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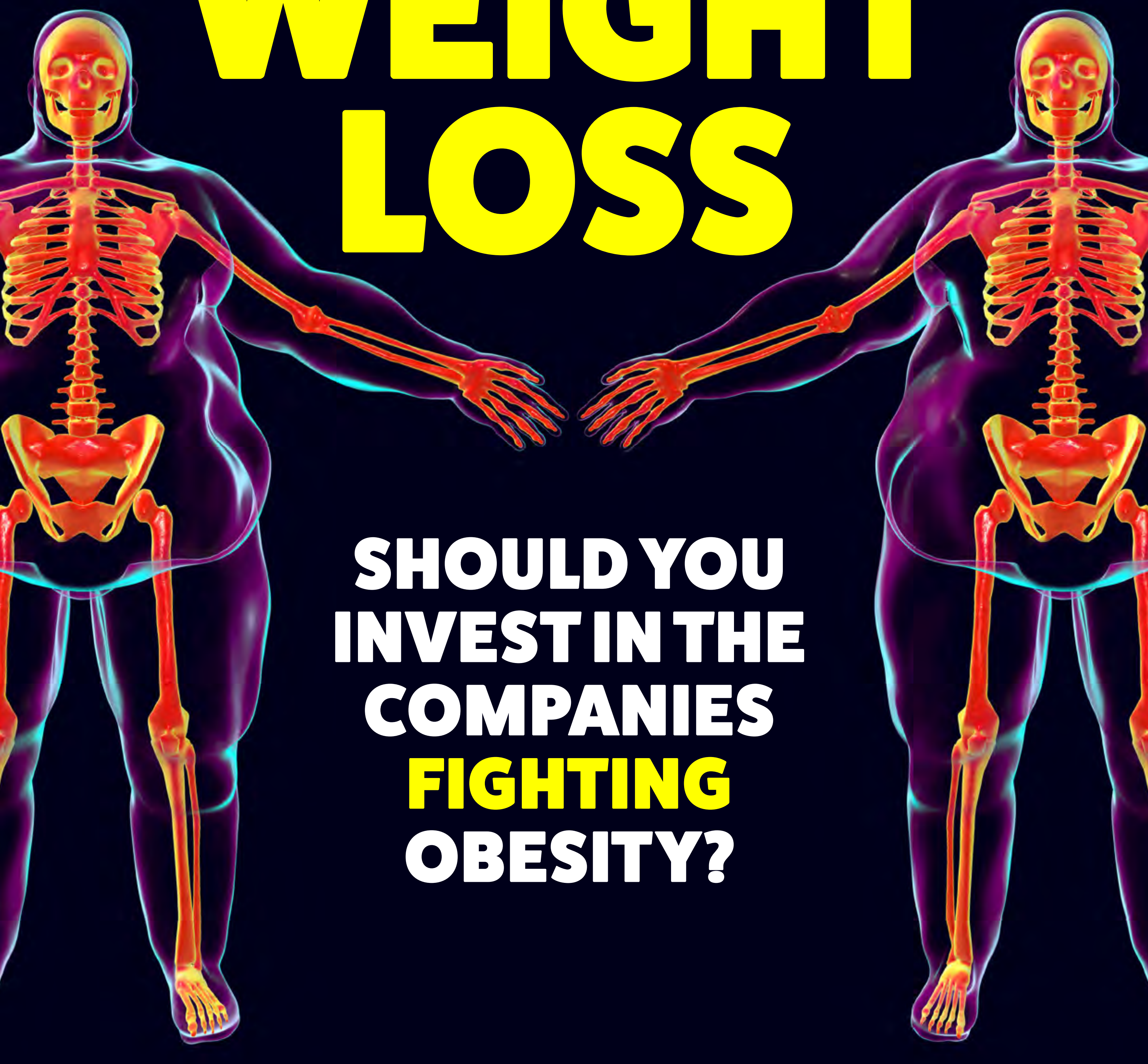

WEIGHT LOSS

SHOULD YOU INVEST IN THE COMPANIES FIGHTING OBESITY?

Investment trusts Actions being taken to address wide discounts

INVESTMENT TRUSTS

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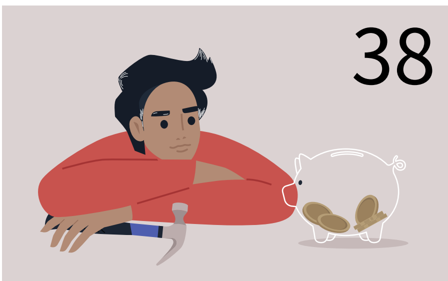


Three important things in this week's magazine

1

Advertising agencies have been fruitful places to make money, but you need to time it right.

The sector is currently going through a bad patch amid an uncertain economic outlook.

2

Investment trusts are busy trying to narrow wide discounts to net asset value.

Investors might want to view this as an opportunity to buy in hope that discounts become less severe.

3

Excitement regarding weight-loss drugs has driven up shares in various pharma stocks.

The outlook for their earnings growth is compelling but equity valuations look rich.

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:

Investors cheer Mondi's €775 million Russian sale and cash return

Directors deals: Fevertree director takes advantage of dip in share price to buy nearly £130,000 of shares

Games Workshop tops mid cap leaderboard after stronger than expected earnings

Trainline shares steam higher on faster growth and maiden share buyback

TSMC spooks chip industry with slowdown threat

Warning overshadows successful ARM IPO in New York

Global microchip stocks from **Nvidia (NVDA:NASDAQ)** to **ASML (ASML:AMS)** have been under stiff selling pressure after a *Reuters* report said that Taiwan's **TSMC (2330:TPE)**, the world's largest contract chipmaker, had asked its suppliers to delay deliveries amid concerns over slowing demand.

The report follows a warning by TSMC during its second-quarter earnings (20 Jul) where chief executive CC Wei warned that a boom in artificial intelligence development was unlikely to offset a broader, cyclical slowdown in the industry.

TSMC's Taiwan-listed shares drifted around 3% lower. Memory chip makers **SK Hynix (000660:KS)** and **Samsung Electronics (005930:KS)** lost more than 2% each.

According to the report, TSMC told investors to expect full-year sales to drop by as much as 10%, with capital expenditure increases contributing to tighter margins. It is also reported to have told its major advanced chip equipment supplier ASML to delay deliveries.

Goldman Sachs predicts flat revenue for TSMC in 2023, maintaining forecasts at $31.6 billion but the investment bank does predict a deeper drop in 2024 than previously anticipated. Goldman Sachs now estimates 2024 revenues of $25 billion, down from $28 billion previously.

A tougher 2024 will also hit wafer output, with Goldman Sachs saying that the most advanced 3nm (three nanometres) wafer capacity utilisation rate is expected to witness a significant drop as well.

TSMC is in the race with other contract manufacturers like Samsung, and US pair **Globalfoundries (GFS:NASDAQ)** and **Intel (INTC:NASDAQ)** to be the dominant supplier of chips, particularly for valuable clients like Nvidia, which has emerged as the chip technology leader in designing AI chips.

An emerging slowdown for microchips has taken some of the shine off an encouraging spell for the industry in the wake of chip architecture firm **ARM's (ARM:NASDAQ)** successful IPO (initial public offering) this month when the shares popped 25% on day one of trading.

The listing was 12-times oversubscribed, according to reports, as investors chased a limited rough 10% share sale in the company that remains controlled by Japan's **Softbank (9984:TYO)**. That saw the stock listed at the top of its $47 to $51 range, valuing the business at approximately $54 billion.

Despite drifting back from intra-day $67 peaks, at $58 ARM shares remain nearly 14% above their IPO price at the time of writing.

According to forecasts published by LSEG, ARM is expected to achieve $0.96 earnings per share for the year to March 2024, putting its shares on 60 times forward earnings.

ARM's earnings per share is expected to hit $1.22 in the year to March 2025 and $1.44 the year after. [SF]

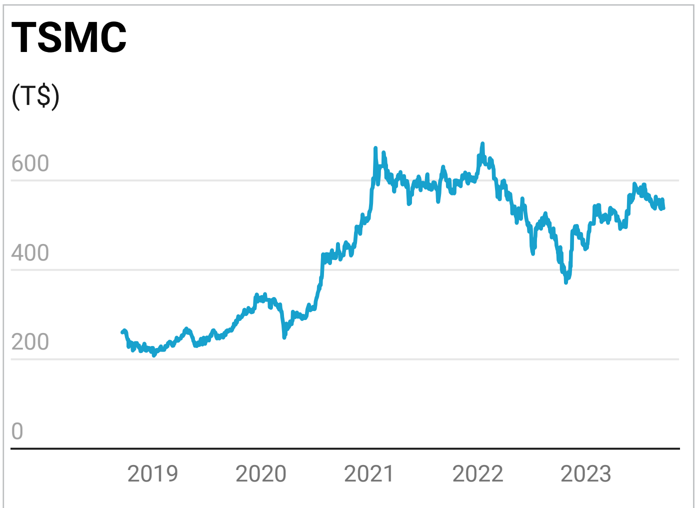


Chart: Shares magazine • Source: LSEG

Frasers could be the key to Shein becoming a bigger player in the UK

Reports suggests the Chinese retailer wants to buy Missguided from the Sports Direct owner

FTSE 100 retail group **Frasers (FRAS)** is in talks to sell Missguided to China's Shein, according to reports. Such a move could have significant implications for the UK retail industry.

It could see the Chinese group become a much bigger player in this country and potentially kick-start a new wave of takeovers in the sector as companies join forces to fight off the heightened competition.

Shein was founded in October 2008 in China by entrepreneur Chris Xu. The company is thought to be worth $66 billion, and according to analysts at Shore Capital has been 'on an aggressive M&A trajectory, aiming to augment its global footprint and diversify its revenue streams.'

It has grown rapidly and has become a fierce competitor to the likes of **Boohoo (BOO:AIM)** and **ASOS (ASC)**, selling clothes very cheaply and shipping them to the UK from China.

Frasers bought Missguided out of administration in June 2022 for £20 million. Selling the business to Shein may not be a simple asset disposal. Analysts speculate the deal could form more of a partnership, with Frasers' stores potentially acting as a place where Shein customers can return goods. Frasers might also be able to sell its products on Shein's platform.

Shein has already forged such a partnership with US low-cost fashion retailer Forever 21. The latter is set to use its American stores to sell Shein merchandise and handle returns, while also listing its products on Shein's platform. Forever 21's parent company Sparc last month said it would become a minority shareholder in Shein. In turn, the Chinese group is taking a one-third stake in Sparc.

'A potential partnership with global online retail player Shein could represent a transformational milestone for Frasers, which is already undergoing a significant strategic elevation and implementation of its credit offerings,' say analysts at Shore Capital.

> **"The fast fashion market is very lucrative, estimated to be worth $123 billion in 2023 and set to grow to nearly $185 billion by 2027"**

The fast fashion market is very lucrative, estimated to be worth $123 billion in 2023 and set to grow to nearly $185 billion by 2027. However, it is also very competitive, which means the leading players might want to consolidate to have economies of scale.

'The (Frasers/Shine) transaction could position Boohoo and ASOS as potential M&A targets, as competitors may explore similar strategic partnerships or acquisitions. This scenario becomes particularly plausible if Shein deploys its considerable financial and operational resources to rejuvenate and scale the Missguided brand,' says Eleonora Dani at Shore Capital. Frasers currently owns 10.4% of Boohoo and 10.6% of ASOS. [SG]

Drax shares tank on fears over new report on UK Government biomass strategy

The NAO is expected to look at how support measures have been funded

Renewable energy supplier **Drax (DRX)** came under pressure on 15 September following news that the National Audit Office will issue a report on the Government's biomass strategy, including analysis of how support had been funded and implemented.

Drax argues burning wood pellets is a sustainable source of renewable energy, but not everyone agrees. Critics highlight subsidies Drax received for burning biomass totalled £617 million in 2022 according to think-tank Ember.

> **"Subsidies Drax received for burning biomass totalled £617 million in 2022 according to think-tank Ember"**

Its shares were the biggest faller in the FTSE 250 index losing just over at tenth to 497.6p and marking their lowest point since October 2022. The shares then bounced 2% on 18 September after analysts said the fall was overdone.

The Government last month laid out its biomass strategy – biomass is defined as any material of biological origin – and its potential role in achieving net zero by 2050. It said: 'We will continue to monitor the levels of biomass supply to ensure the UK can secure the necessary supply for increasing biomass use across the economy and we will consider interventions to remove barriers to increasing biomass supply if necessary.'

The Government added: 'Based on current analysis, the strategy sets out that biomass uses that can produce negative emissions (i.e., those that capture and store CO2) should be prioritised in the long term to support UK's net zero target.'

Drax has spearheaded the UK's energy transition over the last few years after repurposing its power station at Selby, Yorkshire to burn wood pellets (biomass) instead of coal to generate electricity.

