STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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BIG DIVIDENDS

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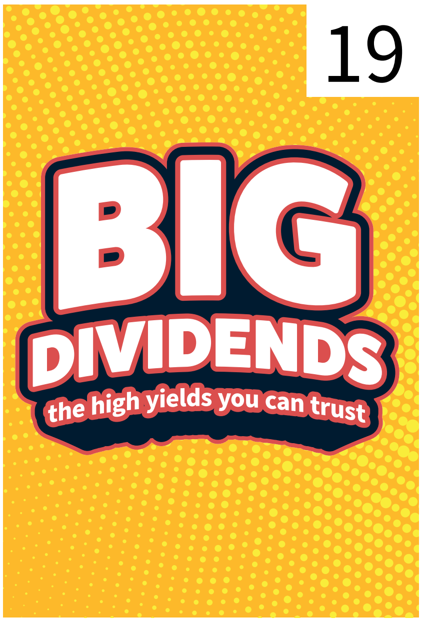
Contents



Three important things in this week's magazine

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3

Big dividends

Shares team examines some of the highest yielding stocks on the UK market and identifies the ones we have confidence in and the ones to avoid.

Dunelm versus B&M

Comparing two top retailers who are in line to benefit from the recent collapse of Wilko.

Tesla under pressure

The electric vehicle maker is cutting prices and missing delivery targets which could hit margins.

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:

Speedy Hire shares jump on trading update and green power acquisition

Treatt shares perk up 12% on resilient full year sales and profit

YouGov shares jump as new CEO Steve Hatch delivers for the full year

Sandwiches giant Greencore gains on profit upgrade and further £15 million share buyback

Markets buffeted by strong US job gains and Israel attacks

Escalation of the tensions could lead to more sanctions and disruptions to oil supplies

Stocks across the Atlantic surprised in the wake of the 6 October US jobs report as they registered their largest daily gains since late August, snapping a four-week losing streak.

Bond yields, which had surged earlier in the day to their highest since 2007, backed off giving some respite to risk assets.

Puzzlingly, the gains came after September's jobs report revealed the economy added 336,000 jobs last month compared with 170,000 expected and the highest print in nine months – with an earlier reading also revised higher.

While it is tempting to see the headline data as providing ammunition for the Federal Reserve to keep interest rates higher for longer, investors took solace from nuances within the data.

Average hourly wage inflation cooled to 4.2% on an annual basis from 4.3% while job gains were concentrated across hospitality, health, and education, sectors which had lagged coming out of the pandemic, suggesting a catch-up rather than something more structural.

The stock market advance was stopped in its tracks after Middle East tensions erupted thanks to the devastating attacks on Israel.

Oil prices surged with Brent crude gaining 3% to $86.70 per barrel on 9 October while gold prices gained 1% to $1,846 per ounce. Previously gold had dropped 7% since the beginning of September reflecting a sharp increase in bond yields.

Gold is perceived as a haven asset during periods of global uncertainty. The price peaked at just over $2,000 per ounce in May 2023.

The dominance of oil companies within the FTSE 100 provided some ballast for the blue-chip index after the share prices of oil giants **BP (BP)** and **Shell (SHEL)** made progress off the back of the commodity price surge.

Bucking the trend in the sector though was oil and gas developer **Energean (ENOG)** whose shares sank 20% due to the proximity of its operations offshore Israel to the conflict zone.

Meanwhile, the airline sector was under pressure after several international carriers suspended flights to Tel Aviv and investors priced in the impact of higher fuel costs.

Liberum's oil and gas analyst David Hewitt believes the effect to crude and product balances should remain 'extremely minimal' if the conflict remains within the Israel-Palestine locality.

The risk is the conflict escalates and draws in other political players such as the US, Iran, and Russia. Under this scenario the availability of the Straits of Hormuz becomes questionable argues Hewitt. 'At that point you can make up any number you want for crude pricing,' says Hewitt. [MG]

Non-farm payrolls at their highest level since January

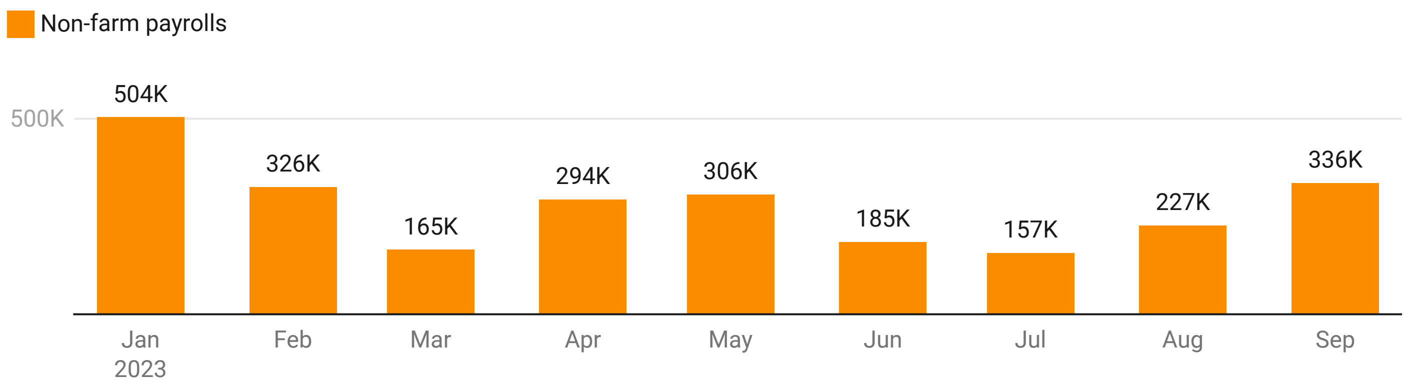

Chart: Shares magazine • Source: US Bureau of Labor Statistics

Tesla deliveries miss in third quarter and pose the risk of lower margins

Electric vehicle buyers may be delaying purchases in the hope of even lower prices ahead

Tesla

($)

Chart: Shares magazine • Source: LSEG

Tesla **(TSLA:NASDAQ)** unveiled another round of vehicle price cuts in the US (2 October), the seventh time this year that the world's biggest electric car maker has lowered prices on some models.

Yet investors were left a little miffed by lower third-quarter deliveries, even after planned production 'downtime', and this helped sour sentiment a touch ahead of third quarter earnings on 18 October.

The company reported a 6.7% fall in third quarter (to 30 September) deliveries versus the second three months to June after its gigafactories in Austin and Shanghai shutdown temporarily for upgrade work.

Tesla delivered 435,059 electric vehicles in the third quarter; missing consensus analyst estimates of 461,640 vehicles. Wedbush analyst Dan Ives expects most of the deliveries drift to come through in a strong fourth quarter, but not all analysts agree.

The latest deliveries miss may also imply that potential buyers are starting to hold off on purchases in the hope that lower prices have yet to bottom out.

There are two main reasons for Tesla's aggressive pricing strategy; to boost sales in a slowing electric vehicle market and, crucially for Tesla, to fend off competition from legacy car makers and Chinese challengers. Global car makers are in a race to electrify their vehicles as they press forward with strategies to drive the next phase of mobility and offer consumers smaller carbon footprint mobility options.

> "Global car makers are in a race to electrify their vehicles"

But if price cuts are no longer stimulating demand, analysts say, it poses an increased risk to profit margins. Tesla's second quarter 2023 gross margins, where analysts once had a 20% line in the sand drawn, were 18.2% versus 19.3% in the quarter to March, and 22.4% in the second three months of 2022.

Over the same period, operating margins have almost halved to 9.6%.

The latest lower prices could cost the company $1.2 billion a year, according to some analyst calculations, leading to criticism of Tesla's reluctance to invest in a marketing campaign underlining the increasing cost parity of a Tesla versus alternative new vehicles.

At $38,990, the base Model 3 sedan now costs $8,700 less than the average amount paid for a car or truck in the US, according to an analysis by Bloomberg Green, including mainstream ICEs (internal combustion engine) models. The starting price for a Model Y SUV is $3,700 below the average auto price of roughly $48,000. This follows months of price cuts as Tesla turns the screw on legacy automakers that were already struggling to make electric vehicles profitably.

Yet many potential new car buyers simply do not realise how competitive Tesla's prices are, according to Future Fund managing partner Gary Black, something it needs to address. [SF]

Weak retail figures and Bank of England gloom dial down rates pressure

Shopkeepers may be looking at the Christmas selling period with trepidation

Although the UK experienced the hottest September on record, shoppers showed no sign of loosening their purse strings according to the latest updates from Kantar Worldpanel and the BRC (British Retail Consortium).

Combined with a gloomy assessment from the Bank of England of the prospects for the UK economy and the pressure for further rate increases is continuing to recede.

The sunny weather may have boosted sales of barbecue food and ice cream but Kantar's till-roll data shows more shoppers looked for deals to make their money go further.

There was positive news in terms of grocery inflation, which slowed to 11% in September from 12.2% in August and 13.9% a year ago, but volumes were still negative meaning shoppers are putting fewer items in their baskets.

Meanwhile, the BRC reported overall consumer spending rose 2.7% in September, down from a 4.1% increase in August, as the cost-of-living crisis continued to pressure UK households.

Food and drink sales rose 7.4% on a three-month basis, with health and beauty sales also positive, but non-food sales fell into negative territory dropping 1.2% over the three months to September.

Sales of big-ticket items such as furniture and electricals performed poorly, as customers put off big purchases in the face of higher housing, rental and energy costs, while the 'Indian summer' meant sales of autumn/winter clothing were also disappointing.

The latter are traditionally higher margin items for clothing sellers and concern around this issue has blighted retail bellwether **Next's (NXT)** shares of late.

The weakness in sales of electrical goods is backed up by figures from the ONS (Office for

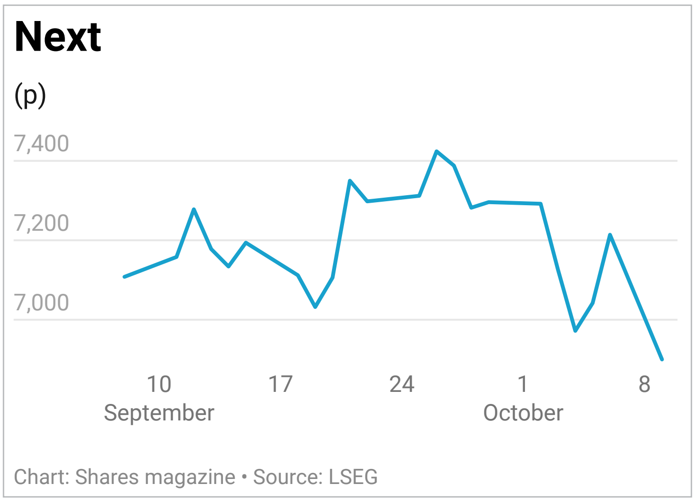

Chart: Shares magazine • Source: LSEG

National Statistics) which show negative growth for the category going all the way back to early 2022.

This is bad news for electronic gadgets chain **Currys (CURY)** which recently said (10 October) it has seen interest for its Greek and Cypriot businesses having put them up for sale over the summer.

Online sales fell again, in the BRC figures with September marking 26 consecutive months of consecutive declines as the return to physical stores continues, underlining the importance of the multi-channel retail model.

Looking ahead to the 'golden quarter' and Christmas, the overall mood music isn't particularly positive and comparisons with last year will be tough given the strength of 2022 sales, so 'the fight for Christmas shoppers will be fierce this year, with promotions likely to be earlier and abundant in a bid to loosen tight household purse strings,' says Paul Martin, KPMG's head of retail insights.

In its latest Financial Policy Summary and Record, the Bank of England described the current outlook for the economy as 'challenging', warning 'a number of risks could weaken growth further'. [IC]

Hunting lifted by higher oil prices and inspiring long-term vision for business

Energy services firm has seen its shares pick up pace in the past six months

A combination of a favourable commodity price backdrop and positive operational progress has helped energy services firm **Hunting (HTG)** to a 20% share price gain in the past six months.

As chief executive Jim Johnson explained to *Shares* an investor day on 13 September was intended to demonstrate to the market the business was about more than its flagship Titan product. This perforating gun is used to penetrate wells in preparation for production and is heavily tied to US onshore rig activity.

Hunting has set out a new strategy which centres around its strategy to achieve 15% EBITDA (earnings before interest, tax, depreciation and amortisation) margins by 2025 with further improvement by 2030, with multiple avenues for growth, reducing cyclicality and volatility from a business previously heavily reliant on Titan performance.

