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EDITOR'S VIEW

BHP's move on Oz Minerals suggests big mining deals are back

While miners learned their lessons last time about overpaying, can they now show restraint?

Three years ago, I posed the question in this column whether it was deal time again for the big mining companies. Now it seems appropriate to repeat the same question, given that **BHP (BHP)** has entertained **Oz Minerals (OZL:ASX)** with a near-$6 billion takeover offer.

Back in February 2019, it felt like a turning point for the mining sector. Commodity prices had picked up, the US/China trade war appeared to be past its worst, and China's increasing stimulus measures would drive further demand for metals.

At the same time, miners were busy paying down debt and operations were significantly more efficient.

History suggests miners have a habit of making big acquisitions when commodity prices are high. While my article three years ago was perhaps a bit premature, since then we've had a massive rally in commodity prices and the mining sector has seen a big uptick in earnings. Investors have been rewarded with big dividends and share price gains.

With the prospect of a global recession upon us, how do miners keep investors interested and on side? After all, shares across the mining sector have been in retreat since April as investors panic about shrinking demand for commodities if economic activity continues to weaken.

One answer could be to make big acquisitions. After all, investing in this sector is about taking big risks to make big returns. It would give investors something new to talk about and, importantly, for them to speculate as to what future rewards they might bring.

Investors in this sector love nothing more than

something new entering a miner's portfolio, whether that's a big discovery or buying new projects that bring the promise of bigger earnings.

BHP hasn't really had anything exciting to offer for some time apart from the fact its copper and nickel products are key components in two revolutions: global investment in renewable energy and electric vehicles production.

Buying Oz Minerals would strengthen its position in these important commodities and provide even greater scale, making it potentially more attractive to investors looking to play these trends.

Oz Minerals knows its assets could be worth a lot more in the future than today, and so it instantly rejected BHP's approach. That means BHP will have to dig deeper to win the prize.

Herein lies the problem. Miners have been restrained when it comes to acquisitions for the past decade, still feeling the pain of having overpaid during the last commodities cycle and suffering large asset write-downs and ballooning debts. This pain is still lodged at the front of their mind.

Investors have become used to large dividends from BHP and the scale of this payout could be threatened if goes back on the acquisition trail.

Standing still may not be an option. No-one wants to be left behind in the sector and there could be a major bout of FOMO – fear of missing out – if someone else buys Oz Minerals.

I would expect to see BHP come back with a higher offer very soon. Let's just hope it doesn't get carried away and pays too much, meaning it can't make an attractive return on investment.

Why China's sabre-rattling over Taiwan matters to UK investors

The island nation is a crucial link in global supply chains

Last week's trip to Taiwan by US House Speaker Nancy Pelosi – the highest-ranking American politician to visit Taipei in 25 years – seems to have been the pretext for China to unleash a demonstration of both its military might and its intention to unify the island with the mainland.

While the White House has sought to reduce tensions over the Speaker's visit, the strategic and economic importance of Taiwan meant the president had no alternative but to say the US would defend the country in the event of an attack by China.

Aside from the impact a full-blown conflict over Taiwan would have on world stock markets, investors need to brace themselves for the possible knock-on effects China's live-fire exercises could have on global trade.

The strait between the island and mainland China is the primary route west for ships from Taiwan, China, Japan and South Korea carrying goods to ports in Europe and the US.

According to Bloomberg, almost half of the global container fleet and nearly 90% of the world's very largest container ships passed through the strait this year.

The US maintains the strait represents international waters and routinely sends naval vessels through the channel on so-called freedom-of-navigation exercises.

China insists the waters are part of its territory and has made no secret of its desire to unify Taiwan.

Andrew Bird, chief executive of Tilstone Partners, advisor to real estate investment trust **Warehouse REIT (WHR)**, told *Shares* China's extended military operations around Taiwan could 'create a ripple effect on global supply chains, driving up prices'.

Taiwan is also home to the world's largest producer of semiconductors, **TSMC (2330:TPE)**, which manufactures under licence for just about every major US chip firm including **AMD (AMD:NASDAQ)**, **Intel (INTC:NASDAQ)**, **Nvidia (NVDA:NASDAQ)** and **Qualcomm (QCOM:NASDAQ)**.

Given the sophistication of its production facilities, which are in real-time contact with customers and suppliers all over the world, any attempt by China to take the country by force would likely result in the complete shutdown of the company, according to analysts.

Fears of supply chain shortages and in particular a lack of chips is already forcing UK companies to think not just about where they source components but even how they design their products.

Ronnie George, chief executive of ventilation products firm **Volution (FAN)**, recounts how after being quoted a 70-week lead time for certain chips earlier this year his engineers redesigned their circuit boards to take alternative components, thereby making sure the company had a steady supply of products available when customers needed them. [IC]

Tesla to do the splits for second time in two years as stock price soars

Shareholders back 3-for-1 division to make investing more affordable for small investors

Tesla (TSLA:NASDAQ) shareholders have backed a move for its stock to be split for the second time in two years. The move should make investing in the company more affordable for small investors.

The three-for-one division will see shareholders receive two additional shares for each one owned at the market close on 24 August. Tesla shares will trade at the split-adjusted price when the stock market opens on 25 August.

If the split were to happen at the time of writing (9 Aug), it would see each share worth approximately $870 become three worth $290 apiece.

Tesla, already the world's most valuable carmaker, performed a five-for-one stock split two years ago, and its share price has roughly doubled since then. Many people could not invest as the high price per share was beyond their means.

Its share price has come under pressure this year as investors turned their backs on higher risk assets. Some investors have questioned whether Tesla will maintain its electric vehicle lead in the face of competition such as Chinese pair **BYD (002594:SHE)** and **NIO (NIO:NYSE)**. EV sales in China topped 3.3 million vehicles in 2021, dwarfing the 608,000 sold in the US.

Leveraged short interest on Tesla has escalated, with **GraniteShares 3x Short Tesla Daily ETP (3STS)** seeing 17.7 million securities traded on the London Stock Exchange on 1 August, a high for the year. Short bets will be closed the night before Tesla's stock split and reopened at the adjusted price the following day. [SF]

US investors chase former 'meme' stocks and heavily-shorted shares

AMC, Gamestop and Bed Bath & Beyond stage spectacular rallies

INVESTORS HAVE STARTED chasing up shares of former 'meme' stocks and companies whose shares have been heavily shorted by hedge funds.

Since the start of August, shares in cinema operator **AMC Entertainment (AMC:NYSE)** have rallied more than 65% to almost $24 after languishing below $15 for most of the preceding three months.

A study in the *Wall Street Journal* showing a shift in consumer spending back towards cinema-going may have been partly responsible for the renewed interest.

Yet AMC isn't the only former 'meme' stock to have surged this month, with shares in entertainment firm **Gamestop (GME:NYSE)** gaining nearly 30% to $43.45.

Part of the attraction may be the remarkable performance of newly listed Hong Kong-based fintech **AMTD Digital (HKD:NYSE)**, whose shares rallied more than 32,000% from their $7.80 initial price in July to an intraday high of $2,555 in less than three weeks.

Meanwhile, shares in US home goods retailer **Bed Bath & Beyond (BBBY:NASDAQ)** have almost doubled this month as retail investors have piled into the stock, one of the most-shorted names in the US market.

A big jump in the price of shorted shares can force bearish investors to rush to cover their bets, which in turn adds to the upward momentum. [IC]

Why Next wants to own part of struggling retailer Joules

Lifeline for troubled lifestyle clothing brand after a string of profit warnings

Cash-strapped clothing and homeware brand **Joules (JOUL:AIM)** looks set to be saved by **Next (NXT)**, although we do not expect the FTSE 100 retailer to buy the company outright.

Next is in talks to invest £15 million in Joules and become a strategic minority shareholder. While it has form in taking equity stakes in troubled retailers, its approach typically involves offering guidance and putting their products on its Total Platform e-commerce system so they can be bought via Next's website. It doesn't go as far as owning these businesses in full.