The firm also generates power from hydroelectricity assets and pumped storage. The latter works like a giant battery produced by two reservoirs which sit between a hanging valley.

The company also has plans to transform the Selby power station into the world's largest BECCS (bioenergy carbon capture and storage) project aimed at capturing 8 million tonnes of CO2 a year by 2030.

It is building transportation facilities to carry the gas into storage facilities under the North Sea, permanently removing it from the atmosphere.

Shares in Drax sank last October thanks to a *Panorama* investigation which cast doubt on whether the wood pellets it makes in Canada were from a sustainable source.

Analyst Adam Forsyth from Longspur Capital sees the NAO's forthcoming report as a 'normal response' to policy announcements. Furthermore, he notes the report follows the announcement on 15 September of a NAO report into 'Approaches to Achieving Net Zero Across the UK.'

He says: 'We think that Drax's BECCS solution is really the only near-term solution at scale that can create negative emissions and overcome the problem of areas that cannot be decarbonised. This is the Net in the UK's Net Zero target. These reports are commonplace and seldom impact policy timing.' [MG]

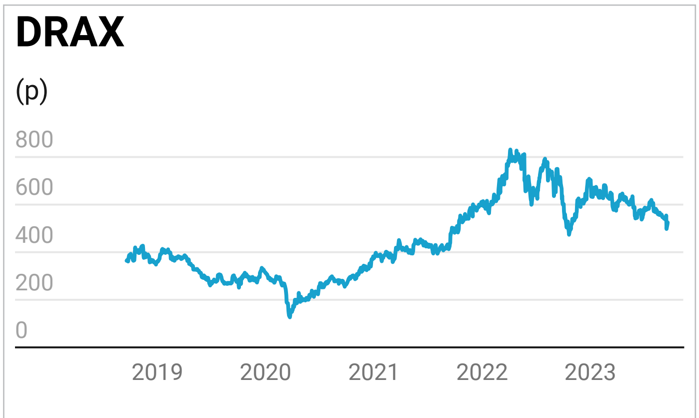
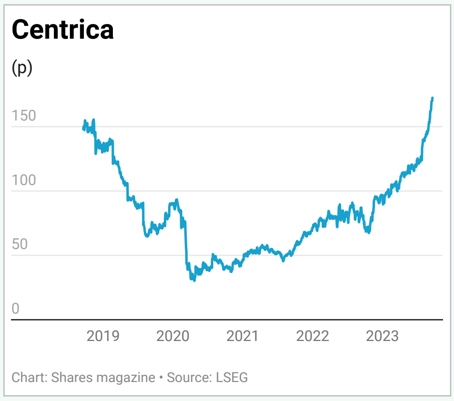


Chart: Shares magazine • Source: LSEG

Centrica share price rally has been 'meteoric', up 420% since 2020

Moving HIGHER

There is no sign of a slowdown judging by how investors continue to bid up the stock



Shares in British Gas owner **Centrica (CNA)** have risen by 150% in value since October 2022. Those gains increase to 420% if you go back to April 2020.

'Centrica's share price recovery since Covid lows has been meteoric, as the company successfully navigated volatile market conditions, culminating in increased buybacks and dividend growth,' says Berenberg analyst Marc Ip Tat Kuen.

While impressive, the strong gains should be seen against a miserable longer-term backdrop for shareholders which saw the shares sink from around 400p a decade ago to lows of around 33p as the pandemic struck. Now trading at 172p, they still have a long way to go to return to those giddy heights.

Strong energy prices have played their part in Centrica's revival with analysts finding it hard to keep pace. For instance, earnings forecasts have doubled over the last year according to LSEG data.

In the first half of 2023 operating profit surged to a record £969 million from £98 million last year but the company is clear this level of profit will not be sustained longer term. [MG]

Bakkavor shares remain in the doldrums after workers vote to strike

The company is trying to protect profits after a difficult time but workers are not happy

DOWN in the dumps

Shares in **Bakkavor (BAKK)** are trading 20% lower than their February year-to-date high, with strike action being the latest issue to worry investors.

Production staff in its London pizza factory have voted to down tools in a dispute over pay. This could affect supplies for big name clients including **Sainsbury's (SBRY)**, **Tesco (TSCO)** and Waitrose.

Bakkavor was hit by a slowdown last year in the UK fresh prepared food market, compounding existing cost pressures including the rising price of raw materials and higher wages. It subsequently announced a plan to restructure the business to protect profits including the closure of two factories.

A trading update in January was well received by the market, with revenue growth driven by price hikes in the UK and strong volume growth in the US. This triggered a short-lived share price rally, but the stock has been weak for most of 2023.

Half-year results on 6 September included an upgrade to its full-year earnings guidance but it wasn't enough to lift the share price out of its rut. [SG]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

September 22: Stranger Holdings
September 25: Wilmington
September 26: Close Brothers, Finsbury Food, Newmark Security, Origin Enterprises, PZ Cussons, Time Finance
September 27: Avingtrans
September 28: Hansard Global

HALF-YEAR RESULTS

September 22: First Tin
September 25: Alphawave IP, Aurrigo International, IQGEO, Ondine Biomedical, Venture Life
September 26: Alliance Pharma, Animalcare, Cambridge Cognition, Card Factory, Diaceutics, DigitalBox, EKF Diagnostics, Ergomed, Lifesafe, The Mission, Mortgage Advice Bureau, Next 15, Niox, Tinybuild, Yu Group
September 27: Amicorp, Arix Bioscience, Biome Technologies, BioPharma Credit, Everyman Media, Pantheon Infrastructure, Pendragon, Pennant International, Plant Health Care, Safestyle, Skillcast, Xeros Technology
September 28: Avacta, Ceres Power, Novacyt, Phoenix, RBG, Shield Therapeutics, Trellus, Trinity Exploration & Production, XLMedia

PZ Cussons is under pressure to justify Nigerian deal as results loom

Ability to compete with cheaper supermarket own-brand products will be in the spotlight too

Full-year results to be published on 26 September from consumer goods firm **PZ Cussons (PZC)** come hot on the heels of the company's announcement that it plans to take full control of its Nigerian business.

This decision may come under some scrutiny as the impact of the devaluation of the Nigerian naira could well mar the upcoming numbers. Volatility in the currency and the country itself has been a regular source of profit warnings from the business.

Shore Capital analyst Darren Shirley says the proposed acquisition makes strategic and financial sense, yet the price paid raised some eyebrows.

The company has offered £23 million in cash to acquire the 26.7% of PZ Cussons Nigeria it doesn't already own, representing a 20% premium to the undisturbed price.

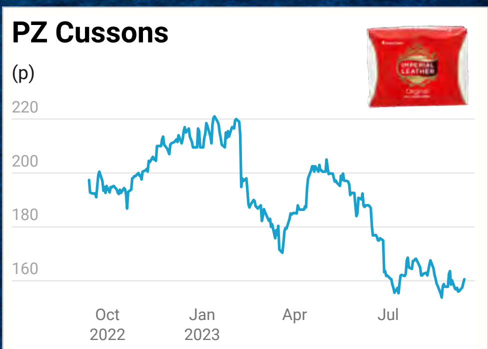


Chart: Shares magazine • Source: LSEG

What the market expects of PZ Cussons

	EPS (p)	Revenue (£m)
Forecast for May 2023	10.6	655.00
Forecast for May 2024	10.1	582.00

Table: Shares magazine • Source: Stockopedia

The Manchester-headquartered firm insisted the acquisition will 'significantly simplify and strengthen' its business in Nigeria, which has seen an improvement in profitability in recent years, putting in place 'a sustainable structure and platform to maximise long-term growth and value'.

Investor focus when the full-year results are published is also likely to fall on how PZ Cussons is balancing price and volume across a portfolio of brands which include Carex, Cussons Baby, Imperial Leather and Original Source. This is a conundrum facing much of its peer group, which in passing on higher costs to consumers have created an incentive to trade down to unbranded alternatives. [TS]

Results preview: a weak retail backdrop in the US could trip up Nike

The Portland firm has seen its share price fall nearly 20% so far in 2023

Trainers and sportswear giant **Nike (NKE:NYSE)** has endured a troubled 2023, hit by slowing consumer spending and difficulties in its key Chinese market. The shares are down nearly 20% year-to-date and to regain some air, the company needs to impress when it posts first-quarter earnings on 28 September.

Weak numbers from some of Nike's key retail partners in the US, including **Foot Locker (FL:NYSE)** and **Dick's Sporting Goods (DKS:NYSE)** mean the backdrop is less encouraging heading into this latest release, which covers the three months to 31 August.

On 28 June Nike posted its first miss against earnings expectations for the fourth quarter as margins took a hit. Earnings per share was marginally below forecasts but was notable given revenue was materially ahead of expectations at $12.8 billion. Pressure on profitability came as the company allocated more money to marketing and promotions as well as elevated product input and freight costs.

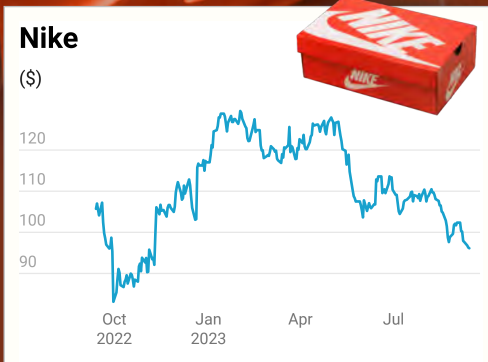


Chart: Shares magazine • Source: LSEG

One area which may be closely monitored and a potential bright spot for the company is its Jordan brand – formed through its partnership with legendary basketball player Michael Jordan. For the 12 months to 31 May 2023, the Jordan brand accounted for 12.9% of overall sales as it enjoys strong growth. [TS]

What the market expects of Nike

	EPS ($)	Revenue ($bn)
Q1	0.69	12.1

Table: Shares magazine • Source: Yahoo Finance

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

September 26: Cintas, Costco
September 27: Micron, Paychex
September 28: Accenture, CarMax, Carnival, Nike

Why the future looks brighter for Associated British Foods

The cut-price fashion-to-foods conglomerate has a positive outlook and broad-based growth appeal

Associated British Foods

(ABF) £20.63

Market value: £15.8 billion

Investors have not missed the boat with **Associated British Foods (ABF)** despite a 30% year-to-date share price rally. The diversified food, ingredients and retail conglomerate is churning out good news and we see further upside for the shares.

A broad-based growth business returning capital to shareholders through progressive dividends and buybacks, the group has passed through the worst of cost inflationary pressures. *Shares* sees a period of significant earnings growth ahead driven by margin recovery at its discount fast-fashion chain Primark and in groceries and sugar, as well as profit improvement in its ingredients business.

In its latest trading update (12 September), the £15.8 billion group nudged up operating profit guidance for the year to 16 September 2023 on the back of a better-than-expected performance from its global sugar production business, which the FTSE 100 firm expects to deliver a 'substantial improvement' in profitability in full year 2024.

Chart: Shares magazine • Source: LSEG

The Weston family-controlled conglomerate also provided a positive current year outlook for Primark, where the adjusted operating profit margin is expected to 'recover strongly' due to falling material costs, the weakening of the US dollar against the pound and euro, and lower freight costs.

The outlook for Primark remains favourable with the discount fashion chain continuing to take UK market share during the cost-of-living squeeze. Primark is opening new shops across Europe and the US and expanding its click and collect trial to include more products.

The resilient budget retail brand's sales for the year just-ended are expected to be around £9 billion, up 15% year-on-year with like-for-like growth of 9% driven by higher average selling prices, well received ranges and strongly performing new stores.

Elsewhere within the group, Associated British Foods expects its sugar arm to see improved profits in the current financial year aided by an improved sugar beet crop in the UK. The company also continues to see 'strong' sales growth in its food businesses, with international grocery brands such as Twinings, Ovaltine, Blue Dragon and Patak's continuing to perform well.

Liberum believes Primark is underappreciated by the market with an implied price to earnings valuation discount of circa 30% to its peers.

For the year to September 2024, the broker forecasts group earnings per share of 162p and a 54p dividend, rising to 180p and 59.9p respectively in 2025. On those 2025 estimates, the shares trade on a mere 11.5 times earnings and offer a near-3% yield. That looks great value for what is a well-run business with plenty of positive tailwinds. [JC]

Time to buy Auction Technology for your growth portfolio

Quality metrics inflecting higher as past acquisitions unwind

Auction Technology

(ATG) 666p

Market value: £808 million

Analysts believe there is substantial share price upside on the cards at **Auction Technology (ATG)**, the digital auction marketplace that is primed to post its first full year of profitable growth for the 12 months to 30 September 2023.

Consensus forecasts may have been trimmed this year, largely because of currency headwinds and the delayed launch of its atgPay feature, yet the anticipated £36.4 million net profit would still smash last year's £6 million loss, based on Stockopedia data.

FTSE 250 constituent Auction Technology runs an online platform that helps connect auctioneers with a global pool of bidders, including businesses and private collectors. The company operates across multiple marketplace brands, including The Saleroom, i-bidder, Proxibid and separate Bidspotter marketplaces in the US and UK.