The company is targeting $1 billion worth of free cash flow generation between now and the end of the decade and has equipment and technologies which can be applied to the energy transition, specifically in areas like geothermal and carbon capture. [TS]

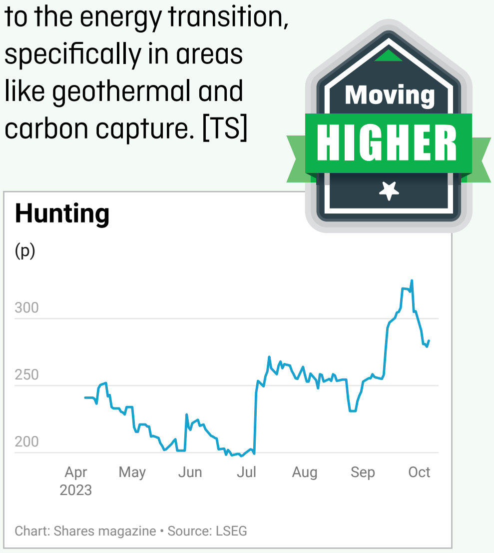

Chart: Shares magazine • Source: LSEG

VinFast stock's rapid rise matched by equally fast falls

Vietnam's answer to Tesla feels the strain of IPO growing pains

A roller-coaster analogy is often used with high volatility stocks, but skiing is perhaps a better one for **VinFast Auto (VFS:NASDAQ)**. To say Vietnam's supposed answer to **Tesla (TSLA:NASDAQ)** was a debut hit would be an understatement - the stock surged roughly 270% on its $22 IPO (initial public offering) price in two weeks for a peak market value of more than $190 billion (28 August).

In the last month alone the stock has halved, falling below the IPO price, after VinFast unveiled a $623 million third quarter 2023 net loss, about 34% up on Q3 2022, despite soaring deliveries of its electric cars, buses and scooters (10,027 cars/ buses, 28,220 scooters).

VinFast's erratic run should not be so surprising considering approximately 99% of the shares are under the control of Pham Nhat Vuon, the company's chairman and founder. With so few available for outside investors, when the relatively rare free float shares do change hands, it can have a dramatic impact on the share price, as we have seen.

Growing speculation that most of VinFast's vehicle deliveries stayed in the domestic market, with many of the cars snapped up by the founder's own taxi firm fleet, as rumours have it, and that Pham Nhat Vuon also wants to sell more of his stake, will not ease the intense uncertainly surrounding the company and its stock. [SF]

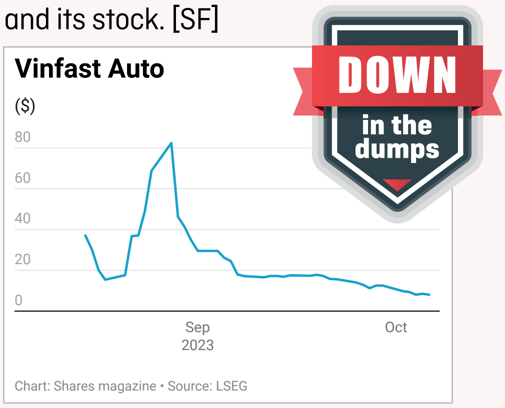

Chart: Shares magazine • Source: LSEG

Appetite is building for pub and hotel group Whitbread's interim results

Strong trading in UK hospitality and a recovery in Germany are on the menu

Given the positive summer trading updates from UK hospitality firms such as **JD Wetherspoon (JDW)**, **Marston's (MARS)** and **Mitchells & Butler (MAB)**, expectations are fairly high for Beefeater, Brewers' Fayre and Premier Inn owner **Whitbread (WTB)** when it reports first-half earnings on 18 October.

In the first quarter to the start of June, Premier Inn accommodation sales were up 18% on last year while RevPAR (revenue per available room) was up 16% with the firm citing strong demand from both business and leisure guests.

The group also reported 'strong momentum across the group' leading into the second quarter with forward-booked revenue in the UK well ahead of 2022 and a recovery in demand in Germany with RevPAR up almost 50%.

Whitbread

(p)

Chart: Shares magazine • Source: LSEG

Shore Capital leisure analyst Greg Johnson recently raised his full-year pre-tax profit forecast for a third time, from £485 million to £535 million, and suggested the group had enough excess capital to carry out more share buybacks this year.

Johnson also argued that adjusting for costs associated with the roll-out of Premier Inn in Germany, Whitbread's UK business is trading on just 14 times net income and eight times EV to EBITDA (enterprise value to earnings before interest, tax, depreciation and amortization), which he set against the group's 'robust trading, market-leading position, freehold-rich and debt-free estate, attractive return metrics and medium-term opportunities'. [IC]

What the market expects of Whitbread

	EPS (p)	Revenue (£bn)
Forecast for 2023	195	2.9
Forecast for 2024	208	3.1

Table: Shares magazine • Source: Stockopedia. Year end 31 December

UK UPDATES OVER THE NEXT 7 DAYS

FULL YEAR RESULTS

16 October: Tristel
17 October: Bellway, Seraphim Space Investment Trust, EnSilica, Revolution Bars
18 October: Whitbread

INTERIMS

17 October: Smartspace Software

TRADING ANNOUNCEMENTS

13 October: Record, InterContinental Hotels
17 October: IntegraFin, Rio Tinto, Jupiter Fund Management
18 October: Segro, Quilter, Liontrust Asset Management
19 October: London Stock Exchange, Network International, AJ Bell, Dechra Pharmaceuticals, Pension Bee, Mondi, Rentokil Initial, RELX

Netflix to update on earnings as writers strike comes to an end

The streaming giant's shares are up 30% so far in 2023

Global streaming platform **Netflix (NFLX:NASDAQ)** is due to report its third quarter results on 18 October with the entertainment sector just emerging from a period of turmoil.

Analysts are forecasting revenue of $8.53 billion and earnings per share (EPS) of $3.50 is expected for the third quarter.

In the second quarter Netflix reported revenue of $8.2 billion, just shy of the $8.3 billion forecast, while net income climbed to $1.49 billion from $1.44 billion in the same quarter a year ago.

The global streaming platform also managed to add nearly six million new subscribers in the second quarter, defying sceptics who assumed customers had been put off by its password sharing crackdown.

Netflix shares have made strong gains in 2023, up just under 30% year-to-date to the $381 mark.

No doubt the Hollywood actors' and writers' strike will get a mention in its third quarter results. According to Californian economic think tank the Milken Institute the industrial action has cost the US economy around $5 billion since the writers' walkout on 2 May this year over the use of artificial intelligence (AI) and pay.

With a deal to end the strikes being struck, Netflix is planning to raise the price of its ad-free service in several markets globally including the US and Canada, according to reports from the *Wall Street Journal*. This could reflect higher costs as some of the demands from industry talent on remuneration are met. [SG]

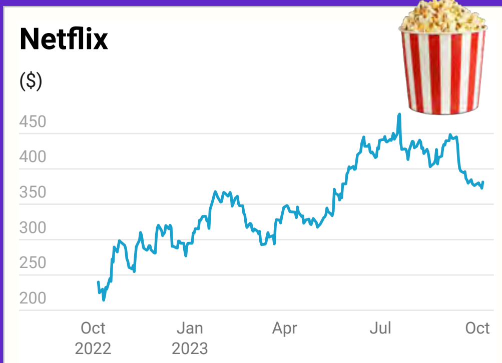

Chart: Shares magazine • Source: LSEG

What the market expects of Netflix

	EPS ($)	Revenue ($bn)
Q3	3.50	8.53

Table: Shares magazine • Source: Yahoo Finance

US UPDATES OVER THE NEXT 7 DAYS

QUARTERLY RESULTS

13 October: UnitedHealth, JPMorgan, Wells Fargo, BlackRock, Progressive, Citigroup, PNC Financial

16 October: Charles Schwab, Albertsons, Equity Lifestyle

17 October: J&J, Bank of America, Goldman Sachs, Interactive Brokers, Bank of New York Mellon, Omnicom, United Airlines, Pinnacle, Hancock Whitney, Nordic Semiconductor

18 October: Tesla, Procter & Gamble, Abbott Labs, Netflix, Morgan Stanley, US Bancorp, Crown Castle, Travelers, Nasdaq, Equifax, State Street, M&T Bank, Antofagasta, Northern Trust, Graco, Globe Life, Alcoa, Wintrust, First Horizon National, Winnebago Industries, Community Trust, Eagle

19 October: Philip Morris, Union Pacific, AT&T, KeyCorp, American Airlines, Tenet Healthcare


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Baillie Gifford UK Growth Trust won't stay this cheap for long

Baillie Gifford UK Growth Trust

(BGUK) 150p

Market cap: £225 million

If there is one thing investors can agree on, it is that the UK stock market is cheap.

How cheap depends on who you ask, but the strategy team at Morgan Stanley believe the FTSE 100 is trading at a 35% discount to the MSCI World Index on a PE (price to earnings) basis.

If inflation pressures continue to ease and the economy shows further signs of cooling, there is a fair chance the Bank of England may decide to hold off from raising interest rates for a second time when it meets next month.

If that is the case, then being able to buy the best UK growth companies in one go today at a material discount to their current share price seems like an opportunity not to be missed.

The **Baillie Gifford UK Growth Trust (BGUK)** is a high-conviction, concentrated selection of the managers' best ideas among UK small- and mid-cap growth companies, which they believe is the market's 'sweet spot'.

The trust's NAV (net asset value) per share at fair value as of 6 October was 178.4p meaning that at the current price investors can access these best ideas at a discount of 16%, which is above the 12-month average, and for an ongoing charge of just 0.7%.

The top holdings at the end of August were as follows: **Games Workshop (GAW)**, **Ashtead (AHT)**, **Auto Trader (AUTO)**, **Volution (FAN)**, Abcam (since acquired by US firm **Danaher (DHR:NYSE)**), **Experian (EXPN)**, **Howden Joinery (HWDN)**, **St James's Place (STJ)**, **Softcat (SCT)** and **Diageo (DGE)**.

As analyst Matthew Read at QuotedData puts it, the trust has faced 'particularly strong headwinds during the last 18 months as investors have either sought sanctuary in value and defensive stocks or pulled money out of equities altogether, often in favour of fixed-income stocks which are now offering a better rate of return than they have for some time'.

Yet at an operational level, its investee companies continue to perform well, with solid balance sheets, and given the discount there is potential for the trust to re-rate once the UK comes back into favour with investors.

Interviewed last month by the AIC (Association of Investment Companies), co-manager Milena Mileva said portfolio turnover in the last year had been just 5%, meaning the team had made very few changes, as 'despite the valuation reset, we are confident the business fundamentals and growth prospects of our holdings remain very strong'.

The managers are 'deeply enthusiastic about the businesses we are invested in', with close to 95% of the portfolio showing positive earnings and free cash flow despite the economic headwinds. [IC]

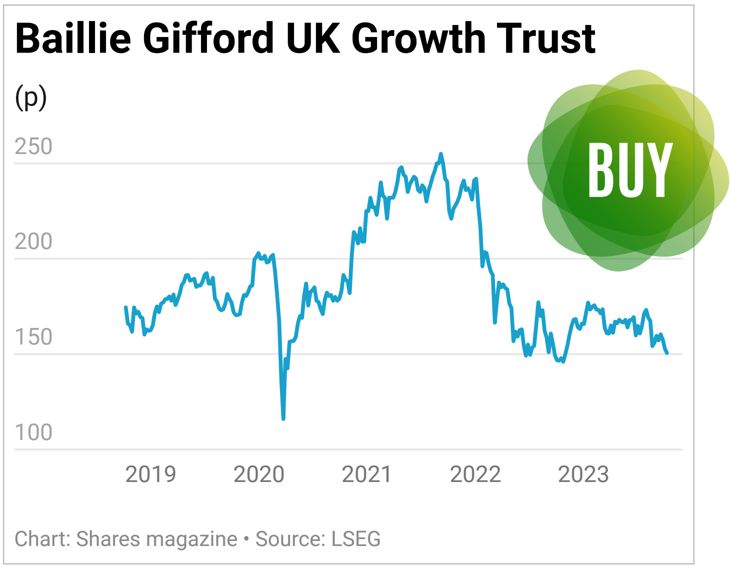


Chart: Shares magazine • Source: LSEG

Buy animal genetics firm Genus ahead of its next exciting growth phase

The company's shares have fallen materially in the last two years creating an entry opportunity

Genus

(GNS) £21.42

Market cap: £1.4 billion

Shareholders in leading global animal genetics specialist **Genus (GNS)** have been through a rough couple of years with the shares losing just under two-thirds of their value.

The fall can be attributed to a big derating in the shares which has seen the forward PE (price to earnings) ratio fall from 53 times to 24 times today, and huge swings in Chinese pig prices which have dented near-term demand for genetics services.

