasn't been a consistently good performer either. Looking at the last 10 years, the AIM 100 index of the 100 biggest stocks on the AIM market has returned just 21%, compared to 102% from the FTSE Small Cap index, based on Morningstar data. That means £10,000 invested in the AIM 100 index would now be worth £12,100, compared to £20,200 from the FTSE Small Cap index.

That's just one snapshot in time, and there are periods over which AIM has performed better, but investors do need to give some thought to whether superior returns elsewhere might offset some or all the inheritance tax benefits of investing in AIM, especially in light of its elevated risk profile.

AB Dynamics

(p)



Chart: Shares magazine • Source: Refinitiv

Experienced investors may be willing to take on these tasks themselves, though many will still be tempted to leave this to a professional manager. There are several smaller companies funds which invest in AIM, but these don't benefit from the IHT relief. That's because investors must hold AIM stocks directly to qualify.

There are several fund management firms out there who offer AIM portfolios which are professionally managed, with each stock held in the investors own name rather than through a fund. This means they qualify for protection from IHT, though as you might expect this is a much more costly service, often in the region of 2% per annum, with initial charges levied to boot. Investors therefore need to consider the extent to which additional costs are going to eat into their IHT benefits over time.



Like any market there have been some fantastic performers within AIM over the last 10 years. Looking at some of the better-known names on the market, the share price of automotive engineer **AB Dynamics (ABDP:AIM)** is up 1,570% over the last decade, public opinion and data outfit **YouGov (YOU:AIM)** has increased by 1,330% and airline and travel operator **Jet2 (JET2:AIM)** is up 322%, according to SharePad data.

But at the other end of the scale there are companies which have lost investors most, if not all of their money. So, AIM is definitely a market to approach with a line and rod rather than a trawling net. You also need to remain vigilant for companies graduating to the main market, in which case the IHT protection expires unless you switch to another qualifying AIM stock before this happens.

TAX RELIEF CAN BE TRICKY

The tax relief itself is also somewhat problematic. Partly that's because the IHT rules say AIM companies qualify provided they don't mainly deal in shares or land, but HMRC doesn't provide a definitive list, so there's always that nagging feeling of doubt. Investors should also consider the potential for the IHT relief to be withdrawn, especially in tough financial times and with a new government potentially waiting in the wings.

Withdrawal of tax protection would leave AIM investors potentially facing a double whammy of losing their IHT protection and seeing their portfolio value sink at the same time. That's because any such tax move would likely see big withdrawals being made from the AIM market. There's no suggestion that politicians of any stripe are considering this, but investors should be alive to this possibility, however remote.

Overall then, the ability to hold AIM stocks in an ISA offers investors one way to manage their inheritance tax liability as well as reducing the income and capital gains tax they pay, but you do have to tread carefully as there are plenty of risks and pitfalls.



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

Why investors in US shares may have to lower their growth expectations

It may be hard to justify the market's lofty valuations for much longer

With investors' attention fixed on inflation and interest rates an economist at the US Federal Reserve argues investors should prepare themselves for a sharp drop in net income growth over coming decades.

A new research paper by Michael Smolyansky based on data from *Compustat* shows that net income has grown at 3.8% a year, roughly double the 2% rate of operating earnings growth over the last 30 years.

For the uninitiated, net income is calculated after deducting interest expenses and taxes from operating profit.

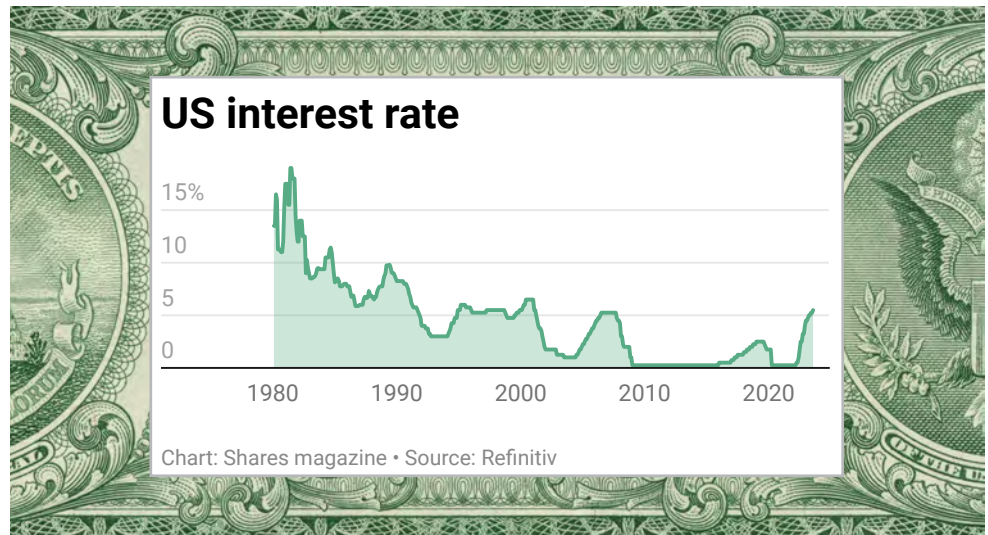
Smolyansky points out that interest expenses and taxes have declined precipitously as a share of operating income from 54% in 1989 to just 27% in 2019. The economist makes the case that the 'Golden Era' is unlikely to be repeated over the next 30 years.

The implication is that net profit growth could halve over the coming decades moving back towards the long-term operating income growth average of 2%.