A wide selection of goods is auctioned, including art and antiques, returned and surplus consumer product and industrial equipment, where there are large secondary markets for farm, manufacturing and other heavy industrial bits of kit.

Chart: Shares magazine • Source: LSEG

This is a market that was already being transformed by the internet, a switch that has been hastened by Covid. Auctions can be online-only or combined with a live auction. Auction Technology charges commission fees that range from 3% to 5% of the selling price struck on lots, plus a fee on vendors to place their stock on its marketplace.

Analysts see reasons to be optimistic, including more revenue coming from value-added services and the potential to drive more bidders on its platform via investments in search engine optimisation, text messages and other new marketing features, such as its payment processing platform atgPay, which has now launched across its Proxibid platform, which can combine with other pay services to make payments easier for buyers.

Although past company financials are muddied by previous acquisitions and a period under private equity ownership, more clarity from its figures this year and in the future should reveal the intrinsic value analysts believe exists within the business.

According to Numis, operating profit margins will exceed 40% this year and stay there as the company levers its powerful market position. This should help earnings growth outstrip sales progress in the high teens.

CFP SDL Free Spirit Fund (BYYQC27) holds Auction Technology in its portfolio, flagging an inflection point for return on equity that has been depressed by historical acquisition premiums paid. Fund manager Keith Ashworth-Lord expects this to unwind and start to inflect upwards given the very high incremental returns generated from organic growth and highly cash generative nature of the business. [IC]

Stick with Pendragon following pivot to becoming a tech stock

Radically transformed car retailer to remain listed as Pinewood, a SaaS business with superior financial characteristics to auto dealerships

Pendragon
(PDG) 23.65p

Gain to date: 46%

We highlighted automotive retailer **Pendragon's (PDG)** deep value appeal at 16.2p on 30 March 2023 with the shares weak after shareholder Hedin withdrew a takeover offer. We acknowledged the business faced near-term economic headwinds, but argued the downbeat outlook was more than priced in on a single digit multiple of forecast earnings.

WHAT'S HAPPENED SINCE WE SAID TO BUY?

The Nottingham-based car retailer's shares motored higher after the company announced a deal on 18 September that can only be described as a takeover with a twist. Pendragon is selling its low margin UK motor retail and leasing businesses to North American car retailer **Lithia (LAD:NYSE)** for £250 million.

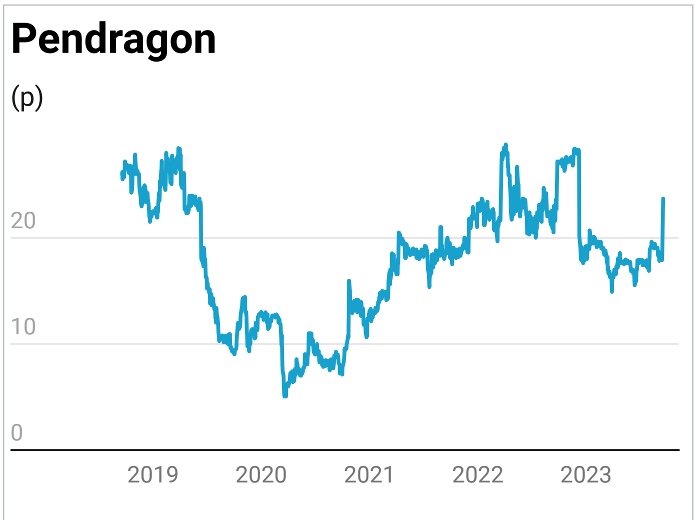


Chart: Shares magazine • Source: LSEG

Following the deal, Pendragon will remain listed and be renamed Pinewood Technologies, in which Lithia will make a £30 million subscription for a 16.6% stake. Crucially, Lithia is taking on Pendragon's debt and pension liabilities, which will leave the remaining company with a clean slate and sharp focus on Pinewood, the cloud-based dealer management software business within Pendragon which boasts compelling growth prospects.

The transaction includes a strategic partnership between the two companies focused on the rollout of Pinewood to Lithia's existing 50 UK sites and the creation of a joint venture to accelerate Pinewood's entry into a North American dealer management software market worth more than £2.6 billion per year.

WHAT SHOULD INVESTORS DO NOW?

Pendragon shareholders should receive aggregate shareholder value of 27.4p per share from this deal, a 48% premium to the closing price on 15 September, which includes a 16.5p per share or £240 million cash dividend from the disposal, a retained 83.3% ownership in Pinewood worth 10.3p per share and 0.6p per share relating to an indirect interest in the North American joint venture with Lithia.

We think it is worth sticking with the shares to see how things play out as a software as a service business with an accelerated growth plan led by Pendragon's current CEO Bill Berman. Around 90% of Pinewood's revenue is recurring and EBITDA margins are attractive at circa 60%. [JC]

Is the end in sight for Hipgnosis Songs Fund after years of misery for investors?

Keep your eyes peeled for the imminent continuation vote as plenty of shareholders are losing patience

Investing in **Hipgnosis Songs Fund (SONG)** was meant to have been a no-brainer. Sadly, that has been far from the truth.

The investment trust owns the rights to certain popular songs. It gets paid every time these songs are featured in a film, TV show or advert; played on the radio or in a public place or streamed.

By proactively finding ways to earn more money from the songs, Hipgnosis should have been able to deliver a growing stream of dividends and capital gains to shareholders. It's not worked out that way. The shares are trading below the price at which it joined the stock market five years ago and the dividend hasn't gone up since October 2020.

Corporate governance has been questionable ever since the trust floated, and investors yearn for more transparency over the acquisition of royalties and how extra money is being earned from owning them.

The sharp rise in interest rates had a negative impact on long duration assets, of which Hipgnosis Songs Fund is one. Higher rates mean the future value of cash flows is less when discounted back to the present, hence why Hipgnosis' shares fell when central banks started raising rates last year.

Hipgnosis' investment adviser HSM found it couldn't raise more funds because the share price had fallen well below net asset value. Raising new equity would have destroyed value for existing shareholders so HSM found a new way to keep buying music royalties, albeit not involving the investment trust.

Blackstone bought a stake in the manager and set up a private fund called Hipgnosis Songs Capital, appointing HSM as adviser.

Investors in Hipgnosis Songs Fund were understandably confused given the similarity in

name to their investment trust. They started to get annoyed, particularly as it looked like HSM was more interested in its work for Blackstone than the trust.

Pressure was put on HSM to revive shares in Hipgnosis Songs Fund and the latest solution is to sell some of its music catalogue to Hipgnosis Songs Capital. While the share price briefly shot up on the news, there were some glaring red flags.

First, the sister fund is paying a 17.5% discount to the March 2023 value of the portfolio. Why is the buyer getting such a good deal? Surely something like the 11.5% discount Concord is paying to buy **Round Hill Music Royalty Fund (RHM)** is more of an accurate benchmark?

Second, the transaction has been backdated to 1 January 2023 with Hipgnosis Songs Fund handing back $15.3 million to the purchaser, while also retaining its liabilities for contingent bonuses. Stifel analyst Sachin Saggar believes the acquisition discount could be 22% when adjusting for these factors.

The market has had time to digest the deal terms and it's notable that the share price has lost all the initial gains on the announcement (and more). So, the transaction has done nothing to revive the stock so far. The catalysts are likely to be share buybacks and debt reduction funded by the proceeds of the deal.

First up, a continuation vote for Hipgnosis Songs Fund will be held at the company's AGM, no later than 25 October. Shareholders could decide they've had enough and might get more money back if the trust was liquidated. We would not be surprised if the vote went that way.

Why Fundsmith and Blue Whale are split over Adobe

Two popular quality growth funds have different opinions about the design tech giant's prospects

Artificial intelligence has been a central investment theme this year, drawing investors to companies that have plans to leverage AI to create or enhance their products and services.

Adobe (ADBE:NASDAQ), the digital design software firm, has been a prime beneficiary of this trend. It shares are up 58% year-to-date, helped by the launch of its new generative AI feature called Firefly.

Adobe's impressive stock performance isn't simply based on hype, the company has been putting up impressive organic growth too, as evidenced by record-breaking revenue in the third quarter at $4.89 billion, compared to $4.43 billion a year earlier. Adjusted earnings were $4.09 per share versus $3.40 last year.

Adobe has more than 50% of the digital content creation software market and this means that whenever you view an image, video, website, magazine, or even an app, there is a good chance it was created using its software.

'We believe Adobe will be a major beneficiary of continued explosive growth in this market, as ever-richer digital content is consumed across devices and as Adobe Firefly generative AI unleashes creativity,' says **Blue Whale Growth Fund (BD6PG78)**.

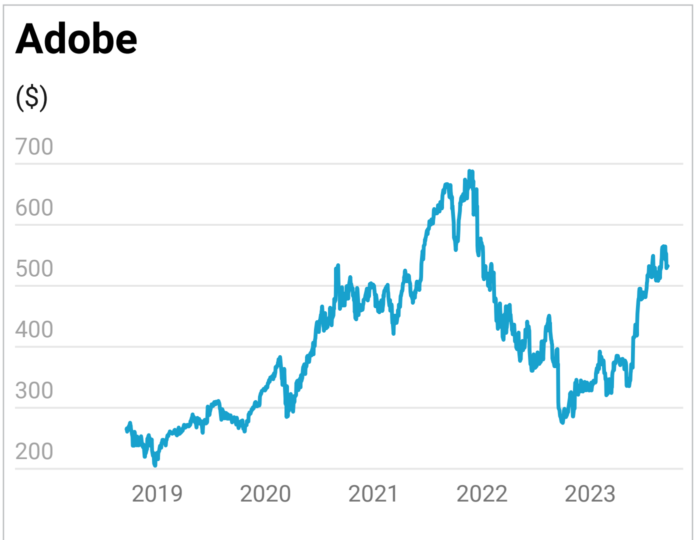


Chart: Shares magazine • Source: LSEG

Yet quality company investor **Fundsmith Equity (B41YBW7)** has a different view of the stock because of the planned acquisition of Figma. This is a direct competitor to Adobe in the design software space, and priced at $20 billion, it isn't cheap. Adobe argues the deal will open up new revenue avenues with Figma's better user interface bolted on to Adobe's own creative tools.

Adobe has faced competition from startups like Figma, Lightricks and Canva. But if you paint yourself as best-in-class, shouldn't you be beating your rivals, not buying them? Fundsmith manager Terry Smith, when complaining about capital allocation policy among companies in his latest letter to shareholders, name-checked Adobe.

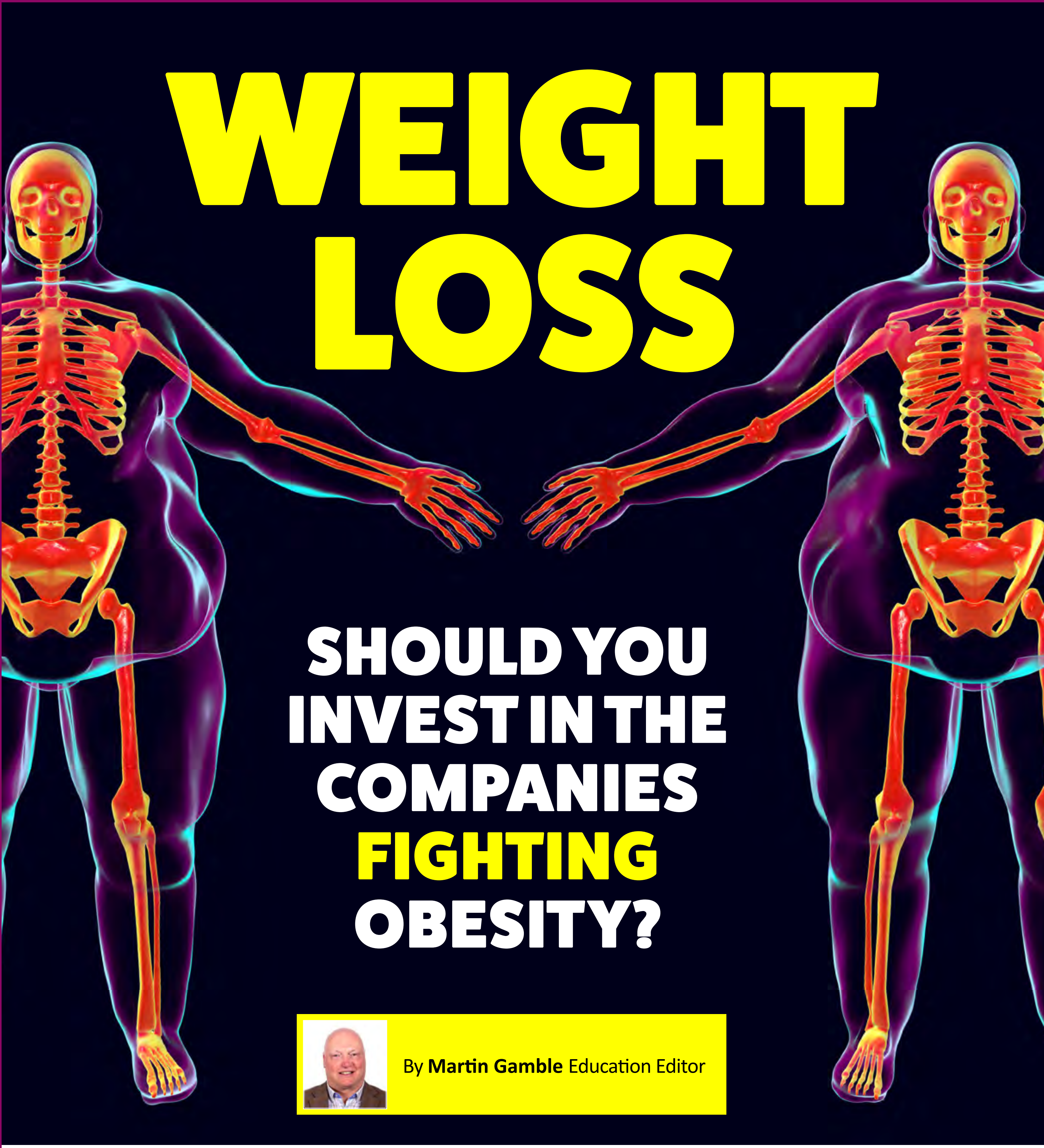
Large M&A is always risky and there are investors who see it as the last roll of the dice when growth has slowed and other options exhausted.