Despite these headwinds Genus' pig business generated record operating profits for the year to 30 June as strong trading in the rest of the world offset a challenging second half in China.

Shares believes the derating has run its course while a key catalyst for the next stage of growth has yet to be fully appreciated by investors.

Genus is on the cusp of commercialising a game changing technology for the pig industry. Using its gene editing platform, the company has created pigs resistant to PRRS (Porcine Reproductive and Respiratory Syndrome). It is estimated that PRRS costs the US and European pig industry around $2 billion a year. There are currently no vaccines or effective treatments.

The company is hosting a capital markets day on 1 November when it will take a deep dive into the science behind the technology and outline its commercialisation plans.

On 5 October Columbia became the first country to approve future sales of PRRS resistant pigs. The company anticipates receiving US FDA (Food and Drug Administration) approval in the first half of 2024 with further approvals sought in Canada, China, Japan, Mexico, and Brazil.

Numis estimates a profit potential of between $1.50 and $2 per pig, which could add more than £140 million a year to operating profits once fully commercialised. In the 12 months to 30 June 2023 Genus generated £40.5 million of operating profit.

Despite trimming 2024 EPS (earnings per share) forecasts by 13% due to higher interest costs and foreign exchange headwinds Numis estimates Genus could grow EPS by a compound annual growth rate of around 16% a year over the next three and a half years. 'With valuation multiples approaching a decade low we think the shares look attractive,' the broker says.

Genus holds a dominant position in animal genetics forged by building proprietary breeding lines which allow farmers to breed animals with desirable pedigree traits.

The company helps farmers produce animals with higher quality milk, breed animals with high feed efficiency and give birth to larger litters. Genus does this for dairy, pig, and beef farmers worldwide. An expanding global population and increasing wealth are key drivers of animal protein consumption. [MG]

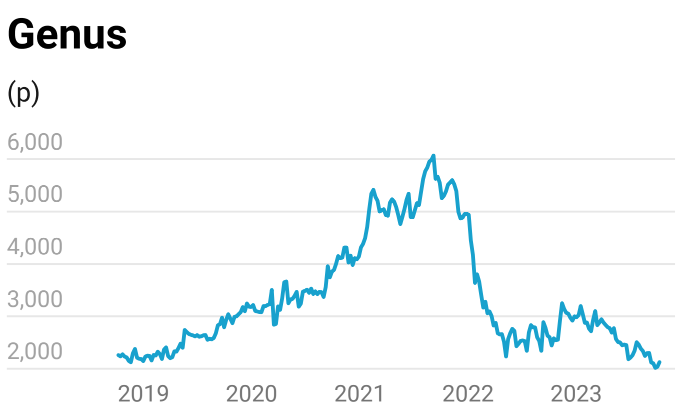


Chart: Shares magazine • Source: LSEG

Volution's bumper results reward our faith in the business

Revenue and profit both come in ahead of expectations for ventilation kit maker

Volution (FAN) 370p

Loss to date: 4.5%

We made the argument in July that ventilation products manufacturer **Volution (FAN)** warranted a valuation in line with other high-quality industrial names, saying to buy at 387.6p.

Volution makes everything from air ducts, extractor fans and heat exchangers and coming out of the pandemic the regulatory drivers behind air quality have really stepped up.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

In difficult markets and amid concern about its construction end-markets the shares drifted lower but then publication of full-year results on 5 October rewarded our faith in the company and help revive the shares.

Revenue for the year to 31 July increased 6.6% to £328 million, which was slightly above consensus forecasts of £326 million. Organic growth contributed 4.6% with the balance coming from two acquisitions made in the year and one completed in the prior year.

Despite inflationary headwinds the company delivered 6.8% growth in pre-tax profit to £65.1 million, around 5% higher than the market expected.

Operating margins increased slightly driven by 'good price discipline, robust cost control and good factory efficiency'.

The business generated strong operating cash, up 50% to £75.7 million leaving the group with net debt to EBITDA (earnings before interest, tax, depreciation, and amortisation) of 0.8 times after spending £30 million on acquisitions.

The proposed dividend for the year increased by 9.6% to 8p per share reflecting strong performance and confidence in the year ahead.

Berenberg analyst Robert Chantry says: 'As with the rest of the European building products space, end construction markets remain subdued. However, we feel the backdrop of regulatory drivers, strong service and broad product availability should help Volution avoid the worst and take market share.'

WHAT SHOULD INVESTORS DO NOW?

The company is successfully navigating a difficult backdrop and we still see scope for a big re-rating from the current 14 times forecast earnings as the market recognises the business for the regulatory-driven winner it is. Keep buying the shares. [TS]

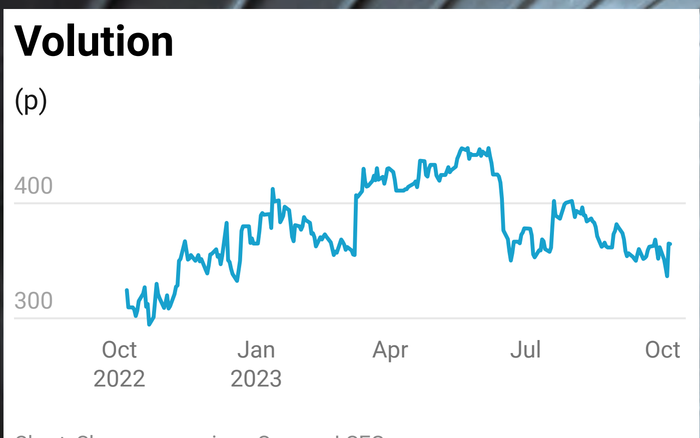
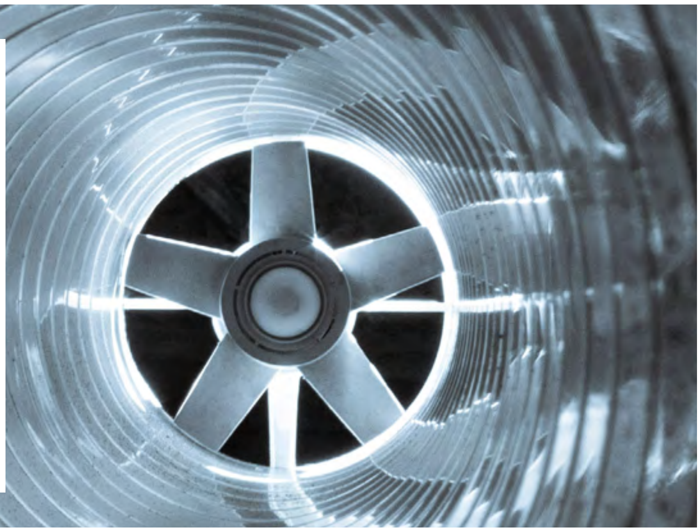


Chart: Shares magazine • Source: LSEG



Schroders

Behind the trust: **Schroder AsiaPacific Fund plc**

At an index level, emerging markets tend to be more volatile than developed ones but investors looking for long-term growth ignore Asia at their peril. Far from trailing the west, many companies operating in the region are global leaders in their fields.

The case for investing in Asia remains strong, driven by a positive economic outlook, long-term growth potential from favourable demographics and a growing middle class fuelling strong domestic consumption.

There are many pitfalls to investing in Asia, however. Asian equity markets are prone to geopolitical risk and investor sentiment often drives share prices. This requires a steady hand on the tiller and the expertise to assess company fundamentals and chart a careful course towards the brightest growth prospects.

Schroders' Asian team is exceptionally well resourced and draws on a wealth of capabilities in London and across Asia. Harnessing them to their full potential is the Schroder AsiaPacific Fund.

Testament to the team's stock-picking abilities is the trust's outperformance of its benchmark, the MSCI All Country Asia excluding Japan Index, since its inception in November 1995. It has also outperformed developed stock market indices, such as Britain's FTSE 100 and Japan's Topix, over the longer term[1].

How exactly does the team behind the trust identify companies that stand to benefit from the Asian growth story and what makes it a worthy addition to an investor's portfolio today?

WHAT DOES THE TRUST DO?

The trust principally invests in companies located in the continent of Asia excluding Japan and the Middle East. Such countries include Hong Kong, China, Singapore, Taiwan, Malaysia, South Korea, Thailand, India, the Philippines, Indonesia, Pakistan, Vietnam and Sri Lanka.

Its objective is to outperform the MSCI All Country Asia excluding Japan Index in sterling terms over the longer term.

Putting their significant experience in Asian and emerging markets towards that aim are Managers Richard Sennitt and Abbas Barkhordar. In running Schroder AsiaPacific, they manage one of the largest and most liquid funds in the peer group.

HOW DOES IT DO IT?

The fund managers employ a bottom-up, stock-picking approach. They seek quality companies with the potential to sustainably generate returns above their cost of capital. They have an eye on valuation too and look for 'quality growth at the right price'.

Key themes resulting from their stock-picking focus are tech leadership and innovation, the Chinese consumption and service sector, and Indian finance.

Commonplace among holdings are technology hardware names, including semiconductor producers in Korea and Taiwan, as well as consumer discretionary and financial stocks, such as regional banks exposed to increasing credit penetration in markets such as India and Indonesia.

The trust benefits from Schroders' proven Asian equity capabilities. The research-intensive process benefits greatly from a wealth of local expert knowledge and a large team of skilled professionals analysing investment opportunities both on the ground in Asia and in London.

The result is a wide range of investments, with the trust holding around 60 companies spread over multiple countries and in a range of industry sectors without any major bias towards growth or value investment styles.

WHY INVEST?

There are many compelling reasons to invest in the Schroder AsiaPacific Fund. Here are 10 of them:

1. Growth profile

The trust seeks to offer investors an attractive way to gain exposure to the compelling long-term growth profile of Asia and the growing volume and variety of world-leading companies based there. The portfolio is positioned to benefit both from Asia's globally-competitive exporters, as well as from domestic growth in the region driven by rising household incomes, greater credit penetration, urbanisation and growing consumer demand for products and services. The managers focus on companies benefitting from competitive positions and the ability to earn attractive returns, or those that are steering a course towards this.

2. Focus on quality

The managers seek to mitigate the risk of investing in Asia by focusing on quality companies. They favour those with sustainable earnings, robust balance sheets, efficient capital allocation and good corporate governance.

3. Buying opportunities

The trust offers exposure to attractive Asian growth opportunities but it does so with a keen eye on valuation. More difficult investment environments, where stock markets have indiscriminately sold off, can lead to buying opportunities. Ongoing shifts of sentiment and market dislocations often present attractive opportunities for the managers because of their longer-term investment horizon.

4. Strength of management

Although they only took over the strategy on 31 March 2021 following the retirement of Schroders veteran Matthew Dobbs, Sennitt and Barkhordar provide stability and experience, having spent their entire investment careers in Asian and emerging markets at Schroders. Sennitt joined Schroders in 1993 and Barkhordar in 2007. Morningstar senior investment analyst Lena Tsymbaluk points to Sennitt being an 'experienced and proven investor'[2] and the continuity provided by him working closely with Dobbs for the prior 13 years. Numis points to Barkhordar bringing more experience in asset and country allocation decisions and the team using more data to help inform decisions[3].

5. Information advantage

Sennitt and Barkhordar are based in London but draw upon the rich resources of Schroders' Asia Pacific equities research team. This comprises around 37[4] analysts based in six offices across the region, who are complemented by Schroders' London-based global sector specialists and emerging markets team. In addition, the London-based data insights unit and ESG team bolsters the strength of these resources, which gives the managers a potential information advantage in under-researched and inefficient markets.

6. Diversification
The Schroder AsiaPacific Fund casts its net far and wide to find the brightest prospects across the region, including in markets such as India and Vietnam. The fund invests beyond just the companies in its benchmark, including in other funds, to gain exposure to the widest variety of opportunities presented by the region.

7. Active management
The managers believe that Asian stock markets are inefficient and provide strong potential for adding value through active fund management, using a systematic and disciplined bottom-up research process. The managers aim to exploit these market inefficiencies by focussing on company fundamentals and taking a long-term view of the sustainability of a company's returns and competitive advantages.

8. Company engagement
The quality of management is important to the approach, therefore high value is placed on regular engagement with companies – the investment team holding over 2,000 company meetings a year. Generally, the fund management duo aims to be in Asia two to three times a year, as well as regularly meeting companies in London.

9. ESG integration
In addition to fundamental financial analysis, Schroders' proprietary sustainability tools and extensive engagement with Asian companies provide a wide range of metrics for its analysts to utilise in identifying the attractive opportunities for investment. The well-resourced central ESG team is key to understanding the wider impact of sustainability issues on the trust's investments.

10. Competitive fees
Fees charged to investors in the trust were reduced on 1 April 2023 to 0.84%. There is no performance fee.