Existing Total Platform clients in which Next has equity interests include the likes of luxury clothing brand Reiss, the UK arm of American clothing company **Gap (GPS:NYSE)**, lingerie brand Victoria's Secret and start-up luxury menswear brand Aubin.

The advantage for Next is it can offer more products on its website which makes it more attractive to customers, and it also earns a fee for handling the e-commerce needs.

Total Platform is an e-commerce outsourcing service that enables third party retailers to grow their sales without large capital costs, operational risks or time developing sophisticated infrastructure. Put simply, it is a low-cost way for distressed brands to reach more consumers.

Joules recently drafted in KPMG to assist in improving its profitability, cash generation and liquidity headroom as the cost-of-living crisis bites.

Known for its posh wellies, Joules' shares have received a serious kicking from investors following a string of profit warnings triggered by disappointing sales, supply chain problems and rising costs.

Confirmation that Next was in talks with Joules saw the latter's share price soar by 34% to 44p on 8 August, albeit still a fraction of the 300p price at which the shares traded last summer.

Next taking equity stakes in retailers has echoes of the modus operandi of Mike Ashley-controlled **Frasers (FRAS)**, the deal-hungry Sports Direct, Evans Cycles and House of Fraser owner. Frasers is different to Next in that it likes outright acquisitions of brands it can slot into its platform.

Frasers continues to find opportunities in a retail sector grappling with rampant cost inflation and consumer confidence. For example, it bought Studio Group and fallen online women's fashion retailer Missguided out of administration, took a 28.7% stake in Australia-based fashion marketplace **MySale (MYSL:AIM)** and snapped up online fashion retailer I Saw It First.

These build on strategic stakes in the likes of German fashion brand **Hugo Boss (BOSS:ETR)** and posh handbag maker **Mulberry (MUL:AIM)**, but in future, Frasers may find it is in competition with Next for retail assets with long-run potential. [JC]

Fundsmith among the funds hit by £4.5 billion outflows in June

New fund flow data highlights the fragile nature of investor confidence

The highly fragile nature of investor confidence has been revealed in the latest fund flow figures released by the Investment Association.

In June UK retail investors pulled £4.5 billion from open-ended funds. This represents the most significant outflow since March 2020, which marked the onset of the pandemic.

Equally disconcerting, there have been net outflows in five of the first six months this year.

Investment Association chief executive Chris Cummings said: 'Savers are pre-empting slowing economic growth and preparing for further interest rates rises as we enter new territory for markets.

'Higher rates mean a weaker performance outlook for the high-growth companies that helped to fuel the bull market of the last decade. (The latest) equity fund outflows indicate that investors are looking at ways to better balance their savings.'

Cummings added: 'All major asset classes experienced outflows in June as investors continue to adjust to the end of the low interest rate era. Investors turned to lower-risk asset classes as a bulwark against rising market uncertainty.

Equity funds witnessed the largest net outflows at £2.27 billion. Funds experiencing the largest redemptions in June included **Vanguard FTSE UK All Share (BPN5P78)**, **BlackRock Absolute Return Bond Fund (B618DS3)**, **BlackRock Natural Resource Growth and Income Fund (B6865B7)** and **Fundsmith Equity (B41YBW7)**, according to Morningstar and Numis.

Conversely inflows were noted at several North American funds including **iShares North American Equity Index (B7QK1Y3)** and **HSBC American Index (B80QG61)**.

In the absolute return space, **LF Ruffer Diversified Return (BMWLQT5)** and **TM Tellworth UK Select Fund (BNY7YM7)** saw notable inflows.

The best-selling IA sector in June was volatility managed funds, which attracted net inflows of £248 million.

Largest outflows from open-ended funds in June 2022

FUND	OUTFLOW
Vanguard FTSE UK All Share	£1.1bn
Baillie Gifford Diversified Growth	£353m
BlackRock Absolute Return Bond	£308m
BlackRock Natural Resources Growth & Income	£303m
Royal London Short Term Fixed Income	£302m
Fundsmith Equity	£279m
Abrdn (Lothian) Pacific Basin	£224m
BNY Mellon Real Return	£222m
Baillie Gifford European	£176m
Quilter Investors UK Equity	£174m

Table: Shares magazine • Source: Morningstar, Numis

After gaining new highs in January, markets plunged in March as economies across the world went into lockdown and have since made a patchy recovery at best. The Vix index, a widely used a measure of volatility on stock markets, hit a record high in March as fears about the impact of Covid-19 ramped up.

Volatility managed funds aim to provide investors with a smoother journey and are designed to avoid the sharp swings in performance that have caused many investors sleepless nights.

Among other asset classes, money market funds experienced the second biggest outflows in June at £1.11 billion, while fixed income funds saw outflows of £653 million. [MGar]

DISCLAIMER: Editor Daniel Coatsworth owns units in Fundsmith Equity

Time to bet on a recovery in UK smaller companies

Grab a decent income and exposure to quality businesses through this trust

Investors seeking a ready-made portfolio of high-quality small fry selling at a knock-down price should consider **Montanaro UK Smaller Companies (MTU).**

The investment trust has a long track record of outperforming peers, and its shares are currently trading at 7.7% below the value of its assets.

While it primarily focuses on capital growth, with the underlying portfolio's income generation considered to be a byproduct of the stock selection process, Montanaro UK Smaller Companies is a quarterly dividend-payer.

It is currently yielding 5.1% based on the past four quarterly dividend payments and the latest share price.

Managed by seasoned stock picker Charles Montanaro, the £194 million trust invests in high quality, profitable and well-managed growth companies for the long term.

To reduce the risks inherent with investing lower down the market cap scale, the experienced Montanaro avoids loss-makers, highly leveraged names and unquoted or illiquid stocks.

Unfortunately, the good-quality growth names Montanaro favours have sold off sharply since the start of 2022 due to the rising interest rates required to tame inflation.

Yet the sell-off in quality growth names and the net asset value discount on the trust has created a compelling entry point for patient investors since Montanaro believes valuations are now the most attractive that they have been in many years.

MONTANARO UK SMALLER COMPANIES INVESTMENT TRUST

BUY

(MTU) 115.75p

Discount to NAV: 7.7%

The sharp deterioration of the fund's relative returns since November 2020's vaccine announcements has pushed the trust towards the bottom end of the peer group performance tables over most short/medium-term time periods.

'If Charles is right and quality starts to come back into favour, Montanaro UK Smaller Companies could move swiftly back up the rankings,' says research group QuotedData.

The fund manager believes good quality, well-managed companies with pricing power are best placed to face inflationary pressures. Montanaro UK Smaller Companies' quality bias is demonstrated by portfolio characteristics including a 2023 forecast return on equity of 18.2%, according to its latest factsheet.

The portfolio's constituents have an average price to earnings ratio of 16.5 based on 2023 forecasts, which is attractive for a basket of quality companies. Dividends for the current portfolio are forecast to grow by an average 6.7% next year.

The trust provides investors with exposure to the technology and industrial sectors, among other areas of the market. [JC]

Low-teens rating leaves Learning Technologies in bargain territory

Analysts predict 50% to 110% share price rally over the medium-term

You can understand why many growth stocks have fallen deeper than the wider market this year, particularly those that are loss-making. Online staff training and engagement company **Learning Technologies (LTG:AIM)** does not fit this profile, yet its stock has been hammered just the same.

Highly profitable and cash-generative (it even pays a modest dividend), analysts have twice this year increased profit margin estimates, yet the share price has fallen 26% in 2022, tracking far slower technology growth businesses.

We believe this trend will reverse and stock market participants will conclude a low-teens price to earnings multiple does not fairly reflect mid-teens net income growth and operating margins pushing towards 20%.

Learning Technologies provides a range of customisable talent management and learning software solutions to more than 2,000 corporate and government clients.

In a world where keeping your best people has become harder, Learning Technologies' services are part of the career development pathway that keeps productive staff happy.