Shares' view is that each potential acquisition needs to be scrutinised on its own merits. Buying Figma could be a disaster for Adobe, but we'll never know for sure unless it pushes the deal through and executes successful integration.

From one angle, it comes down to trust in the management. The top team is filled with industry experts and therefore well placed to make calls regarding best use of company resources to secure future growth, and Adobe's leadership have proved to be excellent generators of shareholder value over the years.

If that is not your opinion, you should be looking to exit the stock and invest elsewhere. [SF]

DISCLAIMER: The author (Steven Frazer) owns units in Blue Whale and Fundsmith. Editor Daniel Coatsworth owns units in Fundsmith.



WEIGHT LOSS

SHOULD YOU INVEST IN THE COMPANIES FIGHTING OBESITY?

By **Martin Gamble** Education Editor

Obesity is one of the fastest growing public health issues facing the world. The World Health Organisation estimates there are two billion overweight adults, of which around 650 million are technically obese.

Having a body mass index over 30 means someone is obese, while anyone with a score over 25 is classified under this system as being overweight. Experts predict almost half of US adults will be obese by the end of the decade.

Obesity can result in chronic health problems including diabetes. Four years ago, the Organisation for Economic Co-operation and Development reported that nearly one in three adults suffered from obesity in the UK, the highest in Europe.

There are 415 million people globally suffering from diabetes which is forecast to reach 642 million

Consensus earnings expectations and valuations for leading obesity treatment companies

	2024 PE (x)	Forecast 2yr EPS growth
Novo Nordisk	31.3	75.8%
Eli Lilly	46.7	55.6%
Pfizer	10.3	−38.5%
Amgen	13.9	46.5%

Table: Shares magazine • Source: Stockopdia, Refinitiv

by 2042 according to diabetes.co.uk. The global diabetes therapeutics market is worth around $62 billion and expected to double by 2032 based on forecasts from Precedence Research.

Barclays pharmaceuticals analyst Emily Field estimates the global market for obesity drugs could top $100 billion by 2030.

While investor focus has rightly been on companies developing treatments, *Shares* believes there is a wider story to tell with increasing scrutiny on certain types of food and their link to obesity and other diseases.

In other words, rather than just looking at the opportunities for treating the disease there may be hidden risks lurking in the food producers which are underappreciated by investors. As we explain later, it is not the foods which are the problem but the way in which they are industrially manufactured.

Novo Nordisk

(DKK)

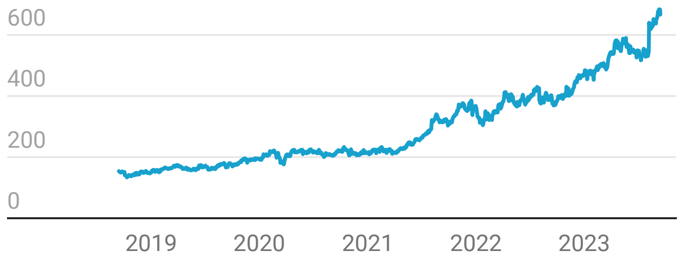


Chart: Shares magazine • Source: LSEG

FIGHTING OBESITY

Danish insulin specialist **Novo Nordisk (NVO:NYSE)** has been at the forefront of developing effective diabetes and weight management treatments.

Novo Nordisk is one of the big three insulin makers which collectively control around 89% of the global insulin market. The other two players are **Eli Lilly (LLY:NASDAQ)** and French pharma company **Sanofi (SAN:EURONEXT)**.

The company's success is reflected in it becoming Europe's most valuable listed company, overtaking luxury goods group **LVMH (MC:EURONEXT)** in the process.

Novo Nordisk's shares have almost doubled over the last year driven by the success of its weight management treatment Wegovy which sells as Ozempic in the US.

Clinical trials showed patients taking the drug lost around 15% of their body weight after 68 weeks with most people seeing a difference in the first month.

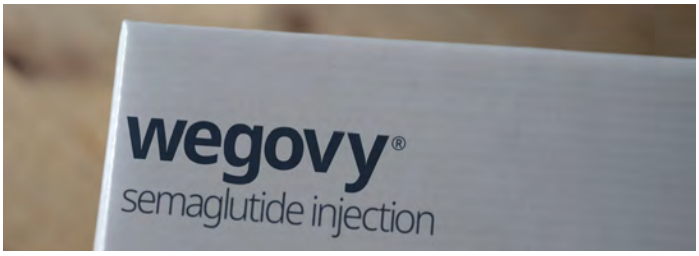
A multi-year clinical trial of Wegovy showed it also reduced the risk of major heart attacks and strokes by 20%. Novo Nordisk plans to file for regulatory approvals for these added benefits in 2023.

Demand for the drug, which was authorised as a treatment for obesity in 2021, has benefited from celebrities using it such as entrepreneur Elon Musk and actor Amy Schumer. Former UK prime minister Boris Johnson also took the drug after he noticed colleagues suddenly getting thinner. Notably, both Schumer and Johnson said they stopped taking it due to unpleasant side effects.

Before rushing out to buy Novo Nordisk shares, it is worth pointing out there are other companies in the race to develop obesity drugs so it is not a one-man race.

COMPETITION FROM ELI LILY AND OTHERS

Eli Lilly's obesity drug Mounjaro could potentially receive approval by the regulator by the end of 2023 and clinical trials demonstrated it achieved greater weight loss than Wegovy with patients losing up to 26% of their bodyweight.



The FDA last year approved Mounjaro for treating type two diabetes in the US. The National Institute for Health and Care Excellence earlier this month published draft guidance approving the use of Mounjaro for treating type two diabetes in England and Wales, with it likely to be available through the NHS by early 2024.

Meanwhile, Wegovy launched in the UK on 5 September for use in the NHS and private practices despite Novo Nordisk struggling to keep up with demand.

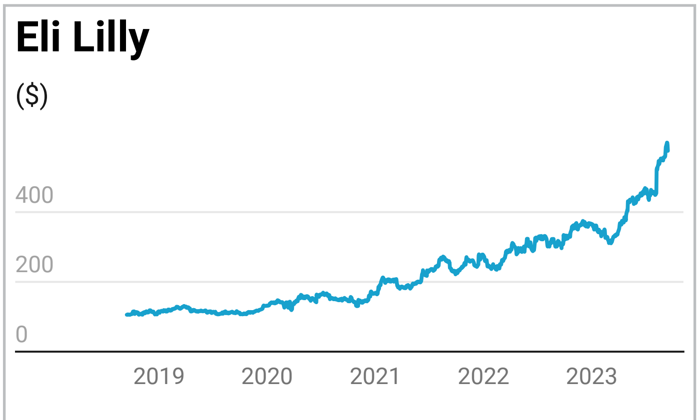


Chart: Shares magazine • Source: LSEG

The opportunity to get its foot in the door before Ely Lilly's Mounjaro is authorised by the regulator for treating obesity may have been a factor in Novo's decision to launch with limited stock.

Although Novo and Eli Lilly have a lead over the chasing pack neither company is resting on its laurels with both developing oral versions of their treatment. Wegovy is currently self-injected weekly.

Big pharma companies **Pfizer (PFE:NYSE)** and **Amgen (AMG:NYSE)** are also in the race to develop obesity drugs.

While investors place their bets on the potential winners from treating obesity it is also worth considering the role that food companies play in the obesity debate.

There are parallels between the tobacco industry and the food industry in that both sell addictive products. As the science unfolds on the causes of obesity, increased regulation is a potential risk to food manufacturers. That suggests investors might want to think about which stocks to avoid as a result of the obesity problem as well as ones to benefit from the provision of treatments.

WHAT CAUSES OBESITY?

There is an increasing body of evidence that certain heavily processed foods have detrimental effects on the body. This is a new phenomenon. For centuries humans got by without becoming seriously overweight.

We have an inbuilt mechanism (a protein made in the stomach) which tells the brain when we are full.

Around 40 years ago food manufacturing companies started to introduce ingredients which made food less expensive to mass-produce and therefore cheaper for consumers to purchase.

These foods looked good, tasted good and had a longer shelf life. Win-win for food companies and consumers, right?

Absolutely not. Today these industrially-made foods are 'ultra processed' and because they have little nutritional benefit, they can encourage overeating, say the experts.

Proteins in the stomach normally signal to the brain when it is full. These proteins fail when unhealthy, unbalanced 'food stuffs' encourage overeating, explains Chris van Tulleken, author of the book *Ultra-Processed People*.

Scientists believe the rapid rise in global obesity has a direct link to increased consumption of ultra-processed foods. Results of a study published in 2020 involving 110,260 patients over a 10-year period showed a higher consumption of ultra-processed foods is associated with weight gain and obesity. Subsequently, public health authorities in several countries have started to recommend limiting intake of ultra-processed foods.

WHAT ARE ULTRA-PROCESSED FOODS?

Ultra-processed foods and beverages are products with additives and industrially processed ingredients technologically broken down and modified.

In simple terms ultra-processed foods contain ingredients you will not find in your kitchen. Typically, they contain additives, artificial flavourings, emulsifiers (binding solution) and preservatives which increase shelf life.

They tend to be energy dense but low in nutrients. In other words, ultra-processed foods contain little natural foods such as meat, fruit, vegetables, seeds, eggs or milk. Examples include confectionery, fried snacks, processed meats, cakes and biscuits. The UK is one of the biggest consumers per head of ultra-processed foods in Europe.

The Nova food classification system is a recognised tool for categorising types of food. It is comprised of four categories with ultra-processed foods being the fourth.

WHICH COMPANIES MAKE ULTRA-PROCESSED FOODS?

An analysis based on a representative sample of 15 to 30 products collected by Tortoise from 30 food companies showed seven out of 10 food items were ultra-processed.

Eleven companies in the sample sell ultra-processed foods cheaper than non-ultra-processed foods measured by calories per pound. These include **Kraft Heinz (KHC:NASDAQ)**, Cadbury's chocolate maker **Mondelez International (MDLZ:NASDAQ)**, cooked meats purveyor **Cranswick (CWK)**, specialist foods supplier **Hilton Food (HFG)** and Birds Eye.

The top 10 companies with the highest profit margins in the sample generated 85% of their revenue from ultra-processed foods, says Tortoise.

Selling ultra-processed foods is profitable despite the lower price point and because they are a cheaper source of energy, they are consumed by lower socio-economic segments of society.

WHAT CAN BE DONE?

Tortoise argues that one option is to add a levy like the sugar tax imposed on soft drinks manufacturers in 2018. The problem with this approach is that clarity is needed on definitions and targets.

'Unless all companies have the same rules, they won't risk their market share to make these changes and our population will continue to suffer,' explains Tim Spector, professor of genetic epidemiology at King's College London.

The scientific definition for ultra-processed foods runs to four pages according to van Tulleken. His preferred solution is to stick a black label on foods containing ultra-processed foods to inform consumers of the health risks. Unfortunately, certain companies simply refuse to accept the Nova classification system.

GAMING THE SYSTEM

There is evidence that international food and drink companies are following the playbook of the tobacco companies and funding research to take control of the health debate.

For example, in 2015 the *New York Times* reported that **Coca Cola (KO:NYSE)** was covertly funding the Global Energy Balance Network, set up to promote the message that all calories are equal. The idea was to show that sweetened beverages were not responsible for obesity.