Find out more about Schroder AsiaPacificFund plc

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[1] - Based on performance since inception to 31 March 2023.
[2] - Morningstar analyst research, 21 October 2021
[3] - Schroder AsiaPacific: Benefitting from the Asian Growth Story, Numis, 15 October 2021
[4] - Schroders, 2023. The 37 ex Japan analysts includes Schroders' local specialist team of equity analysts in Sydney, as well as a joint-venture team of Indian equity analysts at Axis Asset Management (Axis AMC) in Mumbai.

BIG DIVIDENDS

the high yields you can trust

By **Martin Gamble** Education Editor

Sky-high interest rates and unruly inflation make the future direction of the economy more uncertain than usual. It is certainly no time to be complacent.

Against such a tough backdrop now is a good time for investors to take stock and consider if the income they expect from dividends in their portfolios are safe.

Investors are often attracted to the highest yields, but this can indicate markets do not believe the dividend will be paid in full.

This article looks at some of the highest dividend yields available in the UK market and identifies which look safe and which may be at risk.

To the casual observer things don't look too bad for the UK income investor. The latest dividend dashboard from AJ Bell (4 September) shows the FTSE 100 is expected to pay total dividends of £78.7 billion in 2023.

Adding £46.6 billion in share buybacks already announced to the tally would make 2023 the second best-ever year for FTSE 100 dividends and buybacks since 2018.

However, before cracking open the bubbly, it is worth noting the deteriorating trends in forecasts. For example, in the last three months analysts' forecasts for pre-tax profit growth have dropped from 19% to just 10%.

Meanwhile, at the end of the second quarter dividends from the FTSE 100 were expected to total £83.8 billion which means analysts have trimmed their forecasts by around 6%.

It is important to emphasise, dividends are discretionary payments and cannot not be considered set in stone by investors.

DIVIDENDS ARE NOT ALWAYS AS SAFE AS THEY LOOK

Dividend cuts and suspensions can appear form seemingly nowhere. Take manufacturer and supplier of critical power components **XP Power (XPP)** which surprisingly scrapped its second half dividend (2 October) amid a collapse in demand.

Running close to covenant limits the company is now in cash conservation mode. 'We are taking appropriate mitigating actions to reduce costs and conserve cash', the company said.

Dividends have been a key part of the investment case for XP Power and excluding the pandemic period the company has never skipped a dividend since floating on the stock market 23 years ago.

With the cost of debt increasing and the economy deteriorating, it is a time to be extra vigilant.

DEFINING THE UNIVERSE

Using *Sharepad* software we screened for companies with a dividend yield of more than 6% and added a filter requiring a dividend cover of at least 1.5 times, the results can be seen overleaf.

Unfortunately, there isn't a magic formula for spotting safe or risky dividends. As mentioned, a very high yield is usually a red flag. In other words, if it looks too good to be true, it probably is.

Dividend cover, i.e. how many times the dividend is covered by earnings, is also a useful if imperfect metric.

High dividend cover isn't a guarantee of safety as XP Power demonstrates, which had a forecast yield of 8.3% and a cover of just under two times before it suspended its payout. Other factors to consider include the cyclicality of the business, recent trading and balance sheet strength.

Resources companies occupy the top end of the table, offering some chunky yields, but it should be remembered they are very cyclical, and some operate in parts of the world which are politically unstable.

Banks also feature with yields of around 8% for **NatWest (NWG)** and **HSBC (HSBA)**. Their dividends are covered by around two times by earnings which suggests they could be safe.

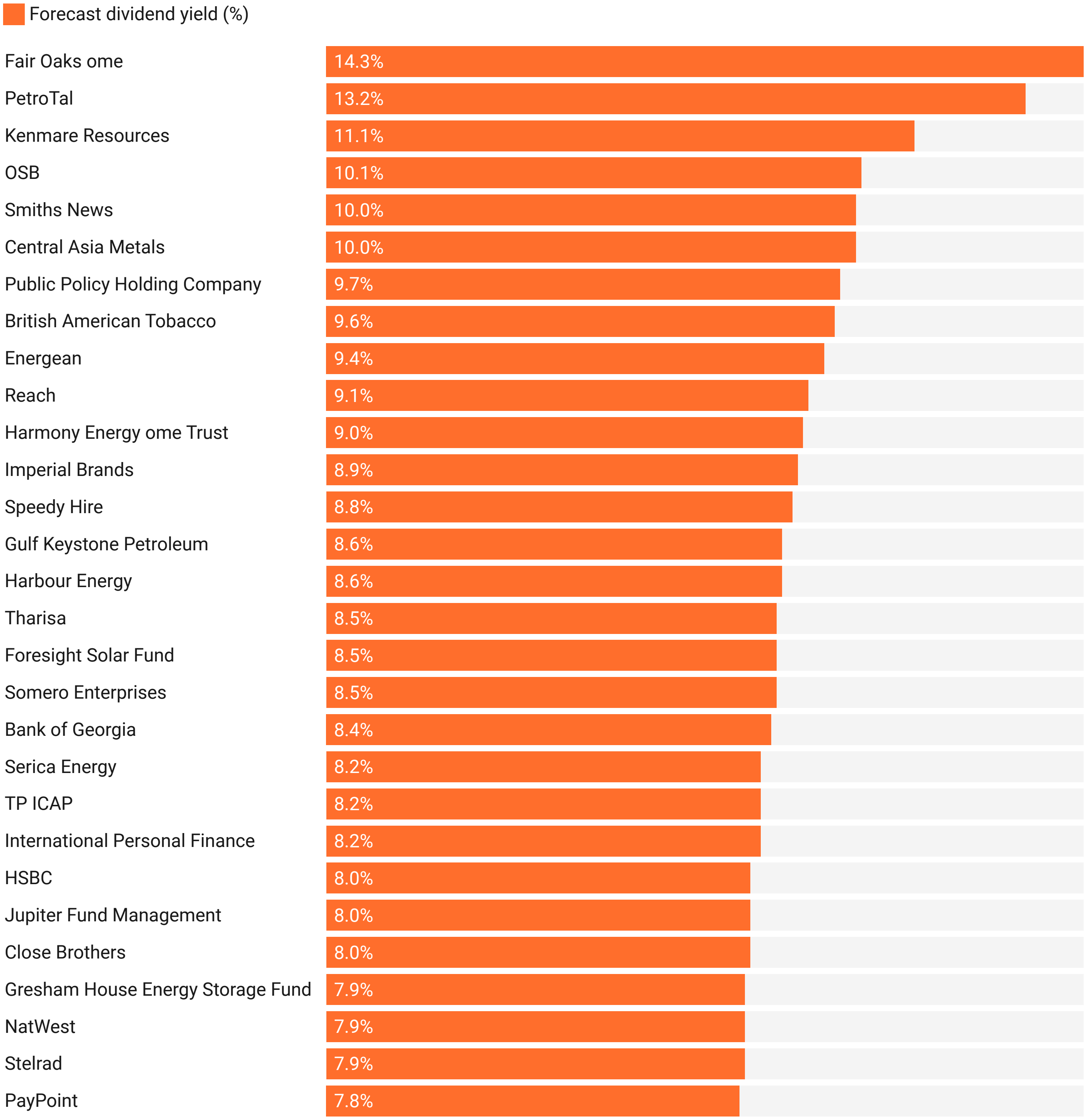
Banks are benefiting from higher interest rates which increase their net interest margins, but it is also worth noting that the cost of funding (interest on customer deposits) has also increased.

The investment narrative could change quickly if the UK economy slows further or enters recession. Investors will then likely be more concerned about rising bad debts and general credit deterioration.

HSBC may be more insulated from UK specific worries given the UK represents a small part of its overall business.

Read on to discover five big dividend yields we think you can trust and three which are too good to be true. We have gone outside of our screening exercise for some of the selections, trusting to our knowledge and experience.

Selected biggest UK yields covered more than 1.5 times by earnings



Market cap above £100m, dividend cover of at least 1.5 times

Chart: Shares magazine • Source: Sharepad, data to 6 October 2023.

FIVE BIG YIELDS YOU CAN TRUST

Aviva (AV.) 421.6p

Forecast dividend yield: 8.6%

The UK's largest general and life insurer **Aviva (AV.)** has been through a major transformation since chief executive officer Amanda Blanc took over in 2020, effectively exiting France, Hong Kong, Indonesia, Italy, Poland, Singapore, Turkey and Vietnam, raising billions of pounds and buying back millions of shares with the proceeds.

Meanwhile, the core UK and Irish businesses continue to go from strength to strength, as demonstrated by the group's first-half results with general insurance premiums up 13%, Workplace wealth net flows up 25% and private health insurance sales up 58%, and its Canadian business grew first-half sales by 12%.

Analysts at Jefferies believe Aviva has the strongest free cash flow in the sector and see a shift towards more capital-light activities leading to a premium valuation for the shares.

The 2023 and 2024 dividends are seen covered between 1.2 times and 1.3 times by earnings, lower than you would like for some sectors but not unusual in the insurance space, we believe investors should lock in a yield north of 8%. Takeover chatter has recently lit a fire under the share price with a several overseas parties reportedly mulling a 600p per share offer. [IC]

British American Tobacco (BATS) £24.75

Forecast dividend yield: 9.6%

For income investors prepared to set aside any ethical objections, **British American Tobacco (BATS)** looks an interesting option with a yield approaching double digits.

The tobacco firm faces regulatory headwinds – notably the UK announcing plans for legislation which would mean today's 14-year-olds will never be able to buy a cigarette in their lifetime in this country – but this is nothing new for an industry which has faced such pressures for decades.

Fundsmith Equity (B41YBW7) fund manager Terry Smith argues these businesses benefit from regulation in the sense there are unlikely to be new entrants to the market and, because there are restrictions on their ability to invest in marketing, this means there is more cash left over for shareholders.

British American generates lots of cash – projected to be approximately £40 billion over the next five years – which provides a measure of confidence in its policy of paying out 65% of its earnings in dividends. The recently agreed sale of its Russian business will mean a modest hit to revenue and profit but removes a key headache for management and the company continues to invest in a pivot towards next generation products including vaping. [TS]

Serica Energy (SQZ:AIM) 222.6p

Forecast dividend yield: 8.2%

North Sea oil and gas firm **Serica Energy (SQZ:AIM)** offers a generous yield despite a strong balance sheet and robust energy prices – this presents an opportunity for investors.

Having previously been almost exclusively focused on producing natural gas, the company added oil to the mix through the £367 million acquisition of Tailwind Energy which completed in March 2023. Its output is now 55% gas and 45% oil and the transaction also made Serica one of the

top 10 North Sea producers by volume.

Despite taking on debt as part of the deal, first-half results published on 18 September revealed the company was still sitting on net cash of £234 million as of 30 June 2023, having generated cash flow from its operations of £266 million through the period.

One risk to the dividend is M&A which remains a key part of the company's strategy. However, the 12.5% increase in the first-half dividend is a marker of the company's commitment to continue rewarding shareholders in this way.

Serica's enviable financial position should allow it to invest to help sustain and build its production, both organically and through acquisitions, providing the cash flow necessary to fund dividends. [TS]

Smiths News (SNWS) 41.5p

Forecast dividend yield: 9.7%

Newspaper and magazine wholesaler **Smiths News (SNWS)** offers a 9.7% prospective yield with the anticipated 4.1p dividend covered 2.6 times by expected earnings. The shares trade on a bargain basement rating of four times forecast earnings for the year to August 2024. So, what's the catch?

The market seems to be pricing Smiths News as a company in terminal decline. Admittedly, there are question marks about the long-term future of supplying print-based publications given so much media is now consumed online. Yet it could be a slow descent, not the market disappearing overnight.

Smiths News has delivered a generous stream of income to shareholders as compensation for the risks associated with investing in the business. That is likely to form the bulk of your returns. Any capital gains will be a bonus – although there is also the

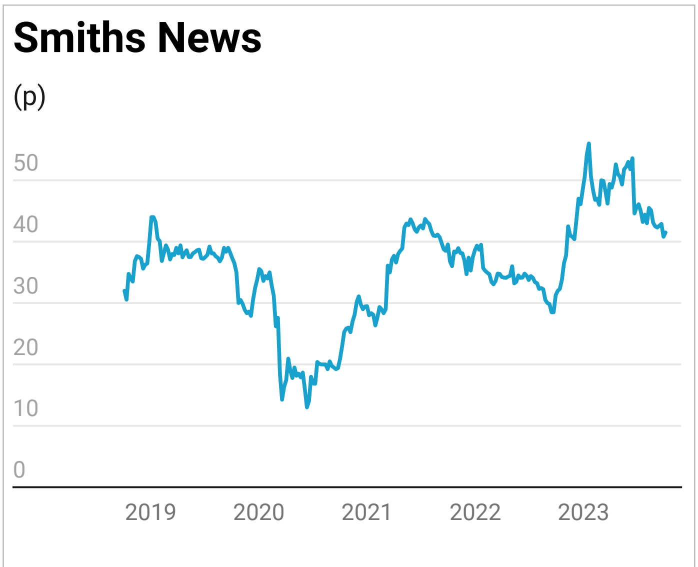


Chart: Shares magazine • Source: LSEG

potential for capital losses.