The big decline in official interest rates since the 1980s has coincided with a commensurate fall in corporate borrowing costs. The aggregate corporate rate of interest expense has fallen from 12% in 1982 to around 3% according to *Compustat*.

With inflation proving stickier than the Fed would like, current 10-year treasury yields of around 4% could remain elevated for some time.

Economist Mohamad A. El-Erian argues that structural changes to global supply chains brought about by the pandemic and the war in Ukraine imply higher core inflation as global businesses build-in more operational flexibility and costs. This



would imply higher interest rates.

Corporate tax rates averaged 44% between 1962 and 1982. By the end of Ronald Reagan's second term as President in 1989 the effective rate of corporate tax had declined by 10% to 34%.

Passing of the Jobs Cuts and Tax Act of 2017 saw the rate decline further from 23% to 15% in 2019 which may prove a floor argues Smolyansky.

The Inflation Reduction Act of 2022 made 15% a minimum while a huge increase in the US deficit over the last three years means Congress is unlikely to approve further debt-funded tax cuts.

Supporting the argument, credit rating agency Fitch downgraded the US sovereign credit rating from triple A on 2 August.

The bottom line is that investors have become accustomed to a rate of net income growth which looks extremely difficult to repeat. Meanwhile the trailing PE (price to earnings) ratio for the S&P 500 excluding financials doubled between 1989, when it stood at 11.8 times, to 20.3 times by 2019 and is even more elevated today.



By **Martin Gamble** Education Editor



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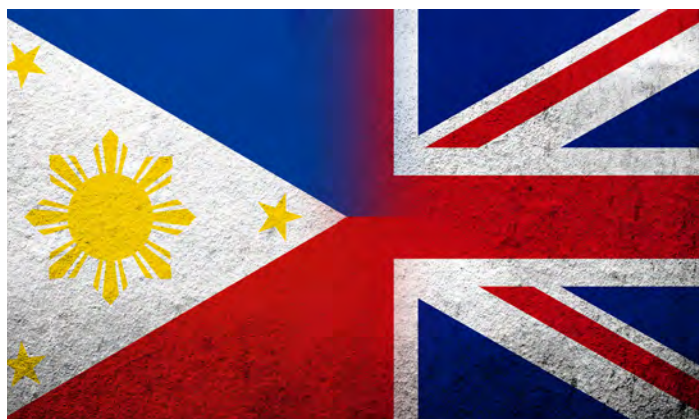
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Why do ex-pats in some countries see their state pension frozen when others don't?

Reader queries why the situation in neighbouring states the Philippines and Thailand is different

British people who retire to the Philippines will receive annual state pension increases as per retirees living in the UK. However, retire next door in Thailand and it is frozen for life from the date you moved there. There is a completely unfathomable list of countries that fall into each category.

Why is this please and what determines which country slots in where?

Simon



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

Retiring abroad is a dream for lots of people. If you are considering finding a place in the sun for your later years, it's important to think carefully about the implications for your finances, including your state pension.

Provided you have a sufficient National Insurance

(NI) contribution record to qualify for the state pension, if you move abroad you can continue to receive the benefit. As a reminder, to qualify for the full state pension, you need a 35-year NI record, and to qualify for at least some state pension, albeit a reduced amount, you need a 10-year NI record. You can choose to have your state pension paid into a UK bank account or a bank account in the country you are living in.

Whether or not your state pension continues to increase in line with the so-called 'triple-lock' – which guarantees it rises by the highest of average earnings, inflation or 2.5% – will depend on the country you move to. This is a major consideration as over the course of someone's retirement the impact of having your state pension frozen could be substantial.

The state pension will only increase each year if you retire to a country in the European Economic Area, Gibraltar, Switzerland and countries that have a social security agreement with the UK. For example, if you move to the US, your state pension will increase, but if you retire across the border in Canada, it won't.

Equally, as you say, if you retire to the Philippines, which also has a social security deal with the UK, your state pension increases should be protected, whereas if you move to Thailand, which doesn't have a similar agreement, they won't be.

You can get a full [list](#) of countries where your state pension will increase.

In terms of 'why', successive governments have justified the state pension freeze by saying they prefer to focus resources on retirees that remain in the UK. UK pensions minister Guy Opperman [responded](#) to a question on the subject in Parliament in 2018.

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.

Main Market

Abdrn 8



AG Barr 12

Burberry 7

Dunelm 6

Frasers 7



Greggs 30

Howden 6

Marks & Spencer 6

Moonpig 6

Next 6

Pod Point 9

RELX 21

Sainsbury's 31

Secure Trust Bank 13

Smith & Nephew 26

St James's Place 8

Ten Entertainment 6

Tesco 31

Unilever 30

UP Global Sourcing 6

Watches of Switzerland 7

Whitbread 6

Wood Group 10

AIM

AB Dynamics 38

Angling Direct 6

EMIS 14



Jet2 38

YouGov 38

Overseas shares

Capri 7

Eli Lilly 9

Hermes 7

Kering 7

L'Oreal 20



LVMH 7, 20

Microsoft 20, 30

Novo-Nordisk 20

Nvidia 11

Philip Morris International 20

Richemont 7

Tapestry 7

UnitedHealth 14



Investment Trusts

City of London 21

JP Morgan Growth & Income 21

Scottish Mortgage 21

Funds

Fidelity American 8

Fundsmith Equity 20

Lindsell Train Global Equity 20

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