Writing in the *British Medical Journal*, Gyorgy Scrinis argues that ultra-processed food corporations use similar strategies not only to 'influence the nutritional knowledge related to their products but also to shape the broader concepts that frame scientists and the public's understanding of food and the body'.

WHAT CONCLUSIONS CAN BE DRAWN?

Obesity and diabetes are on the rise across the globe which equates to billions of suffering people and billions of dollars of medical costs.

This has presented a big opportunity for pharma companies to help alleviate the suffering by developing effective treatments. Novo Nordisk and Eli Lilly are ahead in the race, but other companies may yet develop better drugs.

Novo trades on a high PE (price to earnings) ratio of around 38 times expected 2023 earnings per share and 32 times 2024 earnings per share. Eli Lilly has a bigger market cap than Novo and trades on an even higher PE of 61 times for 2023 and 47 times for 2024.

Both shares are at all-time highs reflecting the excitement around obesity drugs. They are great businesses yet it would be prudent to wait for a better buying opportunity given their elevated valuations. Watch the shares closely and snap them up if you see any share price weakness.

The scientific evidence linking certain types of food such as ultra-processed foods to obesity is building and may yet result in more regulation on food companies. This risk is underappreciated by the market and so anyone owning any food stocks in their portfolio might want to reconsider if they are still appropriate as investments.

Where next for markets? Here are three potential scenarios

Investors are right to be confused given different signals from stocks, bonds, currencies and commodities

Legendary American broadcaster Edward R. Murrow is known for many pungent epithets, but one of this column's favourites is, 'Anyone who isn't confused really doesn't understand the situation.' Right now, investors feel confused because stock, bond, currency and commodity markets are giving out different signals. They cannot all be right.

Equities are pricing in a return to the Goldilocks economy of the 2010s, where low inflation, low growth and low interest rates prevailed.

Nothing ran too hot, and everything felt just right, at least if a portfolio was heavily exposed to long-term growth plays such as technology companies, which were highly prized for their ability to increase earnings whatever the economic conditions.

America's stock market is heavily weighted towards tech, and it is outperforming again in 2023, as seen by how the increase in the market capitalisation of the so-called Magnificent Seven of **Alphabet (GOOG:NASDAQ)**, **Amazon (AMZN:NASDAQ)**, **Apple (AAPL:NASDAQ)**, **Meta Platforms (META:NASDAQ)**, **Microsoft (MSFT:NASDAQ)**, **NVIDIA (NVDA:NASDAQ)** and **Tesla (TSLA:NASDAQ)** which are responsible for the vast bulk of the advance in total US market cap this year.

Currencies are buying into this view, at least to the degree that the US economy is seen as outperforming that of everyone else. The dollar is on the rise once more, at least if the DXY (or 'Dixie') trade-weighted basket is a dependable guide.

Fixed-income markets remain terrified of a recession. The yield-curve remains steeply inverted in both the US and UK, as 10-year government bonds offer a lesser yield than their two-year equivalents. This is usually seen as a warning that a slowdown is coming, because bond investors are pricing in future interest rate cuts in response to the downturn.

Seven big tech stocks have fired US equities higher in 2023

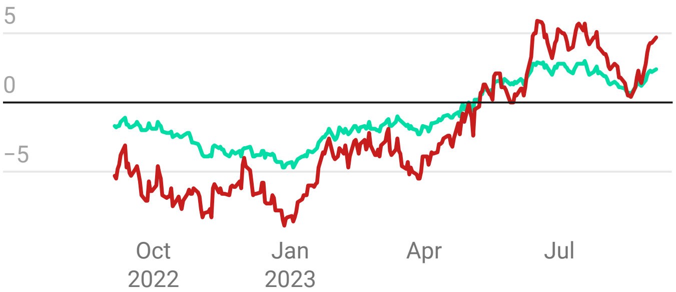


Chart: Shares magazine • Source: LSEG

Yield curves are warning of a recession

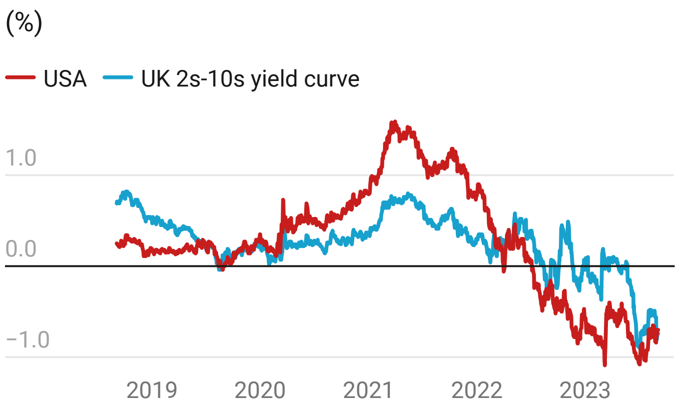


Chart: Shares magazine • Source: LSEG

Commodities are somewhere in between. Orange juice and cocoa are surging, as are oil and uranium, while precious metals hold firm, but industrial metals are weak (aluminium) or going nowhere fast (copper, tin). Higher energy prices may point to stagflation, if not inflation.

A Goldilocks scenario, an inflationary boom, a deflationary slump or a stagflationary quagmire all remain outcomes and not even central bankers know what is coming next, given how the US

Federal Reserve, European Central Bank and the Bank of England are approaching every interest rate decision, while the Bank of Japan continues to do nothing at all.

The hard part is that each scenario potentially requires a different portfolio solution and asset allocation strategy, at least if history is any guide.

RANGE OF OUTCOMES

The Goldilocks scenario just feels too easy and too simplistic, especially after 15 years of unorthodox, ultra-loose monetary policy and then the post-2020 explosion of fiscal stimulus.

Equities may like it, but this column is not convinced, although this does make life much simpler for portfolio builders, because it is easy to make a case for any one of the other three scenarios:

SCENARIO 1 Inflation could result from onshoring or friendshoring and the reversal of globalisation (as this will mean more expensive, Western labour); trade unions flex their muscles and demand higher wages at a time of low unemployment; and America in particular continues to pump federal subsidies and grants into its economy courtesy of the Biden administration's CHIPS and Inflation Reduction Acts.

SCENARIO 2 Deflation, or disinflation, could yet result as technology continues to drive productivity and automation reduces the need for staff and workers; rising interest bills weigh heavily upon governments, consumers and corporations alike; and the supply-side bottlenecks and dislocations of 2021-22 start to ease.

SCENARIO 3 Stagflation, the worst of all worlds, could yet result owing to global debt levels, which stand at record highs and where interest payments suck cash away from other, more productive investment and hold back growth. Sustained increases in energy prices would also be a worry, as they filter through to so many parts of their economy and could also fuel higher wage demands to create the vicious upward price cycle seen in the 1970s.

RAW DEAL

If forced to guess, this column would sit in the inflation (or stagflation) camp and if a 40-year period of cheap money, labour, energy and goods is coming to an end, then it may not be sensible to expect what worked in that period (long-duration assets like tech and government bonds) to keep working. If the mood music changes, then value style investments, small caps and raw materials (and other things that central banks cannot print) may be the way forward.

Is equities' 10-year outperformance of commodities ending?

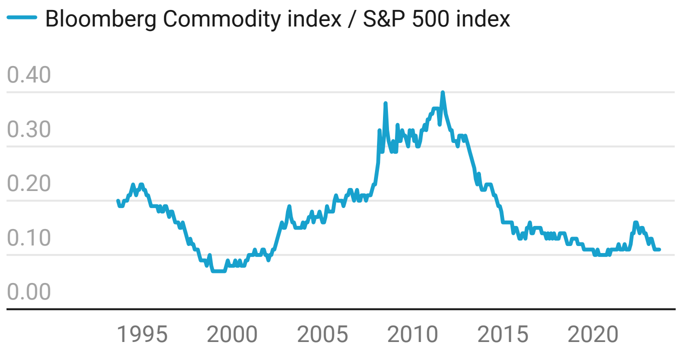


Chart: Shares magazine • Source: LSEG

This column's crystal ball is no better than anyone else's but, in search of guidance, it will continue to look at one chart in particular. This is the relative performance of the S&P 500 against the Bloomberg Commodities index.

Equities massively outperformed in the 1990s, commodities led in the 2000s and then equities stormed back in the 2010s. The chart suggests the tide may be about to turn again. We shall see.

By **Russ Mould**
Investment Director at AJ Bell

What investment trust boards are doing to address wide discounts

Share buybacks, mergers and managed wind downs are levers boards are pulling to narrow stubbornly large discounts

According to data from the AIC, the average investment trust discount to net asset value has widened from 12.2% at the end of 2022 to 14.5% as of 8 September 2023, while sector averages have generally widened. The exception is private equity, which narrowed from 25.1% to 4.5%, skewed by **3i's (III)** dramatic swing from discount to premium.

While this presents an opportunity to buy into parts of the market cheaply, it's unlikely that the board of directors for each affected trust will be sitting back and doing nothing. They will be under pressure from shareholders to find ways to narrow the discounts, and it is here that investors might want to look closely.

Any signs that action is being taken to narrow the discount implies you could make money as the gap is closed.

Annabel Brodie-Smith, communications director of the Association of Investment Companies, says: 'Many analysts believe these wider discounts present long-term buying opportunities and, in the past, brave investors who have invested in turbulent markets have been richly rewarded.'

PROACTIVE RESPONSE

Wide and persistent share price discounts to NAV on investment trusts arise when demand for the stock falls out of sync with the value of the underlying investments. Stubbornly wide discounts can wipe out long-term investment performance so investment trusts need to do something to stop the rot setting in.

Brodie-Smith explains that in recent years investment trust boards have been 'proactive and creative in looking for ways to deliver shareholder value' and says this year the pace has stepped up.

Boards have proposed mergers, fee changes and the wind-up of investment trusts as well as implementing share buybacks at record levels. Several strategic reviews are under way, which are likely to lead to more consolidation in the final quarter of the year.

Her view chimes with that of Kepler analyst Ryan Lightfoot-Aminoff, who says boards have stepped up and shown their ability to add value, using all the tools available to them to help generate returns for shareholders.

Analysts at investment bank Stifel note that a high number of continuation votes are due in the alternative trusts space with investors left frustrated at the lack of proactive action being taken to address wide discounts. But they believe boards have 'heard the message loud and clear' and expect continuation votes will 'focus minds towards what more can be done'.

LEVERS TO PULL

Winterflood's head of investment trust research Emma Bird says in recent years, an increasing number of trusts have introduced enhanced dividend policies (i.e., paying dividends at least partially out of capital profits) in an attempt to bring in discounts by appealing to a wider range of investors.

Another way to deal with the situation is to have a discount control mechanism, which means the trust buys back shares to help the price trade as close as possible to net asset value. Should the trust trade at a premium, trusts can issue new shares to bring the price closer to NAV.

Examples of trusts with a discount control mechanism include **Troy Income & Growth Trust (TIGT)**, **Personal Assets Trust (PNL)**, **STS Global Income & Growth (STS)** and **Capital Gearing (CGT)**.

PANTHEON SETS THE STANDARD FOR PRIVATE EQUITY

Despite an excellent long-run performance record, 14 out of 17 trusts in the AIC's private equity sector trade on double-digit NAV discounts amid concerns over portfolio valuations in a higher rates environment.

The board of **Pantheon International (PIN)**, the FTSE 250 trust chaired by John Singer, recently sprang into action, committing up to £200 million to buy back shares in a bid to drive a re-rating. This is beginning to have a positive effect, with the discount narrowing from a 12-month average of 44% to 36.4%, admittedly still wide, at the time of writing.

Investec says Pantheon's enhanced capital allocation policy 'throws down the gauntlet' to the rest of the listed private equity sector, increasing pressure on companies to take tangible action to prioritise shareholder returns and address both the absolute level of discounts and discount volatility.

The broker adds that 'the somewhat toothless defence' of discounts last year was 'a deeply underwhelming experience', and it believes permanent capital has been taken a little too literally and bred complacency across the sector.

CLOSURES AND TAKEOVERS

Boards of sub-scale trusts are biting the bullet and leaning into size and liquidity challenges, with the market witnessing more mergers, strategic reviews and wind downs.

Examples include Abrdn Latin American, wound up earlier this year with the board citing the fund's (lack of) scale, as well as two small-scale debt funds that are winding down their portfolios and returning proceeds to shareholders; **RM Infrastructure Income (RMII)** has consistently traded on a discount since the onset of Covid in 2020 while **Blackstone Loan Financing (BGLP)** is off the radar of most investors, languishing on a cavernous 35% NAV discount.

GREENWOOD SPIES 'GOLDEN OPPORTUNITY'

Nick Greenwood is the manager of **MIGO Opportunities Trust (MIGO)**, which takes stakes in other investment trusts trading at discounts, typically funds that are misunderstood by generalist investors.

Greenwood says the rapid widening of discounts means we have reached the point where many commentators are suggesting that recent events have sounded the death knell for investment trusts. 'This is a call that we have heard many times over the decades, however, as the sector continues to evolve, natural selection remains alive and well in the world of investment trusts.'