Chart: Shares magazine • Source: Refinitiv

It has a buy and build strategy, with a dozen or so acquisitions now under its belt, including GP Strategies, a $343 million deal in summer 2021.

Operating margins at GP Strategies have doubled to 9.2% since being acquired, which speaks volumes for Learnings Technologies' operational streamlining, such as stripping out unnecessary layers of management and duplicated back-office jobs.

There are positives to draw from its latest trading update on 26 July, such as news that half-year revenue will be at least £280 million versus prior expectations of £274 million, and adjusted operating profit of more than £43 million, also beating forecasts (for £38.9 million).

'With margins raised in GP Strategies to a run-rate level of 15% by the end of full year to 31 December 2023, this is what causes our circa 6% uplifts to 2023 and 2024 earnings before interest and tax at a group level,' said analysts at Berenberg in response. EBIT is effectively another way of saying operating profit.

The group operates in a rapidly growing digital learning market estimated to double in value to $400 billion by 2026, according to Statista data, with roughly 40% based in the US, justifying Learning Technologies' push into that region in recent years. Last year more than two-thirds of its overall £258 million revenue was earned in the US.

Analysts see the share price moving beyond 200p, and perhaps to 275p, over the coming 12 months or so, implying upside of 50% to 110% (bull case). [SF]

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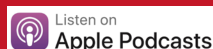


Reasons to be positive on Berkshire Hathaway despite share price dip

The group's operating performance tells a much brighter story

BERKSHIRE HATHAWAY

(BRK.B) $292

Loss to date: 8.8%

We highlighted **Berkshire Hathaway (BRK.B:NYSE)**, the investment vehicle controlled by Warren Buffett, on 17 February 2022 due to its attractive mix of businesses and its large cash pile which topped $100 billion at the end of March.

WHAT'S HAPPENED SINCE THEN?

Due to the sell-off in markets in the second quarter, the share prices of Berkshire's three biggest listed holdings – **Apple (AAPL:NASDAQ)**, **American Express (AXP:NYSE)** and **Bank of America (BAC:NYSE)** – all fell, reducing the value of the portfolio from $391 billion at the end of March to $328 billion at the end of June.

That meant the firm reported a 'paper' loss of almost $44 billion for the quarter, despite a strong operating performance by its businesses which increased their revenues from $69.1 billion to $76.2 billion.

More importantly, the profitability of its owned businesses also improved with operating earnings climbing to $9.28 billion from $6.69 billion last year.

Buffett has long maintained that Berkshire's earnings are a better measure of the quality of the company than its paper gains and losses, which as the last quarter has shown can vary greatly.

Due to its broad spread of domestic interests, from insurance to retail and railroads, Berkshire is often seen as a reflection of the broader US economy so a strong operating performance would seem to suggest fears of a recession are

somewhat premature.

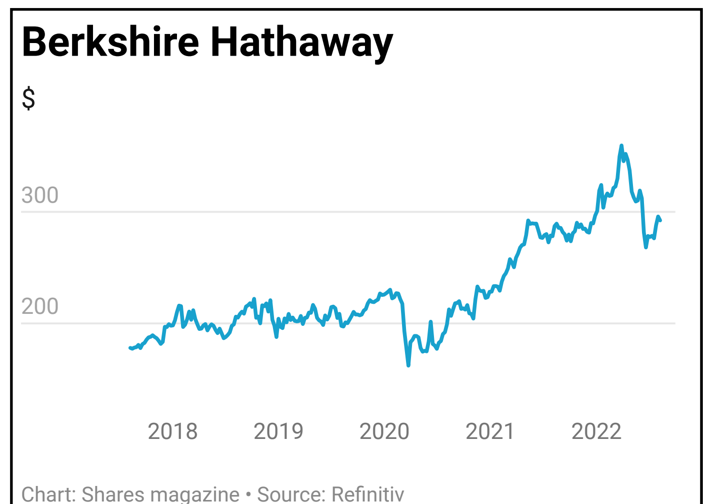
Interestingly, after buying over $50 billion of stocks in the first quarter including oil producer **Chevron (CVX:NYSE)** and printer-maker **HP (HP:NYSE)**, Berkshire slowed its spending during the second quarter.

It also reined in buying its own shares, spending $1 billion against $3.7 billion in the previous quarter.

WHAT SHOULD INVESTORS DO NOW?

Since July, the share prices of Apple, American Express and Bank of America have rallied meaning most of the second-quarter losses will likely be reversed. Meanwhile, Berkshire's operating results have demonstrated the strength of its underlying businesses.

Investors should sit tight and let the shares continue their recovery. [IC]



BUYS AND SELLS FROM THE BOSSES

When a director of a firm sells shares there could be any number of reasons for their decision, the most common one being they need to raise cash to pay an income tax or capital gains tax bill.

However, when a director dips into their own pocket to buy shares there is usually only one reason – they expect the price to go up.

The question is, can investors rely on insider buying as a useful tool when trying to pick stocks?

'THE ILLUSION OF CONTROL'

We should stress that when we say insider buying or selling we aren't referring to insider trading, which is based on having specific, unpublished, price-sensitive information, and is strictly banned by the FCA (Financial Conduct Authority).

What we are talking about is directors buying or selling shares in their own company completely off their own bat on the basis that

By **Ian Conway** Companies Editor

they are either too cheap or too dear.

Tom Stevenson, investment director at US asset manager Fidelity International, cautions that insiders can suffer the same emotional biases as any other investor and can often be 'too quick out of the blocks when it comes to buying their companies' shares'.

Studies show that more often than not managers are over-confident about the future returns from their companies' shares.

'One study asked finance directors on a quarterly basis how confident they were about both the economy and their own company's prospects,' relates Stevenson.

'The study found they were routinely more confident about their company than the economy as a whole – a classic case of overconfidence

springing from the illusion of control,' he adds.

Elon Musk, chief executive of **Tesla (TSLA:NASDAQ)** and its biggest shareholder, certainly couldn't be said to lack self-confidence.

Musk's purchases of Tesla stock in 2018 and 2020 created plenty of headlines but they didn't have much of a positive effect on Tesla's shares and they didn't add any value for shareholders.

Stevenson also suggests looking at the amounts of money involved relative to the wealth of the investor.

For multi-billionaire owners, spending £10 million or $10 million on their own shares may be a drop in the ocean, whereas for most normal people it is a fortune.

Moreover, wealthy owners can afford to sit on losses for a long time whereas most of us don't have that luxury.

THE MORE THE MERRIER

However, when a group of insiders buy shares in the same company – what is known as a 'cluster-buy' or 'pack buy' – it is often considered a strong signal.

When one director buys it might be because they are optimistic about the future, but when half a dozen top executives buy at the same time it usually means they have a fairly good idea there is positive news on the way.

Often, buying by independent directors can be a good indicator, especially if they come from an investment background, as they tend to take a more objective view of the business than people who have worked for the firm for a long time.

Also, investors should look at the broader context, says Stevenson.

'Are similar insider buys going through in other companies in the sector? This might indicate a change in sentiment in an out of favour industry.'

The fact more directors were buying shares than selling them in May – for the first time since the onset of the pandemic in March 2020 – could be a signal things are looking up, says Stevenson.

'Insider buyers can be a powerful leading indicator of a change in direction for the market,' he adds, which alongside what looks like a change in the tide of markets, could be an encouraging sign.

A RELIABLE SIGNAL?

While *Shares* has found no concrete evidence that following directors buys and sells is a good lead indicator of future share price returns, one study is worth flagging.

In their paper *Trading Against the Grain: When Insiders Buy High and Sell Low*, published in the Journal of Portfolio Management in 2019, authors Wesley Wang, Zhipeng Yan and Qunzi Zhang studied US director share deals stretching from 1986 to 2017.

The authors found that, for all their supposed informational advantage, directors tended to have exactly the same behavioural biases as normal investors.