The share price over the past five years has followed a repeated pattern. It goes nowhere for a while, it then falls before bouncing back, and then does the same thing again.

The latest trading update (4 October) was robust and half-year results in May talked about major contract renewals, a sharp decline in average net debt and ambitions to find new profits streams beyond magazines and newspapers. This business could be around for longer than the market thinks. [DC]

Telecom Plus (TEP) £15

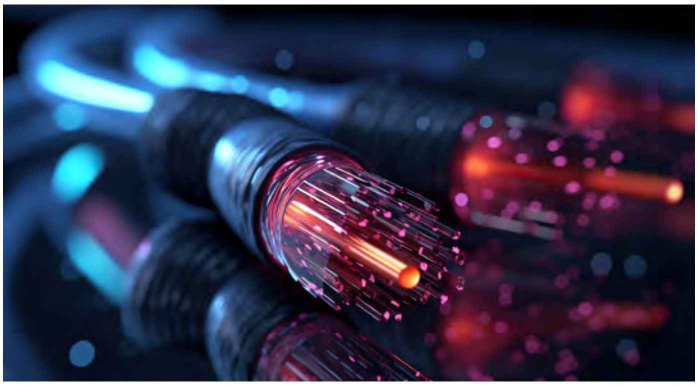
Forecast dividend yield: 5.7%

With winter looming for Brits, household energy bills will quickly become a big talking point, and with more stable wholesale pricing compared to a year ago, expect a lot of account switching, usually good news for **Telecom Plus (TEP)**.

As a multi-service provider, the company – trading as the Utility Warehouse – has the scope to pivot its sales drive to match consumers biggest concerns at any time, a great lever to keep new subscriber numbers bubbling higher and cash flows stable, vital for sustainably growing shareholder dividends.

Telecom Plus excels at steadily upping income for shareholders, even managing to hold the payout during the worst of the Covid pandemic, and not many companies can say that. This speaks volumes for the financial management of the business, as does the fact that in fiscal 2023 (to 31 March) it increased the per share payout from 57p to 80p (up 40%) despite overall dividend cash costs increasing only 13%.

Consensus points to per share dividends rising to 85.2p and 89.4p this year and next, implying am income yield of 5.7% and 6%, and prevailing management optimism at May's fiscal 2023 results in May will see them mull share buybacks as a way of underpinning shareholder returns. [SF]



THREE HIGH YIELDERS TO AVOID

BT (BT.A) 115.2p

Forecast dividend yield: 6.6%

Vodafone (VOD) 76.4p

Forecast dividend yield: 10.2%

New broom CEOs are sweeping into **BT (BT.A)** and **Vodafone (VOD)** in a desperate roll of the dice to get growth going again. BT revenue have increased just 13% in a decade, Vodafone sales are virtually flat.

Given shareholder returns have been dismal for years, something's got to give – it's not rocket science, and dividend payouts are bang in the frame. Forecast yields are 6.6% and 10.2% respectively and consensus expects zero growth anytime soon. Worse, *Shares* believes there is enormous rebase risk for future dividends given this is a common move for incoming CEOs something analysts seem to be slow to admit.

It's only the promise of bumper income yields that have stopped more shareholders dumping these two stocks, yet with BT's cash flows largely tied up with fibre network rollout, and Vodafone attempting to tie the knot with mobile rival Three in the UK, investors can expect even more pressure to build on balance sheets already piled high with debt (approximately £20 billion and €47.7 billion net debt),

That their share prices are down 66% or so each over the past decade yet annualised total returns are only mildly negative (-4.65% for BT, -1.2% for VOD) tells you how important dividends have been for both investment cases. [SF]

Taylor Wimpey (TW.) 112.5p

Forecast dividend yield: 8.2%

UK housebuilder **Taylor Wimpey (TW.)** offers an enticing dividend yield of 8.2% based on consensus analyst forecasts, but *Shares* believes there are risks to the dividend over coming months.

Chief among them is that the Bank of England holds interest rates higher for longer which will squeeze consumers and potentially lead to bigger than expected fall in house prices.

Although Taylor Wimpey has a strong balance sheet with net cash of £655 million, analysts are forecasting EPS (earnings per share) will more than halve over the next two years.

If this were to happen it means earnings would no longer cover the anticipated dividends and the company would have to dip into its cash reserves.

This may test the resolve of management who have committed to paying 7.5% of net tangible assets per share in dividends. [MG]

Why have bond yields suddenly soared and what does it mean for investors?

The era of cheap money is over, which has implications for stocks and bonds

If anyone thought financial markets were efficient at pricing in all available news and views, the experience of the last few weeks should have shown them they are anything but.

For months the US Federal Reserve has been repeating the mantra that interest rates would need to stay 'higher for longer' to tame inflation, yet equity and bond investors chose to ignore the message.

The penny – or dime – finally seemed to drop with US equity investors last month, causing the S&P 500 index to shed 4% of its value and confirming September's reputation as a rotten month for stocks.

However, until recently, bond investors seemed to be blithely unwilling to heed the central banks' warnings that the era of low interest rates is well and truly over.

Now, UK long-bond yields are hitting their highest level in a quarter of a century as a global debt market sell-off gathers pace (the yield is the inverse of the price, so yields fall as prices rise and vice versa).

The yield on the 30-year gilt or UK government bond touched 5.1% at the beginning of October, the highest since September 1998 and above the peak reached during the panic sell-off in late 2022 caused by the disastrous 'mini-budget'. Yields on US government bonds are at levels last seen in 2007.

Adding to the selling pressure is the fact central banks are increasing their sales of bonds over the coming year as a way to reduce their balance sheets, which ballooned during the pandemic as governments everywhere splurged on stimulus measures to keep the global economy from grinding to a halt.

Soaring government debt and interest bills are a key factor behind the 'bond market blitz' of recent days, says AJ investment director Russ Mould.

'The UK's government debt has surged past the £2.5 trillion mark, and the Office for Budget Responsibility reckons the annual interest bill will be £115 billion – the only government department that will cost more is the NHS,' says Mould.

Why does this matter for investors? Clearly for investors in bonds, and any bond-like, long-duration assets such as infrastructure and renewable energy, higher yields mean lower prices.

For equity investors, an increase in the risk-free rate – which is generally considered as the yield on 10-year gilts or US treasuries – makes shares, which are typically riskier than bonds, a less attractive place to put their money.

When interest rates were at rock bottom, a commonly-used acronym to justify buying shares was TINA, or There Is No Alternative.

Now, says Mould, there is a new acronym in town - TIARA, or There Is A Real Alternative to equities, in the form of cash.

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

US 10-year government bond yield

Chart: Shares magazine • Source: LSEG

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Commercial property: is the cycle turning?

Will Fulton and Jamie Horton, Investment Managers, UK Commercial Property REIT

- ***Interest rates have dented commercial property valuations over the past 18 months***
- ***Three elements are crucial to the outlook for the commercial property sector: revaluation, investment recovery and a supply squeeze***
- ***There are still vulnerable parts of the market, particularly in the office market***

Commercial property has faced two major challenges over the past 18 months. Rising interest rates led to the fastest revaluation of commercial property assets recorded, with reductions particularly felt at the lower yielding end of the market. At the same time economic conditions have meant occupier demand in certain segments of the market has remained unpredictable or weakened. While it has unquestionably been a turbulent period, there are reasons to believe the cycle may be turning for high quality commercial property from here.

We identify three key elements that are crucial to understanding the outlook for the commercial property sector: revaluation, investment recovery and a supply squeeze. Our view is that the revaluation of the property market is largely behind us with the exception of the office sector which is facing structural challenges. While calling a peak in interest rates is a challenge that even the Bank of England shies away from, our central expectation is that interest rates will rise once or twice more before starting to fall next year. Inflationary pressures have weakened, and the Bank of England has made it clear that further rate rises will be data-dependent.

For the industrial sector, where operational performance is still strong, this suggests that asset values should recover albeit they are unlikely to achieve the extremely low yields witnessed in late 2021 / early 2022. However, there are still vulnerable parts of the market, where valuations could dip lower. We see this particularly in the office market, where landlords face the combined challenge of reduced occupier demand as a result of post-Covid working habits and an increase in costs to provide the amenity and ESG credential tenants require.

Investment recovery will depend on a revival in the economy and the UK is unlikely to recover significantly until interest rates start to drop. The interest rate cycle has had a more significant impact on commercial property markets in this cycle compared to previous cycles as it followed a long period of historically low rates followed by sharp increases. If interest rates start to drop next year, there is a case for an investment recovery led initially by rate cutting and thereafter economic growth. Again, we believe the higher quality sectors with structural growth potential will be the early beneficiaries.

We have also identified an imminent supply squeeze in certain segments of the commercial property market such as industrials as development has been constrained by rising build costs, increased finance rates and weakening yields. We therefore still see potential for strong rental growth in the industrial sector and in alternatives, and this is where we are focusing our attention for the portfolio. There isn't enough space, particularly in the right spots, to meet demand.

HOW WE ARE HANDLING IT

While the outlook is improving, until the interest rate cycle has clearly turned there is still uncertainty. UKCM continues to focus on high-quality assets, with strong operational characteristics to maintain resilience into the portfolio. This is shown in our occupancy and rent collection statistics – 99% and 96% respectively.

We continue to refine our portfolio to ensure that every asset meets our investment criteria and we have prioritised balance sheet discipline while debt costs remain elevated. This year, it has seen us sell a very low-yielding prime distribution warehouse, Hannah Close in Wembley. Existing lease agreements meant that low yield was constrained and it wasn't possible to realise the full underlying rental value until 2029. We had also completed our full asset management plan on the property, leaving less upside to its valuation and used the proceeds to reduce the amount drawn on our revolving credit facility by 71%. While our overall debt costs are low, the cost of this facility which is now only 12% of our total borrowings has risen.

We have made great progress on our development programme completing three properties across the industrial and student hosing sectors. Our last remaining development is the Hyatt-branded hotel in Leeds' Sovereign Square. As well as a fantastic location in thriving Leeds and a great brand in Hyatt, it has strong ESG credentials, an increasingly important factor in the hotel market. Construction continues at pace, and on completion the hotel will deliver a yield of 7.25% with the hotel opening early Q3 2024.

RENTAL DEMAND

At a time of higher inflation, being able to push through rental increases is vital and a key advantage for commercial property over fixed income investments. Rental uplifts across the portfolio have generally been encouraging as we seek to capture the reversion within the portfolio we own through careful asset management.

Nevertheless, the economic picture is still fragile and certain sectors still look vulnerable. As a result our portfolio is well-diversified by sector, geography and with a mix of 193 tenants. We remain judicious in our focus on quality assets and also in our tenant selection and mindful of how the economic climate might change.

The Company's dividend yield of 6.6% compares favourably to the higher quality end of the fixed income market, while also giving the potential for income growth. This puts us in a good position should the interest rate cycle start to turn next year.

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

B&M versus Dunelm: *Shares* weighs the prospects for two top retailers

Wilko's demise presents a big market share opportunity for discounter B&M, but homewares leader Dunelm is also poised to profit

Discount homeware chain Wilko's summer collapse into administration prompted analysts to upgrade estimates for the listed retailer regarded as the obvious beneficiary, **B&M European Value Retail (BME)**.

The FTSE 100 variety goods value retailer has agreed to acquire up to 51 Wilko stores for up to £13 million in a deal funded from its existing cash reserves and will undoubtedly benefit from Wilko's disappearance from the high street, as will competing discounters Home Bargains, The Range and Poundland.

Yet judging by the share price weakness of recent weeks, investors seem to be underestimating the potential market share opportunity for **Dunelm (DNLM)**, the UK's number one homewares leader which sells everything from bedding and curtains to kitchenware seller with a sharp value focus.

Shares sees Dunelm as another name likely to capitalise on the void created by Wilko's demise, which presents an opportunity for the FTSE 250 retailer to increase market share in areas including affordable home décor.

TWO STRATEGIES FOR GROWTH

Cut-price groceries-to-general merchandise seller B&M is arguably the ultimate play on the cost-of-living crisis, retailing a range of goods at cheap prices spanning branded groceries and drinks to toiletries and cleaning products, homewares, garden furniture and even toys.