He adds: 'A fundamental reason why the trust sector should prosper is that asset classes such as property, private equity and shipping cannot operate as open-ended funds. It would be impossible to sell a fraction of an office block or a container ship within twenty-four hours to meet a client sale.' Greenwood firmly believes that 'we will look back at the summer of 2023 and reflect that it represented a golden opportunity to buy discounted investment trusts.'

Examples of investment trust sector discounts

Sector	Discount to NAV 31 Dec '22	Discount to NAV 8 Sep '23
North America	25.2%	26.9%
Debt - Direct Lending	14.4%	25.2%
Renewable Energy Infrastructure	5.3%	20.0%
Flexible Investment	13.0%	18.1%
Country Specialist	10.9%	17.8%
Global	6.8%	13.6%
UK Smaller Companies	10.0%	12.6%

NAV = net asset value

Table: Shares magazine • Source: AIC, Morningstar, sector weighed averages

Unhappy with a 30% discount, **Ecofin US Renewables Infrastructure's (RNEW)** board has launched a strategic review which will centre on a sale of the assets which if successful, will result in a winding up with cash returned to shareholders.

Regional REIT (RGL) is trading on a 48% discount to net asset value, the widest in the UK commercial property peer group. Emma Bird at Winterflood believes that situation could make it a takeover target. She says it may offer 'an interesting trading opportunity' with a fully covered 13.7% dividend yield offering 'some downside protection'.

Regional REIT

(p)

Chart: Shares magazine • Source: LSEG

MAKING PROGRESS

James Carthew, head of investment companies at QuotedData, has been 'generally impressed' by the way boards are responding to widening discounts.

'It feels as though they have been swifter to act and are being more radical in their thinking than in previous downturns,' he tells *Shares*. 'Unfortunately, this is not stemming the tide of selling, as yet.'

Carthew says the most obvious response has been far more share buybacks, which rebalance supply and demand and allow share prices to recover.

'Back in January this year, 69 investment trusts repurchased £191 million worth of shares, offset by £86.9 million worth of share issuance by 20 trusts,' explains Carthew. 'In August, £399 million worth of stock was bought back by 93 investment trusts.'

Discounts have emerged on trusts that have almost always traded at premiums since launch, with **Pantheon Infrastructure (PINT)**, **Downing Renewables & Infrastructure (DORE)** and **Aquila European Renewables (AERI)** buying back stock.

'Others, such as **NextEnergy Solar Fund (NESF)** and **Triple Point Social Housing (SOHO)**, are selling off part of their portfolio as a way of demonstrating the accuracy of their NAVs and freeing up cash to tackle discounts.'

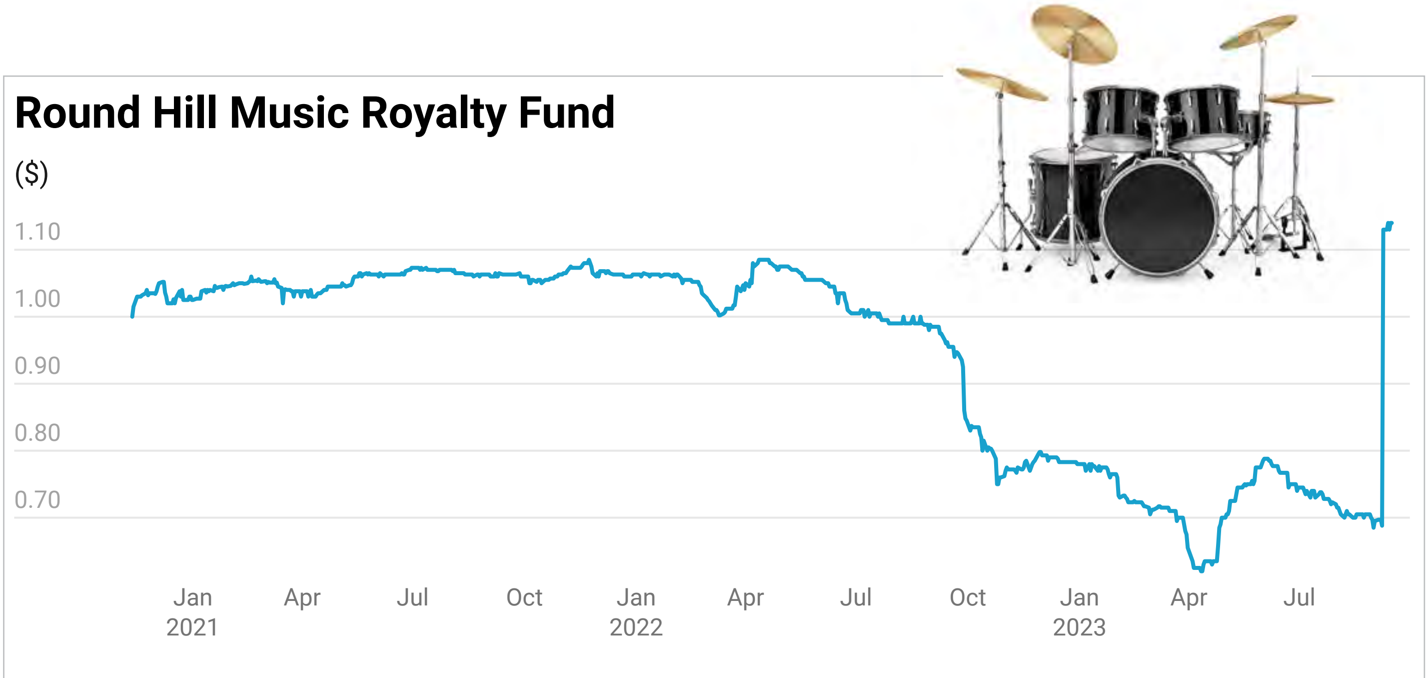
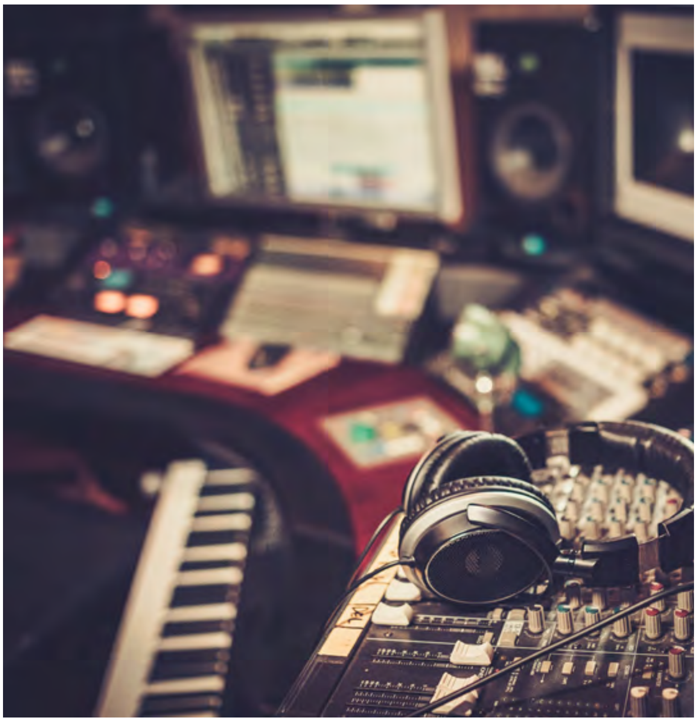


Chart: Shares magazine • Source: LSEG

A takeover offer for **Round Hill Music Royalty Fund (RHM)** was announced on 8 September 2023 which Stifel thinks will 'reflect the starting gun being fired on a wave of corporate activity in the listed alternative sector' in time.

Round Hill Music Royalty Fund has accepted a cash offer of $1.15 per share from Alchemy Copyrights, a 67.3% premium to the undisturbed share price and an 11.5% discount to NAV, amid shareholder frustration at the persistent discount.



MERGERS GALORE

Smaller trusts on big discounts are being absorbed by larger ones, with five mergers are already proposed this year, the same amount as seen in the whole of 2022.

Nippon Active Value Fund (NAVF) is absorbing **Abrdn Japan (AJIT)** and **Atlantis Japan Growth (AJG)**. **Abrdn New Dawn (ABD)** is being folded into **Asia Dragon Trust (DGN)** in a move that will create an enlarged trust with a market cap big enough for FTSE 250 inclusion.

Elsewhere, **Abrdn Smaller Companies Income (ASCI)** will roll over its assets into **Shires Income (SHRS)**, and **GCP Infrastructure Investments (GCP)** plans to merge with **GCP Asset Backed Income (GABI)** in a move creating a much bigger vehicle and one able to fund share buybacks.

Kepler's Lightfoot-Aminoff says: 'Despite the malaise in the sector, boards have shown they can add value to investment trusts by creating catalysts for discounts to narrow and value to be realised.' He adds: 'These are not easy decisions for boards to take, but we salute their valuable role in providing multiple routes for shareholders to make good returns from buying assets at wide discounts.'

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

Why investment trusts invested in bonds could be worth a look

The yields available look generous but you need to be aware of the risks

The surge in bond yields as inflationary pressures pushed central banks to move interest rates sharply higher has created an opportunity for investors.

Just how generous is this income stream though and how do the potential returns from investing in bonds and credit compare with cash? Or put more simply, what sort of returns can you expect from fixed income?

THE IMPACT OF HIGHER INTEREST RATES

Bonds offer a higher yield when their prices fall and they have an inverse relationship with rates – meaning prices go down when rates go up.

Because many bonds require minimum investment levels running into the tens of thousands of pounds, investors often use funds to gain access to this asset class.

According to FE Analytics data the 228 open-ended bond funds available to retail investors offer an average historic yield of just 2.4%, well short of the levels of interest available from cash on deposit and current levels of inflation.

Investment trusts are better placed to put money into less liquid and more niche investments to generate higher levels of yield. This is because they don't need to sell assets to meet redemptions when investors want to exit.

The average yield from the relevant AIC Debt: Loans & Bonds sector, a universe of 10 names, is a much healthier 7.6%.

This makes it an interesting area to explore for income investors, particularly as there is also scope for capital appreciation too, assuming bond prices start to recover. However, you need to be aware of the hazards which come with these higher yields.

INVESTING TO ACHIEVE HIGH LEVELS OF YIELD

The manager of **Invesco Bond Income Plus (BIPS)** Rhys Davies explains the investment process behind his trust. He says: 'Myself and the board will agree on a dividend target in pence per share – that is currently 11.5p. That's a figure which I think is achievable without taking too much risk.'

The share price is currently 164p so the implied yield is 7%.

Davies says the portfolio is put together with this dividend target in mind by investing in the higher yielding parts of the bond markets.

This includes traditional high yield corporate bonds – what the trust calls income generators – which form the core of the portfolio.

On top the trust invests in subordinated debt (ranking lower in the list of creditors than other types of credit) from European banks and financials (an area which has been hit by the collapse of Credit Suisse and tangentially by the US banking crisis).

Investment trusts in AIC Debt: Loans & Bonds sector

Trust	Discount/premium to NAV	1-year share price total return	10-year share price total return	Ongoing charge	Dividend yield
CQS New City High Yield Fund	4.6%	-0.5%	65.7%	1.2%	9.4%
NB Global Monthly Income Fund	-11.0%	0.4%	14.1%	1.2%	9.1%
TwentyFour Select Monthly Income	-1.9%	4.8%	N/A	1.2%	8.6%
CVC Income & Growth	-5.6%	14.5%	63.3%	1.8%	7.4%
Invesco Bond Income Plus	1.4%	14.1%	71.9%	0.9%	7.1%
Henderson Diversified Income	-10.5%	-0.7%	24.6%	1.0%	7.1%
M&G Credit Income	-4.5%	4.6%	N/A	1.2%	5.9%
NB Distressed Debt	-8.0%	-0.3%	-35.6%	1.0%	4.3%
NB Distressed Debt New Global shares	-49.4%	-5.6%	N/A	1.3%	1.0%
NB Distressed Debt Extended Life shares	-39.7%	18.1%	-39.9%	1.0%	0.7%

NAV = net asset value

Table: Shares magazine • Source: Morningstar, data as at 13 September 2023

It also invests in bonds which have come under price pressure but where there are plans afoot to turn around the business and its balance sheet, although this is only a small part of the portfolio.

The trust was enlarged by its merger with Invesco Enhanced Income in 2021 and Davies, who steers the vehicle along with Edward Craven, has been in place since 2014. He observes that since the financial crisis there have been windows of opportunity when it has been possible to lock in high yields, but these have tended to be very brief – citing the period after the Brexit vote and the initial stages of the Covid pandemic.

Discussing the impact that the sharp rise in interest rates has had on bonds, Davies says: 'We've now got a much larger window of opportunity and it is still there. I do think we have shifted into a high yield environment for the foreseeable future. The coupons we're being paid on new issuance are two or three times the level of coupon at the height of the market back in 2021.'