For instance, the closer a stock price got to a 52-week low, the more likely directors were to buy shares in their own companies, and the closer it got to a 52-week high the more likely they were to sell.

This is a classic example of 'anchoring' an investment decision based on the price of a stock. All investors are ingrained with the lesson they should 'buy low, sell high'.

As a result, insiders were progressively less likely to buy or sell the further the price moved from the 52-week low or high.

THE CONTRARIAN VIEW

However, the study's most intriguing finding was that when directors went completely against the grain and *bought* shares close to their 52-week highs or *sold* shares close to 52-week lows, it was because they were typically better informed.

'Corporate insiders are actively involved in the operations and management of their firms, which help them enjoy certain informational advantages over outside investors,' say the authors.

‘Except for meeting instant liquidity needs, insiders trade under the influence of both the anchoring bias and private information; if the insider actually trades *against* the bias, we can infer that this type of insider trades may contain information,’ they suggest.

They go on to argue that outside investors can ‘piggyback on insiders following these informative trades and reap sizeable abnormal returns’.

According to their analysis, a long-short trading strategy of buying high and selling low along the lines of insiders and riding the price momentum generated an average monthly excess return of around 200 basis points or 2% before dealing costs.

While 2% per month before costs may not sound much, it adds up to an annual return of 24% which is more than the stock market has returned annually over any five-year or 10-year period.

WHERE CAN I FIND DETAILS OF INSIDER DEALS?

The *Shares* website has details of all director deals reported to the London Stock Exchange.

Under Tools, on the home page, subscribers can click to see all the latest director deals as well as search for deals by company.

In addition, subscribers can discover which directors have been the most active in terms of number of deals in the last month, three months, six months or year, and which have been the biggest buyers or sellers in terms of total consideration.

There are also tabs for contrarian buys, ‘cluster’ or ‘pack’ trades – when more than one insider buys or sells together – and the most profitable trades.

For subscribers who want to analyse buys and sells near 52-week highs and lows and test the theory set out in the paper above, that facility is also available under the ‘Analysis’ tab.

Examples of recent significant director dealings

Date	Buy/Sell	Company	Director	Price	Value
7 July 2022	BUY	Next (NXT)	CEO Simon Wolfson	£60.95	£10 million
15 June 2022	SELL	Experian (EXPN)	President Kerry Williams	£23.86	£2.8 million
1 August 2022	BUY	MJ Gleeson (GLE)	NED Christopher Mills	515p	£2.6 million
15 June 2022	SELL	Experian (EXPN)	CEO Brian Cassin	£23.86	£2.5 million
8 July 2022	SELL	Best of The Best (BOTB)	CEO William Hindmarch	600p	£2.0 million

Table: Shares magazine • Source: Shares magazine. Data correct as of 2 August 2022. Directors: CEO = chief executive officer, NED = non-executive director, FD = finance director

Examples of recent 'pack' or 'cluster' director dealings

Company	Directors	Buys	Sells
Legal & General (LGEN)	7	7	0
Stagecoach (SGC)	7	1	14
Ocado (OCDO)	6	16	0
DS Smith (SMDS)	5	5	1
Assura (AGR)	5	13	3
Fevertree (FEVR)	5	9	0
Investec (INVP)	5	0	18
Best of The Best (BOTB)	5	0	5
Mitie (MTO)	5	7	0

Table: Shares magazine • Source: Shares magazine. 3 months to 8 August 2022

REAL-WORLD EXAMPLES

Some recent significant trades in terms of size include a £10 million deal linked to the CEO of retailer **Next (NEXT)**, Simon Wolfson.

The shares were bought through a charitable trust linked to Wolfson and imply a degree of confidence in the outlook for the company despite an extremely difficult backdrop.

At a purchase price of £60.95, the shares were bought a long way from 52-week highs of £84.84 and not a million miles from year lows of £55.78. As we write the shares are trading at £64.70, buoyed by an encouraging set of first-half

Examples of directors who bought or sold when the shares were near 52-week highs and lows

Date	Buy/Sell	Company	Director	Value	High/Low
7 May 2021	BUY	Ocado (OCDO)	Non-executive director Jorn Hausing	£25.9 million	52wk High
11 May 2021	BUY	Ocado (OCDO)	Non-executive director Jorn Hausing	£12.9 million	52wk High
21 October 2021	BUY	TUI (TUI)	Non-executive director Alexey Mordashov	£12.5 million	52wk High
25 October 2021	BUY	TUI (TUI)	Non-executive director Alexey Mordashov	£11.1 million	52wk High
22 April 2021	SELL	Morgan Sindall (MGNS)	CEO John Morgan	£7.8 million	52wk Low
22 April 2021	SELL	Morgan Sindall (MGNS)	CEO John Morgan	£5.5 million	52wk Low
16 April 2021	SELL	Dechra Pharmaceuticals (DPH)	Executive director Tony Griffin	£962,950	52wk Low

Table: Shares magazine • Source: Shares magazine. Data correct as of 2 August 2022. Directors: CEO = chief executive officer, NED = non-executive director, FD = finance director

numbers published on 4 August.

To illustrate the point that there are lots of reasons why directors might sell, several board members at competition runner **Best of the Best (BOTB:AIM)** recently sold shares as part of a tender offer (where shareholders have the opportunity to sell shares at a specified price, in this case 600p).

A big sale by the CEO of consumer credit reporting outift **Experian (EXPN)**, Brian Cassin, was to cover tax liabilities associated with a share award.

Swedish businessman Jorn Hausing, an early investor in online groceries firm **Ocado (OCDO)** and a non-executive director on the board, added to his already significant stake in the business with a couple of significant purchases in May 2021. At the time the shares were trading close to a 52-week high.

In the short term this trade has performed poorly with the shares having halved in the interim.

In contrast, Tony Griffin, a director at veterinary medicines group **Dechra Pharmaceuticals (DPH)** sold nearly £1 million shares at what was close to a one-year low and while the shares did subsequently rally in the short term. They now trade below the price at which he sold.

THIS IS AN ADVERTISING PROMOTION

Janus Henderson
INVESTORS

IS NOW THE TIME TO INVEST IN EUROPE?

In this latest episode of Trust TV, we speak to Tom O'Hara, Portfolio Manager of **Henderson European Focus Trust** – to discuss how he is steering the Trust through a challenging market environment, areas where he is finding opportunities, and the risk of a recession and its impact of global markets. Tom also looks at how the war in Ukraine has affected the ESG narrative.

Key takeaways:

- We have circa 18% exposure to the energy sector, and we have been refining our exposure within the consumer mass market space as the cost-of-living crisis intensifies. We are style agnostic - so we have been investing in a blend of growth and value stocks.
- Due to higher input costs (raw materials, wages, and energy) and lower consumer spending, businesses within the European industrials and consumer discretionary sectors have been experiencing higher margin pressure.
- ESG is partially responsible for the distortion in the capital allocation process both within equity markets and corporations. It's not our job to cancel businesses – we prefer to work with companies to ensure that they are travelling in the right direction whilst aligning shareholder and societal interests.

Visit the website for more information about **Henderson European Focus Trust**. For more insights, research and commentary on the range of Janus Henderson Investment Trusts, visit the **Insights Hub**.

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RUSS MOULD
AJ Bell Investment Director

Why commodities hold the key to the FTSE 100

Miners, oil companies and financial institutions are the main contributors to earnings growth

The UK's first-half results reporting season is drawing to a close, and investors may be feeling they can breathe a sigh of relief. As in the US more firms are beating or meeting expectations and disappointments look relatively few and far between.

Smith & Nephew (SN.) and **Rolls-Royce (RR.)** look to be the only real let-downs, while a range of industries from chemicals and banks to pharmaceuticals and retail are still looking good, if **Croda (CRDA)**, **Lloyds (LLOY)**, **GlaxoSmithKline (GSK)** and **Next (NXT)** are any guide. That's before even mentioning the bonanza earnings from Big Oil, in the form of **BP (BP.)** and **Shell (SHEL)**.