By offering a broad choice at great value, B&M encourages a 'treasure hunt' browsing experience for shoppers on a budget which often leads to impulse purchases, helping to drive average

B&M European Value Retail – key details

Ticker: BME

Share price: 562p

Market cap: £5.52bn

FTSE subsector: Diversified Retailers

Dunelm – key details

Ticker: DNLM

Share price: £10.16p

Market cap: £2bn

FTSE subsector: Home Improvement Retailers

transaction values. A key tenet of the strategy is an unwavering focus on a limited assortment, direct sourcing model, which enables B&M to purchase deep volumes at competitive rates and pass the cost savings on to customers through value prices, helping their shopping budgets stretch that bit further.

Continuing to expand into southern areas of the UK, the £5.5 billion cap has three divisions; B&M UK is the core business operating from over 700 stores, while B&M France operates around 114 stores in a country with a similar population to the UK, suggesting it can sustain a strong opening programme over the long term. The third division, Heron Foods, is a convenience store chain with outlets in local neighbourhoods and shopping parades.

The opportunistic Wilko's store acquisition will only enhance B&M's geographic and growth potential. Analysts expect these stores will be rebranded under the B&M fascia, accelerate its store rollout and even extend what looks to be a conservative 950 UK stores target.

British homewares champion Dunelm has around 180 UK stores and was founded in 1979, then floated on the stock exchange in 2006.

It has grown to become the UK's largest home furnishing retailer, built on a customer proposition featuring strong value, range, service and convenience. The founding Adderley family continues to hold a 40%-plus stake in a business whose competitive strengths include an extensive range of some 70,000 products spanning multiple homewares and furniture categories.

Core products are those that make the home cosy, including soft furnishings such as curtains, bedding and cushions, homewares including tableware and kitchenware, and also accessories such as lighting and gifts.

The Leicester-headquartered shopkeeper has successfully expanded out of its Midlands heartland to the rest of the UK and has set a 200 to 250 stores target. The focus over the past few years has been on establishing a multi-channel platform for its core homewares offering, which would also facilitate a bigger push into the furniture market, where the retailer's share remains very low.

Management of the £2 billion cap company is increasingly confident of driving future growth through the ongoing digitalisation of the business, supporting growth in stores, active customers and market share, and believes profit growth will be driven by selling higher volumes of products rather than through hiking prices. While the company is the market leader, Dunelm still only holds a 7% share of a highly fragmented £24 billion UK homewares and furniture market.

The retailer continues to see a strong payback,

B&M is a clear cost-of-living crisis winner

Years to March	Pre-tax profit (£m)	EPS (p)	DPS (p)	Price to earnings ratio	Yield
2023 (A)	455.0	36.3	14.6	15.5	2.6%
2024 (F)	472.8	35.3	14.2	15.9	2.5%
2025 (F)	507.7	38.0	15.2	14.8	2.7%
2026 (F)	609.8	45.6	18.3	12.3	3.3%

Table: Shares magazine • Source: Forecasts from Shore Capital, PE and yield calculated on 5 Oct share price

Dunelm is delivering income and growth

Years to June	Pre-tax profit (£m)	EPS (p)	DPS* (p)	Price to earnings ratio	Yield
2023 (A)	193.0	75.0	82	13.5	8.0%
2024 (F)	204.0	75.3	84	13.5	8.3%
2025 (F)	218.0	80.3	85	12.7	8.3%
2026 (F)	225.0	82.9	86	12.3	8.5%

Table: Shares magazine • Source: Forecasts from Berenberg, PE & yield calculated on 5 Oct share price *Includes special dividends

under three years, with its new larger and smaller store formats, with depressed lease rates in high-density locations presenting an attractive opportunity to expand the latter format.

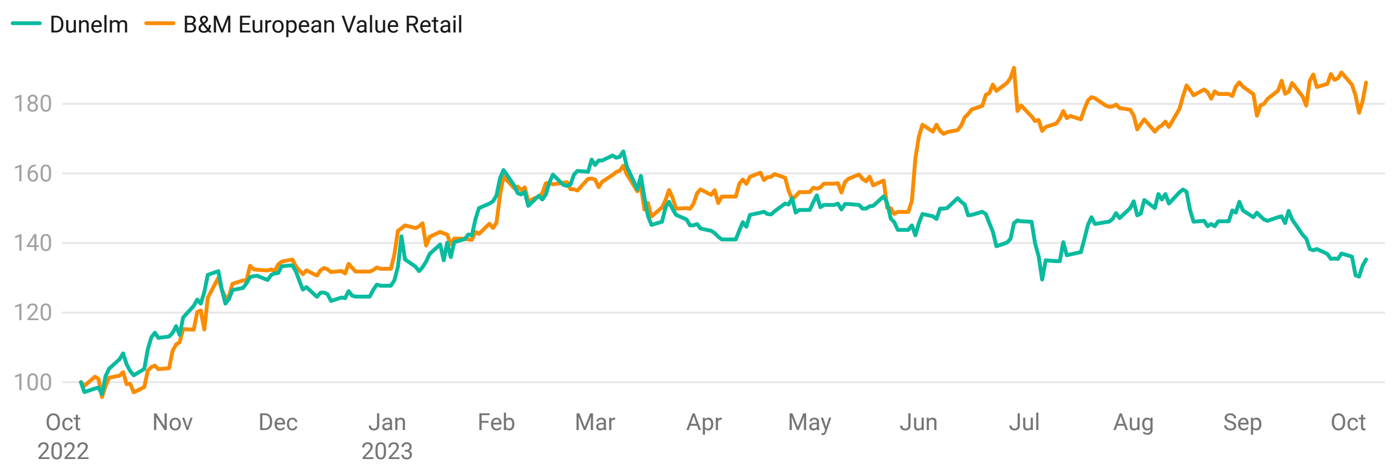
HOW DO THEY DIFFER?

Besides the fact B&M has almost four times as many UK stores as Dunelm, key points of difference between the two retail star turns include range. B&M's relentless focus on prices leaves it better placed to profit from trading down than Dunelm, which does have well-deserved value credentials, but also caters to a more affluent customer through ranges such as the iconic luxury Dorma brand.

Albeit smaller by store number and market cap, Dunelm's gross margin is higher than B&M's, 50.1% versus 36% based on results for their last financial years respectively. This indicates Dunelm has superior pricing power and is better able to absorb cost of goods inflation. And whereas Dunelm has one of the strongest online propositions in the UK home-furnishing market, complemented by its well-invested store estate, B&M doesn't trade online since the economics of selling and delivering low ticket items don't stack up.

Location is another difference. Dunelm is predominantly an out-of-town retailer, whereas B&M trades from both town centre and out-of-town locations. B&M's town centre stores are well positioned to benefit from convenience shopping and have a greater emphasis on grocery and fast-moving consumer goods (FMCG) products, whereas the larger out-of-town stores carry the full product offering.

Unlike Dunelm, which has grown its estate organically, B&M has built over one third of its UK store base through acquiring parcels of stores, a key driver of its growth and market share gains. While acquisitions come with greater risk, B&M's track record gives investors some confidence in the group's ability to successfully integrate the acquired Wilko sites.



Rebased to 100
Chart: Shares magazine • Source: LSEG

HOW ARE THEY PERFORMING?

Two resilient, cash generative companies offering attractive dividend yields, over 8% in Dunelm's case as a strong balance sheet allows it to pay generous special dividends, both businesses have momentum with their value-for-money propositions resonating with hard-pressed UK consumers at a time of rising interest rates and inflationary pressures.

Dunelm's results (20 September) for the year to 1 July 2023 illustrated a well-run business successfully navigating sector headwinds. Although pre-tax profits fell 7.8% to £193 million due to operating cost inflation and Dunelm's ongoing commitment to investment for the future, sales grew 6% to a record £1.64 billion.

Management remains upbeat about the retailer's prospects with cost pressures easing and value-for-money products being launched; management said it was 'pleased' with trading early in the new year and despite flagging 'unpredictable' consumer behaviour, expects to see growth in full year 2024 sales and pre-tax profits driven by volumes.

Berenberg forecasts a rise in Dunelm's pre-tax profit to £204 million this year ahead of £218 million next.

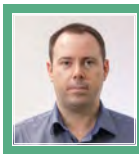
Bears will argue Dunelm is exposed to fluctuations in consumer spending and the vagaries of the housing market and that barriers to entry in soft furnishings are low, but a confirmation of positive trading in the first quarter update scheduled for 19 October could be a positive catalyst for Dunelm's shares, which have been weak since the annual results.

B&M is 'a rare case of a retailer that has held onto its Covid gains' according to Liberum Capital. B&M's total revenue grew 13.5% to over £1.3 billion in the first quarter to 24 June 2023 with UK like-for-like sales up 9.2% amid strong performances in groceries and general merchandise.

At the time (29 June), CEO Alex Russo, who Shore Capital says has 'seamlessly' taken up the leader's mantle from Simon Arora, remarked the retailer's 'strong trading momentum' demonstrated 'the strength of our unchanged strategy to relentlessly focus on price, product and excellence in retail standards. The business is well positioned as we start to transition to our autumn winter season. We will continue to work hard to help all our customers manage the cost-of-living crisis.'

Off the back of the Wilko deal, Shore Capital sees pre-tax profits building from £472.8 million in the year to March 2024 to the best part of £610 million in the 2026 financial year.

Even when the cost-of-living squeeze abates, B&M should retain many of the customers it has won during these tougher times since their shopping habits will have become ingrained. Investors can expect the details about the acquired Wilko stores and the integration process at the interim results on 9 November.



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

TR Property Investment Trust

Assessing ‘Peak Interest Rate’
Implications for the Property Sector

Is ‘peak interest rate’ nearly upon us? And what would this mean for the property sector? TR Property Investment Trust’s manager, Marcus Phayre-Mudge, takes a look. TR Property has focused solely on the property sector since 1984, offering diverse exposure to the UK and European property markets, primarily through listed real estate equities. The Trust has beaten its benchmark in 11 of the past 12 years.

Many of the lessons that apply to our local residential real estate markets can be extended to listed property, a world that retail investors often access by buying shares in real estate investment trusts (REITs). REITs are essentially giant landlords that often specialise in a given sub-sector – say warehousing or supermarkets. REITs pay investors a share of the rents and sale proceeds they collect via a dividend.

Over the long term, listed property can act as a wealth generator – and is often viewed as a sort of hybrid between stocks and bonds, due to its virtue of producing index-linked, and therefore inflation-proof, income. Across much of TR Property’s pan-European investment universe, rental increases are tied to national inflation, giving property owners and operators excellent protection against the erosion of their earnings.

A tale of two borrowers

Despite the rosier long-term picture painted above, performance of the sector over the last 18 months has been poor, with listed property companies now languishing at large discounts to their net asset values (NAVs). I will outline the main reason behind this downward price action, as well as why I believe there may be light at the end of the tunnel.

Property investments succumb to two main sicknesses. One is an oversupply of physical real estate, or a collapse in demand. The other is when the cost of money shoots up, and debt becomes more expensive. It is this latter factor that is responsible for the most recent downturn: investors panicked about rising inflation and the resultant activities of central bankers, who ratcheted up the cost of borrowing.

The good news here is that there are many property companies – particularly in the UK – that still have very manageable loan to value (LTV) ratios, and debt that is fixed longer-term. The 2008 global financial crisis contributed to a generation of board members and managers who are repelled by over indebtedness.

We have focused vociferously on weeding out companies that bucked this trend towards more caution, and therefore have debt burdens they are no longer able to cope with. Imagine you have two friends who both bought their flats two years ago. One is on a floating rate mortgage and has struggled financially as central banks raised rates. The other secured a five-year fixed deal – so isn’t overly worried about what is happening to interest rates. The same situations are playing out in our world but on a much bigger scale – and it demonstrates how the impact of rates can be neutral for some companies.

A remedy on the horizon

Nonetheless, listed real estate companies are highly sensitive to the news and sentiment that accompanies rampant inflation and rising rates, which has led to the overselling of the sector as a whole.

But a remedy for this rate-induced illness could be appearing in the near distance. Inflation is easing, meaning I am increasingly optimistic about the proximity of 'peak rate'. Market cycles over the last 30 years have shown that when interest rates peak, property equities recover much more sharply than the wider stock market. This recovery should be supported by the fact that unlike previous downturns, there are many sub-sectors where demand remains strong.

Who will benefit most in a recovery?

I am often asked which real estate sectors provide the best value; a question that becomes more relevant as our interest rate-related illness begins to improve.