Davies gives the example of BT which came to the market with what's called a corporate hybrid (its most junior piece of debt) paying an 8.375% coupon for five years. According to the Invesco manager, the same sort of debt would have cost the company half that level of coupon two years ago.

UNDERSTANDING THE DEFAULT RISKS

Higher yields are usually accompanied by a potentially higher risk of default – i.e., a company being unable to pay its debts. Erik Knutzen, chief investment officer of the multi-asset team at Neuberger Berman, observes: 'We are looking out for cracks in the credit market as the high-yield maturity wall comes ever closer and the first policy rate cuts get priced further and further out, raising the threat of expensive refinancings.

'This is perhaps the most visible threat, and therefore one we think could be priced in sooner rather than later—a "canary in the coalmine" warning of broader market volatility.'

For his part Davies acknowledges the risks. He comments: 'Companies which are able to come to the market and issue bonds with these higher coupons are generally in a position where they can afford to do that. The market wouldn't lend to them if they didn't think that. They create very exciting opportunities for us.

'Where we need to be focused at the moment is in the secondary market, where bonds may be offering a much better level of yield than when they were issued. We need to be thinking about the future credit risk of that company. If we have doubts, we have already started the process of removing them from the portfolios.'

Davies notes the maturity profile of the market is a good indicator for when companies are likely to have to roll over to higher levels of debt. 'Right now, we are looking at late 2024, early 2025 when a "wall of maturities" comes through – so in a year's time the market will really have to start thinking about it,' he adds.

Fixed income fund managers can mitigate credit risk through diversification – Invesco Bond Income Plus has exposure to 170 different issuers, for example.

Including the coupon and the capital upside Davies believes a high single-digit return from the high yield market is possible. 'I'm enthusiastic and excited about the outlook for credit because of the types of yields available today which were last available when I first started 20 years ago, but we do need to manage our way through the credit risks.'

WHAT HAS CVC INCOME & GROWTH BEEN DOING RIGHT?

Among the best performers over the last 12 months in the AIC Debt: Loans & Bonds category is **CVC Income & Growth (CVCG)**.

Manager Pieter Staelens says: 'The strategy was started in 2009 off the back of the financial crisis – we mainly invest in leveraged loans which is the big difference between us and other credit investment trusts which invest in high yield bonds.'

This market does not have a fixed rate of interest but a floating coupon which changes every three months or so to reflect the interest rates set by central banks.

Leveraged loans tend to be secured in nature, or in other words backed by the issuers' assets, which is not always the case with bonds.

Staelens says: 'It's a little bit like a mortgage on a house. If I lose my job and I can't pay the interest on my mortgage anymore then the bank will repossess my house and sell it, and if my loan to value is 50% the bank probably won't lose too much money on it. Unsecured bonds are more like credit card debt where yes, I promise to pay you back but the bank doesn't have security over any of my assets.

'In an environment where companies are

INVESTMENT GRADE BONDS VERSUS HIGH YIELD BONDS

Investment grade refers to the highest quality part of the bond market and these issuers have stronger balance sheets which should make them more resilient in an economic downturn.

High yield corporate bonds are the riskiest part of the bond market because they are considered the most likely to default during economic downturns.

Investors may not get their capital back in full when this happens.

struggling with the higher cost of financing, we would expect default rates to go up. But if you have higher default rates and you get some good recovery on these loans, default rates don't hurt as much as if you were to invest in unsecured debt.'

Staelens observes the average default level over the last five years has been around 1% with recovery rates for senior secured loans at 60 to 70 cents on the dollar.

'During the great financial crisis default rates peaked at 10%. Even at those levels if you assume the 60 to 70 cents recovery rate still holds, you're looking at a loss rate of 3% but we're getting paid 9% so it's still a very attractive opportunity and we're nowhere near great financial crisis kind of conditions,' he says.

FOCUSED ON LARGER COMPANIES

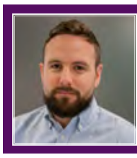
Staelens says CVC Income & Growth principally lends to large companies and not small and medium-sized firms which are more at risk of default.

While there have been some examples where recovery rates have come in lower than average thanks to looser credit agreements struck when market conditions were more favourable for borrowers, the trust stays away from such loans.

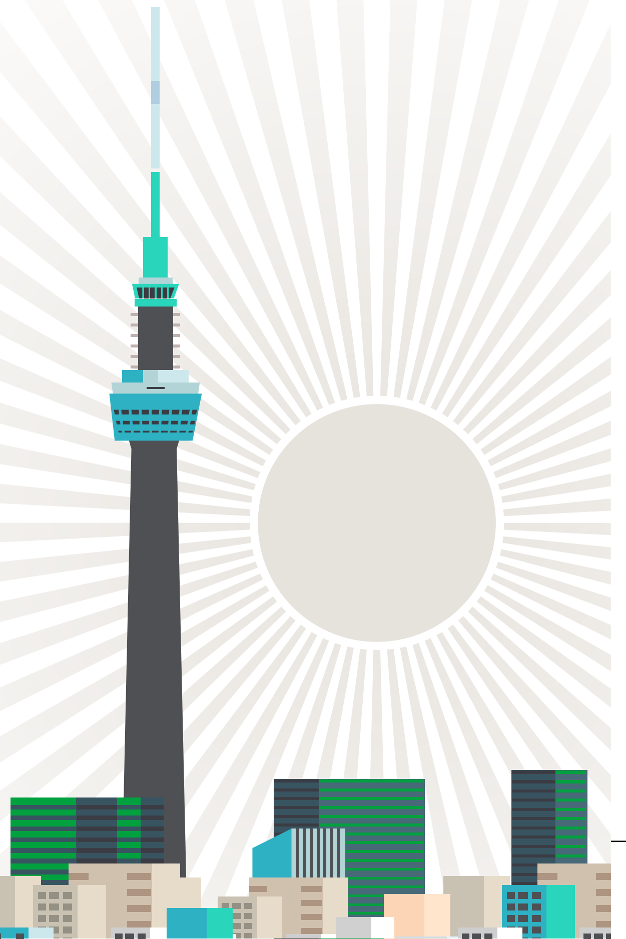
CVC Income & Growth also benefits from a large team of analysts which do a lot of work when deciding which businesses to lend to – Staelens says this capacity is really important in a tougher economic environment where the rate of defaults is higher.

One downside compared with high yield bonds is if central banks start to cut base rates. In this situation floating rate debt might compare unfavourably with the elevated levels of fixed income currently available on corporate bonds.

However, Staelens argues there is potentially a place for both in a broad portfolio and notes the trust itself holds some high yield bonds.



By **Tom Sieber** Deputy Editor



Everything you need to know about investing in the advertising sector

While uncertain economic conditions are currently weighing on the sector, there are reasons to be optimistic longer term

The recent share price performance of certain advertising companies has not impressed investors. **WPP (WPP)** has seen its share price fall by 8% year-to-date and **S4 Capital (SFOR)** has seen its shares dramatically fall 62% in the same period.

Both companies have cited tech clients in the US cutting their advertising spend and the current macroeconomic climate as reasons for weak performance. This is a short-term issue and history tells us that advertising companies are capable of delivering strong returns for shareholders when times are good. It may simply be a matter of picking your entry point.

Sentiment is certainly weak towards the sector now, but the first sign of brighter economic conditions could be the trigger point to consider getting exposure to these types of companies.

In this article we discuss the different advertising-related stocks on key markets in the UK, mainland Europe and the US, and funds that invest in this space. We also discuss the key performance indicators to study when researching investment opportunities and explore the role of AI in the sector.

WHY INVEST IN THE SECTOR?

Advertising agencies are a good proxy for the state of the economy. If corporates are worried about the near-term outlook, they cut back on advertising and marketing. If they are bullish, they spend more on promotions.

When times are good, companies can spend significant amounts of money to get their brand or products noticed. That means big business for advertising agencies.

Global advertising spend is forecast to grow by 3.3% in 2023 to reach $727.9 billion, according to the Dentsu Global Ad Spend report published in May this year. Stronger growth is expected in 2024 where the global advertising market is forecast to increase by 4.7% to reach $762.5 billion, with a further 3.8% growth in 2025.

Although the Dentsu report points to continued growth in 2023, the forecast has been adjusted marginally downwards from the 3.5% predicted in December 2022. Growth is being driven by media price inflation rather than increased advertising volume.

The second half of 2023 is expected to see ongoing growth in digital advertising, but in an 'uncharacteristic single digit increase' (7.8%), which has only happened twice before in the last 20 years: in 2009 (financial crisis consequences) and in 2020 (pandemic), according to the report. There was double-digit growth in preceding years.

KEY METRICS FOR THE ADVERTISING SECTOR

RETURN ON ADVERTISING SPEND The amount of revenue a company is earning for every pound or dollar it spends on advertising.

AVERAGE CLICK-THROUGH RATE The click-through rate measures the percentage of people who viewed an advert and clicked on it. The average click-through rate for an advert can help an advertising company or agency understand how effective their copy, design and landing pages has been.

CONVERSION RATES This is a method used by advertising companies or agencies to measure sales growth and engagement. It looks at the percentage of people who responded to an advert and then bought the product or service.

COST PER CLICK This is a measurement of the amount of money you pay when a consumer clicks your advert.

CUSTOMER ACQUISITION COST This show has much it has cost to acquire customers via promotions. You divide the total cost of sales and marketing by the total number of customers acquired over a given time.

Source: Shares Magazine, LayerFive

Digital spend is expected to reach $424.3 billion by the end of 2023, accounting for 58.3% of all advertising spend. This could increase further to a 59.1% share in 2024 and 60.3% in 2025, predicts Dentsu.

THE RISE OF ARTIFICIAL INTELLIGENCE

Artificial intelligence has created opportunities for social media networks, helping to keep users more engaged by serving up more relevant videos on Facebook, for example. The longer people spend on social networks, the greater the opportunity to serve more adverts to them.

Companies are embracing AI in their promotions and it is giving them a new creative spark. Fresh ideas could lead to increased advertising spend.

For example, **Coca-Cola (KO:NYSE)** recently used AI to help create an advert called 'Masterpiece' which features its products integrated into famous paintings and sculptures.

'Artificial intelligence has grabbed the attention of not only big tech firms like Microsoft and Google, but also marketers who are starting to assume that AI-powered platforms can also provide creativity,' says Ali Mogharabi, senior equity analyst at Morningstar.

Advertising agencies are doing everything they can to capitalise on the trend. Mark Read, managing director of WPP, said at the company's second quarter results: 'We have exciting future plans in AI. We are leveraging our efforts with partnerships with the leading players including Adobe, Google, IBM, Microsoft, Nvidia and OpenAI. We are delivering work powered by AI for clients including Nestle and Nike.'

Nick Waters, chief executive of media marketing consultancy **Ebiquity (EBQ:AIM)**, told *Shares* that AI is transforming the advertising industry at pace with the use of personalised adverts and chatbots, which can help consumers make buying decisions.

Waters says notable success can be seen in the paid search market where AI is used to generate keywords and text that achieve stronger results than human input.

'There have been tentative steps taken to apply AI to the development of longer form copy, but this is yet to prove itself,' he remarks.

ADVERTISING COMPANIES ON THE STOCK MARKET

Investors are able to buy shares in the world's biggest advertising agencies including WPP, **Omnicom (OMC:NYSE)**, **Interpublic (IPG:NYSE)** and **Publicis (PUB:EPA)**.

Interpublic is one of the best performing stocks in its sector over the past five years with a 33% gain.

Publicis

(€)

Chart: Shares magazine • Source: LSEG

However, it was one of the worst-performing stocks in the S&P 500 after it announced disappointing second quarter results on 31 July this year.

The company reported a 2% drop in net revenue of $2.33 billion and revised its full year organic growth expectation to 1% from 2%. It is busy on many projects but tech clients are holding back on spending, with similar messages coming from the likes of S4 Capital and **M&C Saatchi (SAA:AIM)**.

Publicis seemed to buck the second quarter malaise experienced by Interpublic and WPP, among others. Organic growth in the period grew by 7.1% and the company upgraded its 2023 guidance on all key performance indicators despite macro uncertainties. Shares in Publicis have increased by 42% over the past five years.