This is despite concerns over input cost inflation, ongoing supply chain stresses, the war in Ukraine, rising interest rates and the real risk of the UK tipping into recession. It also offers support to analysts' forecasts, which, in aggregate for the FTSE 100 are looking for 20% growth in net profit in 2022 and another 14% in 2023, despite this long list of possible challenges.

Analysts see higher profits from the FTSE 100 in 2022 and 2023

Source: Company accounts, Marketscreener, analysts' consensus estimates

Those estimates put the FTSE 100, with its £2 trillion market capitalisation, on 12.4 times earnings for 2022 and 10.9 times for 2023. Both multiples look tempting, and suggest the UK is cheap relative its own history and international peers, especially once the FTSE 100's dividend yield of just over 4% is added to the equation.

The question now is how reliable are those earnings forecasts? If they prove too optimistic, then the FTSE 100's resilient showing so far this year could prove to be a nasty bear trap.

ALL IN THE MIX

Profits already stand at a record high, given 2021's outcome, and there are multiple challenges ahead, so at first glance, it seems a stretch to expect double-digit percentage profit increases for this year and next.

Aggregate earnings dipped in 2019 before the pandemic as the global economy started to lose momentum. Then came the virus, but the economic impact was more than counter-acted by vast amounts of monetary and fiscal stimulus. But rising interest rates and quantitative tightening now dominates central bank policy while penniless governments are no longer handing out cash with such abandon.

Under such circumstances, an economic slowdown, or downturn now, would seem logical.

RUSS MOULD
AJ Bell Investment Director

However, the FTSE 100's profit mix means it may not be such a dubious proposition as it may first appear. Mining, oil and financials (banks and insurers) are forecast to generate two-thirds of aggregate FTSE 100 pre-tax profits in 2022 and not much less in 2023. An environment where inflation stays sticky and rising interest rates keep the yield curve steep could help all three of these key sectors.

The counter argument is that a recession would hurt demand for commodities and crush raw material prices (as happened in 2007-09) and also lead to an increase in provisions for sour loans from the banks (as also happened in 2007-09). But commodity prices stayed firm throughout much of the stagflationary 1970s and shrugged off economic downturns quite readily so a negative outcome may not be quite so certain, even under a bearish macro scenario.

Percentage contribution to FTSE 100 profits

	2021	2022 E	2023 E
Mining	21	**24**	17
Oil & Gas	17	**21**	22
Financials	25	**19**	21
Consumer Staples	12	**12**	12
Industrial goods & services	7	**7**	7
Health Care	3	**5**	7
Consumer Discretionary	3	**5**	6
Utilities	4	**3**	3
Telecoms	3	**3**	3
Real estate	3	**2**	2
Technology	1	**1**	1

Table: Shares magazine • Source: Company accounts, Marketscreener, analysts' consensus estimates

Percentage contribution to FTSE 100 profits growth

	2021	2022 E	2023 E
Oil & Gas	39%	**37%**	37%
Mining	25%	**34%**	(78%)
Health Care	(4%)	**15%**	30%
Consumer Discretionary	12%	**11%**	23%
Consumer Staples	1%	**11%**	15%
Industrial goods & services	6%	**8%**	12%
Telecoms	(0%)	**1%**	5%
Technology	0%	**0%**	1%
Utilities	5%	**(4%)**	2%
Real estate	7%	**(4%)**	(4%)
Financials	9%	**(9%)**	58%

Table: Shares magazine • Source: Percentage contribution to FTSE 100 profits growth

The importance of these three sectors become even more clear when their percentage contribution to earnings growth is quantified. Oils and miners are expected to provide 71% of FTSE 100 earnings growth in 2022 but financials are not expected to contribute anything, thanks to a return to taking loan loss provisions this year, compared to 2021's writebacks.

The picture changes for 2023 when insurers, banks and oils are expected to generate a very substantial portion of FTSE 100 profits growth, but miners are forecast to detract from the overall pot, thanks to an anticipated retreat in their earnings.

Again, any investors who think commodity prices can confound the consensus may find UK equities of greater interest. Those who do not may well take a more cautious view.

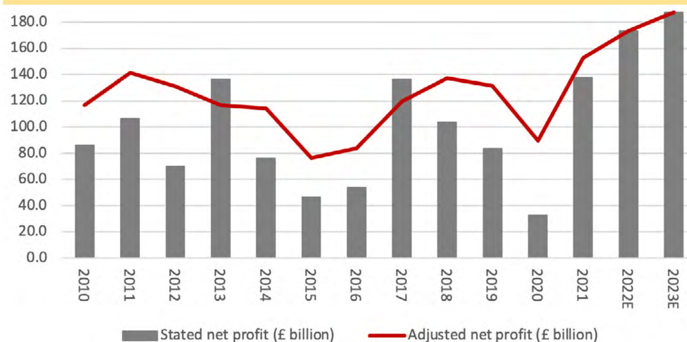
RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues

WEIGHTS AND MEASURES

One final point to bear in mind on industrial sectors' profit contributions is how their percentage of FTSE 100 earnings compares to their weighting within the index by market capitalisation.

Markets are implicitly distrustful of 2021-22's oil and mining profits boom



Source: Company accounts, Marketscreener, analysts' consensus estimates, Refinitiv data

Miners' and oils' market cap weightings within the benchmark lay well below their forecast profit contribution for 2022 and 2023. This suggests that they could yet surprise on the upside if commodity prices prove more resilient than analysts and economists currently expect, but investors will have to decide for themselves how likely they think that is.

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How BlackRock World Mining outperforms by using all the tools at its disposal

Trust has been run by Evy Hambro for more than 20 years

The mining sector has had a wild 2022 to date. It started strongly, supported by pent-up demand from the pandemic, with the invasion of Ukraine affecting the supply of key commodities and helping to drive prices even higher.

More recently, concerns about a global downturn, rising interest rates and a stronger dollar have all contributed to a big crash.

With metals prices stabilising and stocks in the sector starting to recover, *Shares* sat down with the manager of diversified mining investment trust **BlackRock World Mining (BRWM)**, Evy Hambro, to get his perspective on the short and long-term outlook for the miners.

'I guess the key question shareholders are asking is "where are we in the cycle?"'

Hambro notes ruefully that investors have been asking this question more frequently since what happened in June which, as he observes 'represented one of the largest one-month falls going back to the Great Financial Crisis'.

SCALE OF SELL-OFF A SHOCK

Hambro adds that the scale of the sell-off came as a bit of a shock given that, unlike in 2007/8, mining firms are not sitting on significant amounts of debt. He observes that with the trust's gearing at 12% as of the end of June 'we're higher than we've been in the past and the strategy is absolutely to take advantage of opportunities'.

It says something if Hambro is shocked given the length of his experience. The trust itself was launched in December 1993, and Hambro has been at the helm for more than 20 years. Since 2015 he has been supported by co-manager Olivia Markham.

He is the eldest son of Peter Hambro, who was the founder and one-time chairman of Petropavlovsk (formerly Peter Hambro Mining), the Russian gold miner which filed for administration in the fall-out from the Ukrainian conflict and Russian sanctions.

The trust is one of the most popular in the resources space with more than £1.13 billion in assets. It is also one of the best performers over 10 years in the AIC's (Association of Investment Companies) Commodities & Natural Resources sector.

BEATING THE TRACKERS

Given many mining companies share prices are heavily tied to commodity prices, it raises the obvious question of why you would invest in an actively-managed fund when you could buy a tracker fund more cheaply. How does Hambro meet this challenge?

'We've done pretty well,' he responds. 'I think if you look at the shareholder base it's pretty much

retail and from this perspective the board's view is very focused on: "what is the value we're adding?"'

Hambro observes that while they may be more expensive than a tracker there is an emphasis on keeping costs low, 'much to my irritation,' he jokes.