The rising volume of goods shipped to us next day has led to more demand for logistics space across the UK and Europe. Macroeconomic factors are creating the need to re-engineer supply chains, resulting in a desire to store more materials closer to home. Given the logistics sector's relatively low rental yields, the rising cost of borrowing can hit landlords hard. Nonetheless the sector's pricing reflects good rental growth prospects and the overall undersupply of space in urban areas.

Retail is another part of the answer to this question that often surprises. Shop rents have effectively halved over the last decade, yet two parts of the retail landscape continue to outperform. The first is outlet shopping centres, resilient because they allow retailers to subtly sell off ageing stock. The second is 'big box' retail parks, where space is cheaper, and retailers can showcase more of their products. These sites also support click and collect, with customers favouring edge-of-town, easy-access locations with ample parking.

Final remarks

Simply, we continue to focus on companies operating in supply-constrained sectors that have little near-term refinancing, manageable loan-to-value ratios and all importantly, the ability to grow their top line earnings through indexation.

Selecting individual property stocks and REITs is time, resource and expertise intensive. Our aim at TR Property is to make it easy to gain broad, balanced exposure to the UK and European property sector with one click.

Why some sectors have been too harshly punished over AI concerns

The arguments for how different sectors may be impacted are more nuanced than the headlines suggest

Arguably the world changed forever in November 2022 after OpenAI said it had created an interactive, conversational AI (artificial intelligence) which drives its ChatGPT app.

According to a *Bloomberg* report the US first quarter earnings season witnessed a 77% increase in company references to AI and related terms, showing company managements couldn't stop talking about it.

Share prices of companies thought to be major beneficiaries have rocketed such as chip maker **Nvidia (NVDA:NASDAQ)** whose shares are up 240% over the last year.

On the other side of the coin industries at risk of losing jobs due to automation have come under increased pressure. The US AUW (Auto Union Workers) strike is arguably just as much about protecting job losses from AI as it is about increasing pay.

New research from investment bank Morgan Stanley throws some light on what markets might be pricing as AI unfolds.

Looking at future implied valuation metrics such EV (enterprise value) to sales ratios analysts can identify how different sectors are expected to be impacted. EV is market cap plus net debt.

Interestingly, the bank notes that the derating (a fall in valuation metrics such as price to earnings ratio) in 'AI challenged' sectors has been far more brutal relative to past technology disruptions.

This may throw up opportunities where forecasts overly discount the risks while being complacent about potential rewards. The bank's analysts argue that the music and education sectors now look relatively favourable from a risk-to-reward standpoint.

A potential concern for music artists and the labels representing them such as **Universal Music (UMG:AEX)** is that copyright laws have not been tested for AI infringements. While analysts may be cautious it doesn't appear to be a big concern for investors judging by the share price of Universal which is on the cusp of new 12-month highs after an initial fall.

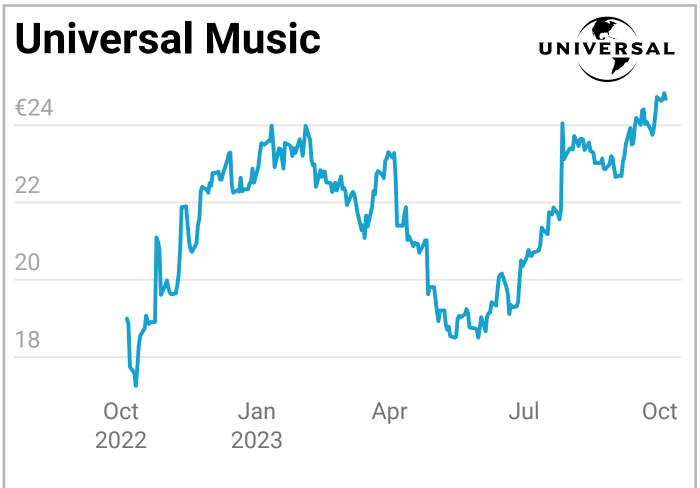


Chart: Shares magazine • Source: LSEG

Universal is the world's largest holder of music rights and Morgan Stanley sees more opportunities than risks from AI as protections are embedded into artists' agreements. The bank argues that progress on 'artist-centric' agreements would improve the amount artists receive in royalties and thereby provide a boost to a label like Universal with lots of major names in its stable.

Education group **Pearson (PSON)** could be seen to be at risk as more students turn to AI for course content thus reducing reliance on its course materials.

But Morgan Stanley points out the opportunities could be greater than the risks. Pearson is launching AI features which may prove more reliable than models which rely on open source, argues the bank.

Another benefit could come from an increase in examined work due to the risk of course work becoming easily plagiarised. This could result in higher demand for Pearson's Assessment and Qualification business.

By **Martin Gamble** Education Editor

Enjoying 'an embarrassment of income' in retirement

Geoff has built the foundations for 30 years to get to where he is now

Despite having worked in finance since the mid-1980s, Geoff admits he didn't actually start thinking about investing for his future seriously until the mid-1990s.

After returning to the UK following a secondment in Europe, he was surprised to receive a cheque from HMRC for the overpayment of income tax while he was abroad.

'It was only £3,000, but I was 31 and at the time that was a decent chunk of money. I opened a PEP (a Personal Equity Plan, the precursor to the ISA or Individual Savings Account, which was introduced in 1999) and put the whole lot in, as £3,000 was the annual limit.'

EYES ON THE PRIZE

Geoff worked for several banks during his career, and each time he was enrolled in the company's DB (defined benefit) pension scheme as well as save-as-you-earn share-ownership and profit-sharing schemes which enabled him to amass a considerable 'pot'.

Keen to stay up to date with the latest developments in markets, and aware that professional qualifications tended to lead to higher-paid jobs, he studied throughout his career, focusing on corporate finance and investment, gaining his FPC (Financial Planning Certificate) from the Chartered Insurance Institute, various professional qualifications and an MBA for his efforts.

Although he no longer needs to study, Geoff enjoys reading finance books and includes *One Up On Wall Street*, by legendary US mutual fund manager Peter Lynch, and *The DIY Investor*, by **AJ Bell (AJB)** founder Andy Bell, among his recommendations.

'Having built up my investment portfolio to a stage when I thought we had enough for me to retire, I took the plunge seven years ago at the age of 53,' says Geoff.

Meanwhile, his wife Louise, who also enjoyed a career in finance, is working in the property sector on a seasonal freelance basis until such time as she decides to fully retire.

TAKING A TAX-FREE RETIREMENT INCOME

As he is still some years away from receiving a full state pension, Geoff funds his retirement almost exclusively through dividends received in his ISAs and SIPPs (self-invested personal pensions), meaning he doesn't have to dip into his capital.

'We all know SIPPs have tax advantages when you're building up a retirement fund, but ISAs are important too as they give you an added degree of flexibility and withdrawals are tax-free,' adds Geoff.

Using the uncrystallised funds pension lump sum (UFPLS) option, which allows pension holders to withdraw some or all of their money with 25%

being tax-free, he takes an annual payment of up to £16,760 from one of his SIPPs.

After taking the 25% tax-free allowance into account, that means the remaining £12,570 comes within the standard personal income tax allowance, so is also free of tax.

He generates this SIPP income through holdings in 19 investment trusts, spread across a wide range of sectors and asset classes, some of which are shown in the table, with the amount of each holding varying so that each is set to pay £1,000 in annual dividends giving him what he refers to as 'an embarrassment of income'.

Most of Geoff's investments are in sterling-denominated trusts, although he bought **Tufton Oceanic Assets (SHIP)** and rather than go through the rigmarole of converting his dividends from dollars into pounds he has let them accumulate, with some of the proceeds used to buy shares in **Round Hill Music (RHM)**, which was acquired at a 67% premium in September 2023 by publishing firm Concord.

His biggest overweight currently is in commercial property, which he holds indirectly through **TR Property Investment Trust (TRY)**.

Not being a property expert, he would rather entrust the stock-picking to Marcus Phayre-Mudge, who has run the fund for most of the 20 years Geoff has owned the shares and who he believes is one of the best managers in the sector.

Geoff's investment trust portfolio (sample)

Trust
Allianz Technology
BG Managed Fund
JPMorgan Growth & Income
Murray International
Pantheon International
Scottish American
Scottish Mortgage
TR Property
Worldwide Healthcare

Also various VCTs (Venture Capital Trusts) and index-linked National Savings Certificates

Table: Shares magazine • Source: Investor's own records

TR Property features in Geoff's portfolio

His investment in **Scottish Mortgage Investment Trust (SMT)** dates back many years and is pure profit, as he took all his original investment off the table in 2021 after the shares had a huge run and his holding became excessively large compared to the rest of his portfolio.

That said, he tends not to deal very frequently, other than reinvesting his copious dividends, and when he does, he ensures the cost of the trade including stamp duty is less than 1% of the value of the investment. 'Having some sort of methodology is a good way to avoid over-trading,' he adds.

THE BENEFITS OF DIVERSIFICATION

Another important aspect of Geoff's portfolio is income protection, which is provided by National Savings index-linked savings certificates bought on a monthly basis many years ago.

'These products aren't available now, so I was lucky to buy them when I did. To begin with the index-linked increase was hardly noticeable, but in the last couple of years it has soared in line with inflation. The capital value of my holdings is probably two and half times what I originally invested and could provide another annuity income stream'.

In addition to his ISA and SIPP income, tax-free VCT (venture capital trust) dividends are left to accrue and when they reach a given level they are used to pay bills and for day-to-day spending.

He only looks at his portfolio once a month, usually halfway through, and at the start of each month he tots up the previous month's dividend income and compares it with the previous year, making sure it continues to grow.

Having spent decades diligently building his 'pot', Geoffrey admits the decumulation phase felt 'very strange' to start with and has taken time to get used to.

'I know if the experts read this they will look at my portfolio and say I'm over-diversified,' he says. 'But there's a good reason for it. It's all well and good generating income, but it needs to be broadly spread to be truly reliable. By having a wide range of investments across different asset classes, I know I can sleep at night.'

Looking ahead, he and his wife are already making plans for her retirement.

'When Louise's defined benefit pension kicks in in a couple of years, we're thinking of taking the maximum 25% tax-free lump sum and putting it straight into ISAs. In due course she should get the state pension as well, so any income from her company scheme would take her over the £12,570 personal tax allowance.'

DISCLAIMER: Please note, we do not provide financial advice in case study articles, and we are unable to comment on the suitability of the subject's investments. Individuals who are unsure about the suitability of investments should consult a suitably qualified financial adviser. Past performance is not a guide to future performance and some investments need to be held for the long term. Tax treatment depends on your individual circumstances and rules may change. ISA and pension rules apply. Financial services company AJ Bell referenced in the article owns Shares magazine. The author of the article (Ian Conway) and the editor of the article (Tom Sieber) own shares in AJ Bell.

By **Ian Conway** Companies Editor

It's not just Metro Bank – nearly all challenger banks have been poor investments

With one of the most high profile names in the space listing badly the disruptors to the big high street banks are in retreat

Financial services group **Metro Bank (MTRO)** has survived another crisis after agreeing a £925 million rescue package yet question marks remain about its future.

Metro Bank was the highest profile of the challenger banks which emerged in the wake of the financial crisis promising to shake up high street and commercial banking.

In theory, because they were not saddled with crisis-ridden balance sheets, a litany of scandals and, in some cases, state ownership of their shares, the challengers had a good chance of thriving and offered a credible alternative option for both customers and investors. Some of these businesses were genuine start-ups while others were built on the bones of existing institutions.

In some ways Metro Bank was an outlier in the emergent space as, rather than looking to avoid the shackles of a large and expensive network of branches, it went big on having a physical presence. This, along with little touches like offering dog treats for customers' canine companions, was meant to make the bank stand out.

This strategy left it with a high-cost operation and one which has been poorly run, leading to the recent crisis. Shore Capital analyst Gary Greenwood observes: 'Subject to the required shareholder approvals, Metro Bank now finds itself in a position where it can continue to trade. However, whether it can ultimately deliver on its growth ambitions to leverage its expensive cost base and improve returns remains to be seen.'

With some names already having exited the market or been subsumed into other businesses, the accompanying table shows how some of the main challenger banks have performed on the stock market over the last five years on a total return basis and it is not a pretty story. Even previous success stories like **OSB (OSB)** have struggled of late as the market frets about the risk of bad debts and the cost of borrowing soars.

Dismal returns from challenger banks

Five-year total return

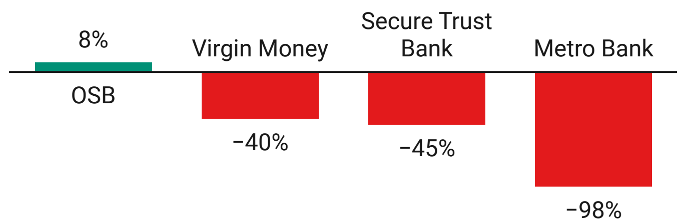


Chart: Shares magazine • Source: Sharepad, data to 9 October 2023

In the case of OSB, the company was hurt by a warning in July of fewer mortgage customers moving on to a variable rate at the end of their fixed term, with higher rates forcing them to be more proactive and seek better deals elsewhere.