Interpublic

($)

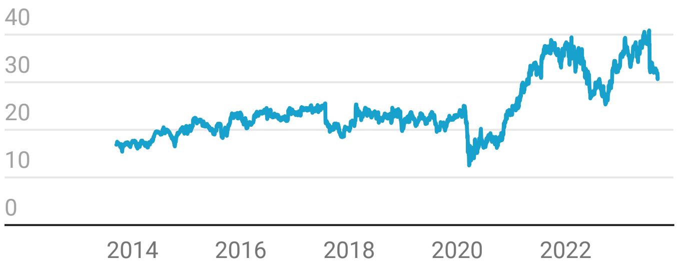
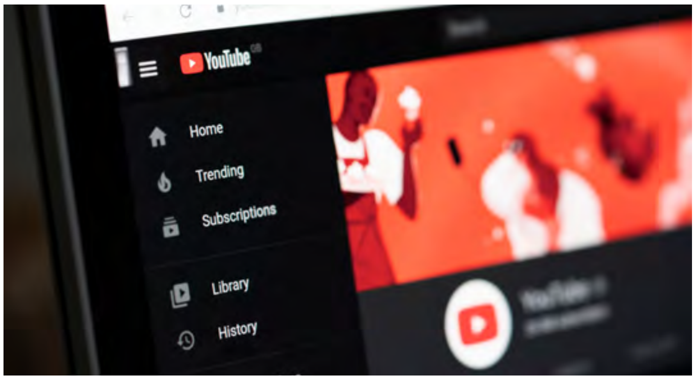


Chart: Shares magazine • Source: LSEG



SOCIAL MEDIA GIANTS

The alternative way to get exposure to the sector is to invest in the owners of social media networks and search engines. **Alphabet (GOOG:NASDAQ)** owns Google and YouTube and generated $58.1 billion in advertising income across these platforms in the quarter to 30 June alone.

Companies pay to appear on Google search results for certain terms, they carry adverts on the search engine, and YouTube has more than 2.7 billion active users who are forced to view adverts when they watch clips on the platform.

Alphabet has attributed its recent success to a better understanding and incorporation of artificial intelligence products into its offering.

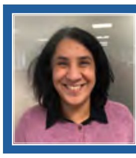
Meta Platforms (META:NASDAQ) is another giant in the advertising space thanks to its ownership of Facebook and Instagram. In the second quarter of 2023, advertising impressions delivered across its apps increased by 34% year-over-year but the average price per advert decreased by 16% year-over-year.

CAN I INVEST IN THE SECTOR VIA FUNDS?

While there is not an advertising-specific tracker fund, a couple of active funds invest in advertising stocks as part of a diversified portfolio.

For example, **Fidelity Global Dividend (B7GJPN7)** has Omnicom in its top 10 holdings, representing 3.02% of the portfolio at the time of writing.

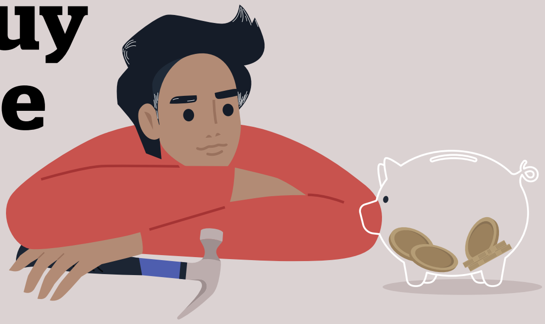
FP Octopus UK Microcap Growth Fund (BYQ7HN4) has 3.1% of its portfolio in digital communications and media firm **Next 15 (NFG:AIM)** and 3.6% of its portfolio in M&C Saatchi.



By **Sabuhi Gard** Investment Writer


BING!
BING!
BONG!

Can I use savings to buy an annuity or must the money come from a pension?



We explain how annuities work and the alternatives for generating income in retirement

Can I buy an annuity with cash from savings or an ISA? I've heard the funds must come from a pension fund – is this true?
Martin

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

An annuity is a guaranteed retirement income for life paid to you by an insurance company, usually in return for your pension pot. However, you don't have to have a pension fund to buy an annuity. You can use any pot of money to buy a 'purchased life annuity'.

Part of each income payment from a purchased life annuity is treated as a return of the original lump sum paid – this is classed as the 'capital' element, which means you won't be taxed on this original payment. However, the difference between the gross income payment and the capital element is taxable as savings income.

If you have a defined contribution pension, you can use it to buy a 'lifetime annuity'. Your annuity income is subject to income tax.

Annuities provide certainty in retirement as you will know exactly how much income you'll receive. But if your circumstances change, you won't be able to flex your income to meet your needs.

Once you buy an annuity, there is no going back. You need to be sure it is the right route for you and shop around the market for the most appropriate product and the best rate.

There are different flavours of annuity to suit different needs and preferences. For example, you can choose to opt for a 'level' annuity or an 'escalating' annuity. The former will give you a higher starting income, but your spending power will be steadily eroded over time by inflation. The latter will give you some protection against rising prices, but you'll be offered a lower starting rate.

When buying an annuity, tell your insurer of any medical or lifestyle factors that may limit your life expectancy, as disclosing these could mean you get a better deal.

If you are comfortable taking some investment risk and prefer more freedom, you might want to consider drawdown – although you will need to have a defined contribution pension. In drawdown, your fund will remain invested, with the potential to grow over the long-term, and you'll have total flexibility over how and when you access your money.

This flexibility comes with responsibility – namely ensuring your fund lasts throughout your retirement by managing withdrawals sensibly. You also need to be comfortable with the risk your investments might fall as well as rise.

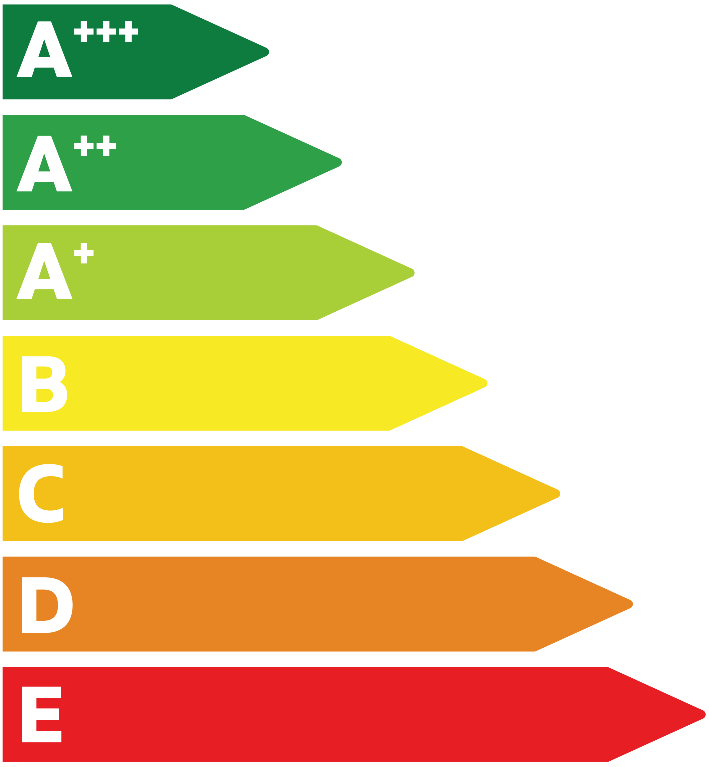
Another option is to take ad-hoc lump sums from your pension, with a quarter of each lump sum tax-free and the rest taxed in the same way as income.

It is possible to combine annuity and drawdown to get a balance of security and flexibility.

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.



I want my savings to go green – what are my options?

We look at savings accounts, mortgages and investments with a green angle

Interest rates on cash savings accounts have risen the past couple of years, as the Bank of England's base rate has been hiked. But some people want their cash to be put to good causes, while also earning them a return on their money.

The 'green' savings market has emerged in recent years, with money saved put towards environmentally friendly projects. However, with all the options you're not going to get a market-leading rate – so you need to sacrifice returns for your green intentions. You also need to do your own assessment of just how 'green' the savings products are, and which ones align with your motives.

THE GOVERNMENT-BACKED OPTION

NS&I launched its own product into the market in October 2021, called the Green Savings Bond. This three-year fixed-rate account raises money for use by the Government on specific projects. Current initiatives range from electrifying the rail network between Wigan and Bolton to incentives for households to install biomass boilers or solar water heating.

The Government savings provider has just launched its fifth issue of the bond, after increasing the interest rate to 5.7%. Savers must be over the age of 16, can put between £100 and £100,000 into the bonds, with all the interest paid out at the end of the three-year term.

The money is locked up for this time with no opportunity for an early exit. Three years is also a long term, so you need to be sure you're comfortable with your money being tied up for this long.

WHERE TO FIND A HIGHER RATE

You can earn more than the NS&I rate with Gatehouse Bank's one-year Woodland Saver. This fixed-term account pays interest of 5.9%, has a minimum deposit of £1,000 and also doesn't allow withdrawals (but the term is shorter).

However, the money isn't invested in green projects, instead a tree is planted for every account opened. The account is also Shariah compliant, which means it has an expected profit rate rather than a guaranteed interest rate.

OTHER OPTIONS

If that feels a little light touch on the green credentials you could opt for an alternative account, but you will sacrifice more interest.

Paragon Bank's green three-year fixed-rate account pays 5.4%, with savings between £1,000 and £500,000. It says money saved in the accounts will be leant out to people wanting buy-to-let mortgages where the properties have an Energy Performance Certificate rating of 'C' or above. Quite a narrow purpose for the savings, but one that might align with some savers.

Another option is Ecology Building Society, which offers a 90-day notice account that pays between

3.5% and 3.9% depending on the balance – a significant drop on the other options. But it does offer funding for a number of community and individual projects; recent ones include funding the building of housing in a cooperative in Brighton and an environmentally friendly conversion of a barn in Cornwall.

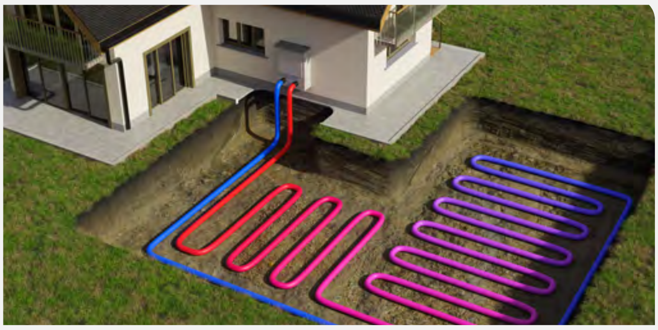
Away from fixed-term and notice accounts Tandem is one option – badging itself as the 'greener' digital bank. It uses money from savings accounts to lend out to individuals for areas like energy-efficient home improvements or buying hybrid cars. Its instant access saver account pays 4.65% interest with no minimum deposit and unlimited withdrawals.

Alternatively, Triodos is another option, with an easy-access account paying 3.45% or a one-year bond paying 4.25%. The winner of the Best Ethical Financial Provider award at the British Bank Awards, this bank publishes details of every organisation it lends to, so you can vet its borrowers. Previous projects include funding a hydropower scheme in Yorkshire and a dairy farm in Kent.

All rates in this article were accurate as of 12 September 2023.

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

Ecology Building Society offers funding for projects such as Bunker Housing Cooperative in Brighton & Hove



Other ways to make your finances green

1. **Switch your investments.** You can move your investments into 'green' or ESG funds. Each fund will have a different criteria of what it will and won't invest in, so you need to do some digging to make sure it fits with your views. Or you can pick a tracker fund that excludes certain companies from the index, such as oil groups or gambling companies.

2. **Turn your current account green.** Make your day-to-day banking more environmentally friendly by switching your current account to a greener bank. You could use one of the banks mentioned in this article, or something like The Co-operative Bank.

3. **Switch your pension.** Lots of people will be invested in their 'default' fund through their company pension, but you could switch this to a 'greener' option. Most company pension providers will have an ESG or ethical fund option that you could move to. Alternatively, you could move to a SIPP (self-invested personal pension) and select the fund yourself.

4. **Get a green mortgage.** This isn't a huge market, but a number of lenders offer green mortgages, which incentivise homeowners to make energy-efficient improvements to their properties. For example, NatWest offers a lower interest rate on mortgages for properties with an EPC rating of A or B, while Barclays offers a cash bonus for homeowners who carry out energy efficient home improvements, like installing a heat pump.

WATCH RECENT PRESENTATIONS

Rainbow Rare Earths Ltd (RBW)
George Bennett, CEO

Rainbow Rare Earths (RBW) aims to be a forerunner in the establishment of an independent and ethical supply chain of the rare earth elements that are driving the green energy transition. It is doing this successfully via the identification and development of secondary rare earth deposits that can be brought into production quicker and at a lower cost than traditional hard rock mining projects.

STV Group (STVG)
Lindsay Dixon, FD

STV Group (STVG) STV Group plc is Scotland's home of news, entertainment and drama, providing audiences with top-quality programming on air, online and on demand. STV is the most popular peak time TV channel in Scotland, reaching 3 million viewers each month. Fast-growing free streaming service, STV Player, is available on all major platforms offering UK viewers an extensive catalogue of content.

Cadence Minerals (KDNC)
Kiran Morzaria, Director & CEO

Cadence Minerals (KDNC) is dedicated to smart investments for a greener world. The planet needs rechargeable batteries on a global scale – upcoming supersized passenger vehicles, lorries and buses – require lithium and other technology minerals to power their cells. Cadence is helping find these minerals in new places and extracting them in new ways, which will meet the demand of this burgeoning market.

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