The ongoing charge is 0.95% which compares favourably with other resources-focused trusts. As a point of comparison the **VanEck Global Mining ETF (GIGB)** has an ongoing charge of 0.5%.

In the short-term its performance has been patchy, reflecting the volatility of the underlying market.

However, on a longer-term view it has arguably justified its extra fees. A three-year return of 92.3%, compares with 53.9% for its benchmark and 40.9% for the aforementioned Van Eck ETF. This long-term performance is being rewarded with a 2% premium to net asset value at the current price of 590p.

The trust is backed by the BlackRock natural resources team, the largest in the world by assets, with real depth of expertise.

TOOLS AT ITS DISPOSAL

It also has tools at its disposal like trading in private companies, employing gearing, buying mining royalties and using derivatives.

Fund/trust	Six-month performance	One-year performance	Three-year performance	Five-year performance	10-year performance
BlackRock Natural Resources Growth & Income	6.5%	28.1 %	47.3 %	64.5%	95.8%
BlackRock World Mining Trust	**-3.4%**	**0.7** %	**92.3** %	**110.7**%	**84.0**%
Blackrock Energy & Resources Income Trust	4.0%	33.7 %	90.4%	112.5%	78.8%
CQS Natural Resources Growth and Income	9.8%	33.6%	134.1%	115.1%	39.5%
JPM Natural Resources	6.0%	21.6%	35.9%	54.5%	24.7%
Geiger Counter	-10.6%	16.7%	140.7%	109.8%	20.7%
LF Ruffer Gold	-5.9%	-9.7%	16.6%	66.0%	12.7%
Ninety One Global Gold	-4.3%	-13.2%	-5.3%	36.4%	12.2%
BlackRock Gold & General	-14.5%	-21.9%	-10.9%	8.3%	-11.8%
Baker Steel Resources Trust	-11.3%	-22.6%	25.0%	88.4%	-24.0%
Golden Prospect Precious Metals	-4.7%	-21.9%	22.6%	7.5%	-49.8%
T. Rowe Price Global Natural Resources Equity	6.4 %	19.0%	27.0%	37.9%	n/a
WS Charteris Gold & Precious Metals	-8.2%	-27.8%	-13.2%	3.3%	n/a
Baker Steel Gold & Precious Metals	-3.4%	-15.6%	3.6%	-20.1%	n/a
Riverstone Energy	28.1%	77.8%	-16.2%	-50.1%	n/a
GRIT Investment Trust	-0.9%	-39.7%	-25.7%	-91.2%	n/a
TB Amati Strategic Metals	-2.8%	-2.9%	n/a	n/a	n/a

Table: Shares magazine Source: FE Analytics, data to 3 August 2022. Total return in GB.

'Back in 2010 – the board took the view that in order to maximise the total return available for shareholders we need to ensure we sweated the portfolio as hard as possible,' Hambro says.

The benefits of the investment in private firms was reflected in two recent IPOs. The larger of which, US battery metals firm **Ivanhoe Electric (IE:NYSE)**, rewarded the trust with, in the words of broker Numis, 'a near doubling of money (in dollar terms) on the investment'.

The company also has two royalties in its portfolio, including one over a copper and gold mine in Brazil. These are transactions which see mining firms sell future production or revenue in return for an upfront cash payment.

'These have been successful and we'd love to do more of them but they're hard to buy as they are an expensive form of financing for resource companies.'

On the unquoted part of the portfolio in general Hambro says: 'Return expectations have to reflect the fact we don't have liquidity so we have a higher return expectation.

'We also put in place safeguards focused on giving us liquidity in a reasonable time frame and we're trying to be as conservative as possible.

'We try to buy things into the portfolio as a private investment and will continue to be invested in when they turn public.'

DIVIDENDS DRYING UP

For years miners have focused on paying out generous dividends to shareholders, in part to compensate them for their patience during a difficult period for commodity prices. However, **Rio Tinto (RIO)** recently signalled a shift, cutting its first-half dividend by more than 50% recently. Does Hambro think we've reached the high watermark in terms of dividends from the mining sector?

'I think mining companies will continue with the same capital allocation policy and look to reinvest back into their business where it makes sense rather than paying special dividends. Given shares are extraordinarily cheap I would expect to see more buybacks announced,' he says.

INVESTMENT CRITERIA

In terms of the broad investment criteria applied by Hambro and Markham when making decisions, the former says they are looking for 'quality businesses, well run with strong ESG (environmental, social and governance) credentials'.

'We try not to invest in countries where there is uncertainty over the mining code and high political risk. However, our view is that Mother Nature put commodities in the ground where she did and you have to back the geology.

'That geology compensates us for the risks above ground which we can mitigate through diversification.'

When it comes to ESG, Hambro is willing to go on a journey with a company but in order to do so there needs to be a high degree of confidence in the governance. This is the most important of the factors according to Hambro as without the company being run properly you are unlikely to make any progress on the 'E' and the 'S'.

For long-term investors who believe the transition to renewables and electric vehicles, and the associated infrastructure this will require, can underpin metals demand we think BlackRock World Mining looks a logical place to invest.

Its track record is decent, it has solid backing from asset manager BlackRock and a diversified approach which should help mitigate some of the risks associated with investing in this sector.

By **Tom Sieber** Deputy Editor

What do special situations funds invest in and how have they performed?

This type of fund often has a focus on value but there's more to it than that

Special situation funds should, in theory, be busy making new investments in the current market environment. Their strategy includes finding unloved stocks which could either bounce back thanks to corporate self-help measures or the market eventually spots hidden value within a business which then attracts more buyers for the shares.

Given how so many stocks have slumped in value this year – many for no reason beyond negative investor sentiment in general – there should be plenty of opportunities for special situation fund managers.

Therefore, anyone looking to take advantage of 2022's market weakness might want to look at these types of funds as they are likely to be building positions now which could drive returns over the coming years, assuming markets recover.

WHAT DO THEY INVEST IN?

'Special situations' is a term mostly associated with recovery stocks, companies in urgent need of a refinancing or suffering from investor indifference, although this style encompasses much more than mere recovery investing.

Special situations funds are meant to be 'benchmark agnostic', meaning they can make concentrated, conviction trades which take them away from the index.

They also have licence to invest in mid, small and micro cap stocks if the manager thinks that's where the opportunities are. Though the majority of special situations funds are value biased, not all are, so here's a flavour of what they do.

Jupiter UK Special Situations (B4KL9F8) is one of the better known funds in this space. It is managed by seasoned value manager Ben Whitmore, whose team uses statistical techniques to screen companies for certain characteristics, narrowing their search for the best value opportunities.

Artemis UK Special Situations (B2PLJQ0) looks for companies that have a degree of self-determination – those where there is a degree of internal change that can act as a value creator and offset any macro headwinds.

Co-manager Derek Stuart says: 'Such value creation may come through capital allocation (disposals, acquisitions, debt paydown), overall improvements in margins and returns, improved business focus and efficiencies.'

Stuart points out that if the business has historically been an underachiever, then a new management team acts as the catalyst for rehabilitation.

'Recent examples of management change stories are **Babcock (BAB)**, **Burberry (BRBY)**, **C&C (CCR)**, **Restaurant Group (RTN)** and **Smiths Group (SMIN)**,' he adds.

The fund manager also looks at companies where exceptional external events have impacted short-term performance. 'For instance, the hospitality and airline sectors during the pandemic when we acquired positions in **Jet2 (JET2:AIM)**, **JD Wetherspoon (JDW)** and **WH Smith (SMWH).**'

How selected special situations trusts and funds have performed

Fund/trust	Six-month performance	One-year performance	Three-year performance	Five-year performance	10-year performance
TM CRUX UK Special Situations	−8.5%	−8.0%	25.3%	n/a	n/a
Fidelity Global Special Situations	−5.0%	−2.5%	24.1%	50.2%	245.7%
Artemis UK Special Situations	−9.6%	−11.4%	18.2%	16.0%	97.1%
Fidelity Special Values	−10.2%	−3.4%	17.1%	24.4%	235.8%
Fidelity China Special Situations	−18.1%	−32.2%	15.9%	20.1%	273.6%
Jupiter UK Special Situations	0.0%	7.0%	13.9%	n/a	n/a
Fidelity Special Situations	−3.7%	0.8%	11.7%	12.6%	132.3%
Liontrust Special Situations	−6.4%	−7.2%	11.5%	n/a	n/a

Table: Shares magazine • Source: FE Analytics, data to 3 August 2022. Total return in GB.