Metro Bank may have secured some breathing space through the agreement thrashed out with its investors and creditors but the Bank of England is reportedly looking to smooth the way for a sale of the company to a larger player with **NatWest (NWG)**, **Lloyds (LLOY)** and Santander in the frame.

Given the regulatory and capital demands and complexity involved in running a bank, particularly during periods of uncertainty, this is a sector which is always likely to be dominated by the large incumbent players.

Though, as a reminder, the big British banks have hardly enjoyed a happy time of it either. In the UK banking sector, it is a case of too big to fail and too small to succeed.

Christmas for hospitality sector risks being ruined by strikes

The golden quarter could be tarnished yet again as the threat of industrial action looms

I suspect I'm not alone in having opened an email in the past week detailing the plans for this year's works Christmas do.

While current cost pressures are having an impact on budgets, in a post-Covid world many employers just want the chance to show their appreciation to their workforce for a job well done in what has been a particularly difficult year for many of us.

But before I could pick out my party outfit, I realised that once again I'll have to wait to find out if trains will be running on the date in question.

I don't think any of us expected the degree of industrial action that has impacted the country for the last 18 months or that those disagreements would last as long as they have.

One sector that is keeping everything crossed that some kind of agreement can be reached in short order with rail workers is the hospitality industry.

It's been estimated that the cost of rail strikes to the sector since last June has been in excess of £3.5 billion with the trade body UK hospitality estimating at least £1.5 billion of that hit came last Christmas.

Latest figures from Barclaycard suggest the consumer is cutting back further on non-essential spending as higher borrowing costs tangle with continued cost of living pressures.

GOLDEN PERIOD IS TARNISHED

Christmas is traditionally considered the 'golden period' for retailers and hospitality businesses, a time when people are prepared to splash out more than they normally would to celebrate with friends, family and colleagues.

So, the prospect of another year of disruption, off the back of 2022's strikes and the previous two years of Covid restrictions, is causing more than a little concern.

In the last couple of weeks 37 of the UK's biggest hospitality brands have written an open letter in association with UK hospitality, urging rail unions not to hold further strike action over the Christmas period.

The bosses of FTSE 350 listed companies **Fuller, Smith & Turner (FSTA)** and **Marston's (MARS)** were among the signatories, urging the Government and unions to redouble efforts to resolve the dispute

saying that 'the significance of the festive season to our sector cannot be overstated.'

Ahead of the latest round of walkouts, which coincided with the start and end of the Conservative Party conference, the leader of the train drivers' union Aslef, Mick Whelan refused to rule out December strikes in an interview with the *BBC*.

FACING INTO LOTS OF HEADWINDS

Clearly the sector has had more to deal with than just the disruption from strike action. Increased costs, strained margins and a consumer under pressure have all added to share price declines of chains like **Wetherspoon's (JDW)** and **Restaurant Group (RTN)**.

But investors are paying attention to external factors, from strikes to the impact of changing work patterns which have affected city centre activity in particular.

They're looking at pub and restaurant locations and they're considering which companies are being cushioned by increased spending from families looking for a cheap night out at a bowling alley or because they're got a budget hotel chain in the mix.

Rail strikes force people to change their plans, and some will choose to tack on a night in a Premier Inn just so they can be where they need to be even if the trains aren't running.

Mostly people will think twice. Workplaces won't want the hassle of having to rearrange big events for hundreds of people if there's any possibility they can't go ahead.

WHO WILL WIN OUT

There will be winners; certainly, one listed airline seemed to be quids in during the last lot of strike action which saw the price of a single flight from Manchester to London shoot up six-fold.

But hospitality businesses might be forgiven for feeling hard done by. The last few months of the year usually provides them with a cushion to make it through the first few months of the new year when budgets are tight and the weather often dismal.

How hospitality and leisure shares have performed since strikes started last June

FTSE 350 hospitality & leisure businesses	Change since 21 June 2022 (%)
Marston's	-48.6
Fuller Smith & Turner	-5.9
Wetherspoon (JD)	-5.2
Restaurant Group (The)	-1.8
Mitchells & Butlers	1.2
Hollywood Bowl Group	18.6
Ten Entertainment Group	20.2
Whitbread	27.9

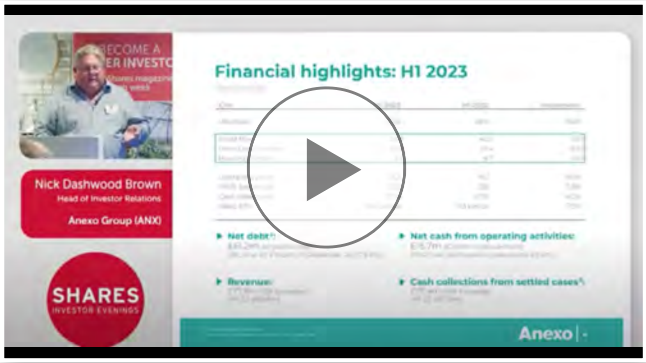
Table: Shares magazine • Source: Sharepad, data to 9 October 2023

> "UK's biggest hospitality brands have written an open letter in association with UK hospitality, urging rail unions not to hold further strike action over the Christmas period"

Without clarity they can't plan, and neither can the public whose patronage they rely on. Rail workers undoubtedly feel they have no choice but to keep on the pressure after a long, hard struggle .

Reaching a resolution seems a long way off but if the economy is to deliver the kind of growth political parties of all stripes say we need then a resolution must be reached and reached quickly.

WATCH RECENT PRESENTATIONS

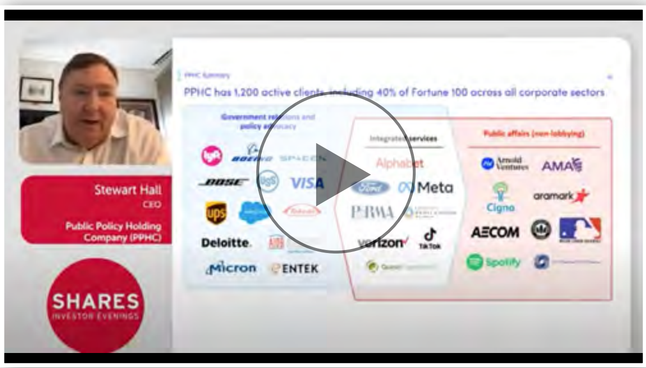


Anexo Group (ANX)
Nick Dashwood Brown, Head of Investor Relations

Anexo is a specialist integrated credit hire and legal services group focused on providing replacement vehicles and associated legal services to impecunious customers who have been involved in a non-fault accident. Nick Dashwood tells us more about the company and it's plans for the future.

Cohort (CHRT)
Andy Thomis, Chief Executive

Cohort is the parent company of six innovative, agile and responsive defence technology businesses providing a wide range of services and products for UK and international customers. It has headquarters in Reading, Berkshire and employs in total over 1,100 core staff there and at its other operating company sites across the UK, Germany, and Portugal.



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Stewart Hall, CEO, Roel Smits, CFO, Thomas Gensemer, CSO -

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Why you shouldn't let your pension be a cost-of-living casualty

Pulling contributions to your retirement pot now can have an outsized impact on your spending power in later life

The cost-of-living crisis which has engulfed the UK over the last year or so has hit people in different ways. All of us have been hit with much higher energy and food bills, and a significant proportion of the population is now facing a housing cost crunch, whether that's in the form of higher rent or bigger mortgage payments.

People have had to adjust in different ways, depending on their financial situation, and one emergency brake it seems many savers are pulling is to stop or reduce pension contributions.

A recent report from the fund group **M&G (MNG)** found that a fifth of savers had either reduced their pension contributions or ditched them completely, in response to the spiralling cost of living.

This may well be the tip of the iceberg in terms of the effect the cost-of-living crisis has had on all our pension wealth, when you consider that many people who may have managed to keep up their pension contributions would actually have paid in more if we weren't facing such huge inflationary pressures.

AN UNDERSTANDABLE BUT DAMAGING MOVE

Turning off the taps to your pension is entirely understandable in the current environment. If you're trying to free up cash in the here and now, saving money for the dim and distant future can seem a bit of a luxury. However, it's worth acknowledging just how much a cut in contributions can harm your retirement prospects.

Permanently cutting your pension contributions from £300 a month to £150 a month can put a £105,000 dent in your retirement pot after 25 years, assuming 6% annual growth. Stopping those contributions altogether for five years can wreak similar damage, shaving £69,000 off your final pension pot after 25 years.

Pulling money from your pension boosts your spending power today but reduces your spending power in retirement, but it's not a one-for-one replacement. That's because your money experiences compound growth while invested in your pension, so every £1,000 withdrawn could be worth so much more in retirement.

That's before you even factor in employer contributions to your pension scheme which often double the amount of money you put in. And then there's tax relief to consider too. For each £1,000 you put into the pension the government adds £250 in basic rate tax relief, and higher rate taxpayers get a further £250 in higher rate relief, and for additional rate taxpayers that extra figure is £312.50.

A LAST RESORT

So, reducing or stopping pension contributions should really be a last resort when it comes to adjusting your finances to accommodate the increased cost of living. If you do find yourself going down the route of cutting your pension savings, you should try and reinstate them as soon as possible. If you stop a £300 monthly pension contribution, this will cost you £15,500 in 25 years' time if your resume payments after a one-year pause, rather than £69,000 if you take a five-year break from making contributions.

There are now some tentative signs that the inflationary strain might be starting to lessen. For instance, figures from the British Retail Consortium found that food prices actually dropped between August and September, the first decline in two years. Hopefully that means we might start to see the pressure on household finances easing up a bit, which would allow those who have cut pension contributions to start them up again. Those lucky enough to find a bit more space opening up in their budget you may even be able to cover any lost contributions by putting some extra payments in.

A CALCULATED APPROACH

It's a good idea to use an online pension calculator such as the one on the Money Helper website, to get an idea of the sort of income you might expect in retirement based on your current savings habits, even if you haven't had to resort to slimming down your pension contributions. Forewarned is at least forearmed, and finding out if you need to fill a pension hole sooner rather than later gives you the best chance of successfully playing catch up.

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

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Can I still claim tax relief on my pension when I'm 76?

Dealing with a question about your pension options later in life

I am 76 years' old and retired. My retirement income is the state pension, a small SIPP, dividends and interest.

Can I pay £2,880 per annum into my pension and get £720 back from HMRC?

Bill

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

Although theoretically there is no limit on the amount you can contribute to a pension each year, in practice tax relief is controlled by government in several different ways. The main 'annual allowance' is set at £60,000 for the 2023/24 tax year and covers personal contributions, employer contributions and upfront pension tax relief.

Annual personal contributions are also limited to 100% of UK earnings. This means if someone earns £20,000 in a tax year, this is the maximum they can personally contribute to a pension, inclusive of upfront tax relief, regardless of their annual allowance.

There are two other annual allowances. The 'tapered annual allowance' applies to very high earners and can mean your annual allowance drops as low as £10,000.

The money purchase annual allowance (MPAA) kicks in where you flexibly access taxable income from your retirement pot and reduces your annual allowance to £10,000. The MPAA also revokes your ability to carry forward unused annual allowances from the three previous tax years.

If you are a non-earner and aged under 75, you can still contribute up to £3,600, inclusive of pension tax relief, to a pension each year. That equates to a personal contribution of £2,880, with the remaining £720 provided by basic-rate tax relief at 20%.

Unfortunately, once you reach your 75th birthday, the government stops providing pension tax relief on personal contributions, thus removing the upfront incentive to save through a pension.

It is possible in some circumstances that pension saving will remain attractive after age 75 – particularly if your priority is passing on money tax efficiently to your loved ones after death. Money held in pensions is not usually subject to inheritance tax (IHT), and if you die after age 75 any unused funds will simply be taxed as income when your nominated beneficiary (or beneficiaries) come to make a withdrawal.

If you are looking for an alternative savings vehicle for your spare cash, you can pay £20,000 a year into ISAs, which offer the same tax-free investment growth as pensions and can be accessed tax-free at any time. Bear in mind any ISA funds you have left will count towards your estate for IHT purposes.

There are other vehicles, such as Enterprise Investment Schemes (EISs) and Seed Enterprise Investment Schemes (SEISs), which offer incentives for investing, although these are focused on high-risk companies, so make sure you do your homework and seek professional advice before going down this route.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **asktom@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

Please note, we only provide information and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

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