YOU GOT THE WRIGHT STUFF

One of the UK's best-known contrarian investors is Alex Wright, portfolio manager of the **Fidelity Special Situations (B88V3X4)** fund and its sister investment trust **Fidelity Special Values (FSV)**. According to FE Fundinfo, these products have delivered 10-year total returns of 132.3% and 235.8% respectively.

Wright says: 'Our focus is on companies that have gone through a period of underperformance but where there are signs of positive change coming through'.

This can be internal change, for example a new management team or restructuring, or external change such as shifting industry dynamics or shrinking competition, 'and preferably both', says Wright, adding that the stock market tends to be inefficient at pricing companies that have gone through a troubled period and are consequently out of favour.

'Unloved companies, especially if smaller caps, are not well covered by analysts,' he explains. 'The lack of research can often combine with market scepticism to leave many companies trading below the true value of their franchise.'

Wright places strong emphasis on understanding the downside risk of each potential investment. 'Chosen investments exhibit an asymmetric risk-return profile, where the potential for future upside in the price of a stock far exceeds the prospect for further declines,' he explains.

Investing across the market cap spectrum, Wright's portfolios are 'fairly differentiated', a good thing as there is 'less competition, not just for flows, but also in terms of the types of stocks we look for. It is much harder to add stock specific,

idiosyncratic alpha if one is just doing the same thing that other investors are doing.

'In contrast, if one is looking at a sector that has been overlooked and where there is much less competition, one stands a very good chance of finding those hidden gems that can add significant value.'

Wright's funds do have a value bias, but a key difference to peers is that he doesn't just look for cheap stocks but also evidence of positive change. Leveraging Fidelity's team of equity analysts worldwide, Wright conducts thorough due diligence and investigates the potential catalysts for change and the likelihood of the change coming through.

'This is a very research-intensive process, which involves not only talking to the management teams, but also competitors, customers, suppliers, industry experts, and considering global industry trends in order to build a 360 degree picture,' he says.

Another fund from the Fidelity stable is the £3 billion **Fidelity Global Special Situations (B8HT715)**. It invests in companies which managers Jeremy Podger and Jamie Harvey believe to be undervalued with recovery potential not fully recognised by the market.

They focus on three specific categories of companies. These are corporate change – businesses undergoing change via restructuring, M&A or spin-offs; exceptional value – companies with the ability to deliver earnings growth in excess of market expectations and enjoy a re-rating. And unique businesses – typically firms with a dominant industry position, strong growth, cash flow and pricing power.

The approach has paid off handsomely as Fidelity Global Special Situations has delivered a 10 year total return of 245.7%. That is slightly less than the 273.6% generated by investment trust **Fidelity China Special Situations (FCSS)**, though the trust is down 32.2% over one year due to the sell-off in Chinese stocks triggered by fears over slowing growth, regulatory crackdowns, rising geopolitical tensions and the return to a zero-Covid policy.

In this case, special situations refers to Chinese companies which manager Dale Nicholls believes to have good long-term prospects, cash generative business models and strong management teams, yet whose strengths are not well understood by the market and not reflected in valuations. Nicholls also focuses on Chinese smaller companies as these tend to be less well researched and, therefore, more mispriced.

Other constituents of the special situations universe include Richard Penny's **TM Crux UK Special Situations (BG5Q5X2)** fund, up 25.3% over three years. Penny searches for companies in the recovery ward, which are refinancing, are subject to management change or boasting strong potential growth, and seeks out firms that hold undervalued assets.

DURABLE COMPETITIVE ADVANTAGE

A special situations fund with a different, though very successful, approach is **Liontrust Special Situations (BG0J268)**. Managed by Julian Fosh and Anthony Cross, this vehicle aims to deliver long-term capital growth using Liontrust's 'Economic Advantage' process.

This seeks to identify companies that possess intangible assets which produce barriers to competition and provide a durable competitive advantage that allows them to defy industry competition and sustain a higher than average level of profitability for longer than expected.

Fosh and Cross believe the hardest characteristics for competitors to replicate are three classes of intangible asset: intellectual property, strong distribution channels and significant recurring business.

Other important intangible strengths include franchises and licenses, good customer databases and relationships, effective procedures and formats, strong brands and company culture.

WHAT ARE THEY BUYING?

Fidelity's Wright has been adding to banks including **Barclays (BARC)** and **Close Brothers (CBG)**, with the sector now speaking for about 13% of his portfolios.

Wright notes that the banking sector typically sees profits hit in downturns, but today banks have strong balance sheets and consumers are in a much healthier position compared to prior recessions. 'Employment is high, wages are rising and households still have savings from the pandemic,' he explains.

He added to Barclays as the lender was 'trading at crisis-like levels' despite delivering a solid return on tangible equity.

'Banks such as Barclays will not only benefit from rising interest rates, but also from expanding loan books at a time when most consumers and large corporates have ample ability to borrow and may need to do so to meet rising costs.'

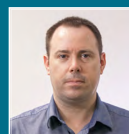
Wright describes Close Brothers as 'a conservative, well-managed, returns-focused niche lender'. He says it won't benefit from rising rates, as it has no current account business, but because of this situation the stock had underperformed and was trading below book value.

'Both stocks also benefit from some counter-cyclical revenues (i.e. revenues strongest when there is high volatility) – Barclays through its investment banking business and Close Brothers through its retail brokerage arm.'

Artemis' Stuart says there were reasons why he invested in JD Wetherspoon. 'Ultimately when the pandemic ended we expected people to revert to their old habits and go to pubs and trading to normalise. But we expected the pandemic to have a longer-term impact too – clearing out some capacity and enabling Wetherspoons to take market share.

'Surveys suggest that over 10% of pub capacity has gone from the UK pub market,' adds Stuart. 'The current inflationary environment puts more pressure on the smaller operators and again forces reduced capacity. The British Beer and Pub Association currently estimates that only one in three hospitality venues is currently profitable.

'We believe that Wetherspoons, as a larger player, is better placed to weather this storm and should come out with greater market share and ultimately more profitability.'



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

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THIS IS AN ADVERTISING PROMOTION

INVESCO SELECT TRUST PLC – CHOOSING COMPANIES FIT FOR THE FUTURE

*By **Ciaran Mallon,** Fund Manager*

Key takeaways

1. Amid rising interest in Environmental, Social and Governance (ESG), there has been much focus in recent years on the need to transition to a low-carbon world. While transition may be at the heart of the energy industry, it is apparent in a lot of other sectors too.

2. When investing in companies in transition we have to look at the scale of the future opportunity as well as looking back to the record of management in introducing change so far.

3. As investors, we think it pays to look at which direction the wind is blowing in each industry, how companies are working to ensure their relevance in the future and whether they have the wherewithal, the skill and the will to make the necessary transitions.

One of the biggest challenges for investors is that we judge companies by their track records. However, the world is always changing, and a company's value lies in its future success.

When managing the Invesco Select Trust plc UK Equity Share Portfolio, my co-manager, James Goldstone, and I believe that we need to pick companies capable of adapting to an ever-changing environment.

I find it fascinating how many of the companies we own are in sectors in transition. Take National Grid and SSE, for example. We think they have a vital part to play in building the electricity infrastructure we need if we are to switch from fossil fuels to renewables and transition to a low-carbon world.

Consider that an electric vehicle can use as much power as a home. Nearly all the cars on UK roads will be powered by electricity eventually. There are 32 million cars1 and 27 million homes2 in Britain today. This gives you a sense of the scale of the challenge. We therefore believe National Grid and SSE have huge growth opportunities. We also own BP, which expects to invest over 40% of its capital expenditure on transition growth businesses by 20253.

What's NEXT?

Transition is apparent in many other sectors, too. When investing in companies in transition we must consider the scale of the future opportunity. We must look back – at the record

Invesco

of managements in introducing change so far. And we must monitor progress carefully against company plans and pledges.

Transition can be expensive. The companies in transition that we tend to favour generate strong profits; their managers use resources intelligently and borrow sensibly.

We consider clothing and homeware retailer NEXT to be a good illustration. NEXT is in a treacherous sector, as the number of retailers falling into liquidation each year illustrates. Despite this, it has continued to generate strong cashflow even while investing in transformation. This year NEXT expects to generate £220m of surplus cash4.

We believe NEXT has a strong management team that has consistently done two things well: anticipate changes in the retail environment and allocate capital prudently in response. In 1986 it bought mail order company Grattan. In 1988 it launched the NEXT directory and 11 years later an online directory. It is now enabling other retailers to benefit from its online retail platform and efficient distribution, leveraging extra value from its infrastructure and years of investment.

Like NEXT, Bunzl's roots lie in the 19th century. Founded in 1854 as a paper manufacturer, today it is a distribution and services company, operating in 31 countries.

It is likely that Bunzl will have touched your life without you being aware of it. It lies at the functioning heart of many businesses. Buy a coffee and there is a good chance the paper cup, lid and napkin will have been sourced and delivered to the café by Bunzl. The workers on that building site you pass each day may well be wearing safety gear from Bunzl.

The company has grown through intelligent acquisition of other businesses, each of which might focus on a particular industry in a specific area, enabling it to widen its footprint geographically and across sectors.

Its scale offers many advantages. Bunzl can negotiate attractive prices. It can also more readily audit the supply chain to ensure products comply with ethical and sustainability standards. This is becoming a major competitive advantage in a world where environmental, social and governance standards are rising.

We believe Bunzl has scope to grow significantly further still, fully exploiting its logistics expertise and scale.

Changing attitudes

There can be many reasons why companies and industries find themselves in transition. Technology can open avenues of opportunity but also facilitate disruptive competition. Sometimes transition can be driven by changing consumer attitudes.

THIS IS AN ADVERTISING PROMOTION

British American Tobacco (BAT) was founded in 1902, before consumers were aware of the health risks posed by smoking. Today, supported by research showing they pose less risk, the company is developing alternatives to traditional cigarettes. BAT expects to generate £5bn from its "new category" businesses within the next three years. Meanwhile, this year alone it is expected to return £2bn to shareholders5.

We think it pays to look at which direction every industry is heading. In tandem, we also think it pays to explore how companies are working to ensure they remain relevant and whether they have the resources, the expertise and commitment to make the necessary transition successfully.

Want to know more?

Ciaran Mallon co-manages the Invesco Select Trust plc UK Equity Share Portfolio with James Goldstone, both members of Invesco's UK equities team. Click below to learn more about the investment trust.

Invesco Select Trust plc UK Equity Share Portfolio

Sources:
[1] Vehicle Licensing Statistics, 2021
[2] Office for National Statistics
[3] BP.com, February 2022
[4] Next PLC, May 2022
[5] BAT.com, July 2021

Investment risks

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

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

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How have three ETFs with inflation protection qualities performed?

The ones tracking gold and infrastructure have done well but the gilts product has disappointed

Theodore White, the American political journalist, described inflation as 'arriving gradually, is recognised too late and can be cured only by ruthless political surgery'.

In June the UK's annual rate rose to a new four-decade high and is predicted to peak at 13% according to the latest Bank of England forecast.

While many of today's investors have never seen meaningful inflation anybody who lived during the 1970s will need no reminder about how destructive inflation can be. In the UK, inflation jumped from 9.2% in September 1973 to 12.9% in March 1974.

The latest surge in prices has generated increased interest in investments which offer a degree of protection against inflation and this includes ETFs (exchange-traded funds).

In this article *Shares* profiles three relevant ETFs and looks at their strengths and drawbacks. They are: **iShares Index Linked Gilts ETF (INXG)**, **Invesco Perpetual Gold ETF (SGLD)** and **SPDR Morningstar Multi Asset Global Infrastructure (GIN)**.

INFLATION AND INDEX-LINKED GILTS

The first modern inflation-linked bonds, or 'linkers',

were issued by the UK in 1981. It was issued by single price auction, and indexation was to the general index of retail prices (RPI).

Index-linked gilts work by benchmarking their coupons and principal repayment amount against an inflation index. Gilts issued by the UK government use RPI as their benchmark.

Coupons are paid on a semi-annual basis (i.e. twice yearly). The coupon amount you'll get with each payment will be determined by how much the

Types of infrastructure assets

Transport	Utilities	Communications	Renewable power
Toll roads	Electricity transmission	Broadcast towers	Hydroelectric power
Airports	Gas distribution	Wireless towers	Wind
Seaports	Water distribution	Satellite networks	Solar
Railways	Wastewater collection	Fibre/wireline networks	Geothermal

Table: Shares magazine • Source: Shares magazine

inflation index used as its benchmark has moved.

Prices for ultra-long inflation-linked debt have fallen in recent months after hitting an all-time high in December 2021, due to a broader drop in bond prices in anticipation of a global tightening of monetary policy to combat higher prices.

The 2073 index-linked bond is down 54% from its November 2021 all-time high, falling 22% in May alone.

Demand for British index-linked debt is generally strong, reflecting appetite from pension funds and insurers with inflation-linked liabilities. This demand has been accentuated by the surge in inflation over the past year.

In April the UK sold 50-year index-linked bonds with a face value of £1.8 billion.

iShares Index Linked Gilts ETF replicates the performance of the Bloomberg UK Government Inflation Bond index which tracks sterling denominated inflation-linked bonds.

The £794 million fund invests in UK inflation-linked bonds across the full range of maturities.

The fund has 32 holdings, with a weighted average coupon of 0.55%. The ETF uses a sampling technique to select the most relevant index constituents and has a 0.1% ongoing charge.

In performance terms, the ETF is showing few signs yet of helping to protect investors from inflationary pressures. On a one-year basis, the sterling return including dividends is -16.1%, and on a three-year basis it is -9.45%.

The problem with many of the index-linked bond products available to UK investors is that they have an extremely long duration which makes them very sensitive to interest rate moves.

In a rising rate environment this means any protection they might offer against rising prices is neutered.

GOLD AS AN INFLATION HEDGE

Swiss asset manager Unigestion has found that between 1974 and 2017 gold delivered an average return of 10% during periods of inflation.

The Invesco Physical Gold ETC (which trades under the ticker SGLP for sterling-priced shares and SGLD for those in dollars) is linked to gold held in JPMorgan's bank vaults in London.

A key attraction is the total expense ratio that has fallen from 0.19% two years ago to its current level of 0.12%. Another appeal of the fund is its size with assets of £12.3 billion.

Over the last six months the fund has returned 9.3% at a time when most equity markets have experienced considerable declines.

On a one-year basis it has returned 11%, and over three years it has generated a return of 21.6%.

INFRASTRUCTURE AND INFLATION

Infrastructure according to asset manager Cliffwater represents 'the basic physical systems required to allow a business, community or nation to function'.

The inflation-linked revenues, low operating costs and high margins of infrastructure investments have increasingly captured investors' attention.

In times of rising inflation, companies that own or operate infrastructure can be an attractive investment option. Investments in infrastructure that are linked to real assets and generate stable, transparent and predictable operating cash flows offer a partial hedge against inflation.

Investors who expect rising inflation can therefore potentially protect their portfolio with infrastructure investments.

On a long-term basis, infrastructure has

generated a return well above the inflation rate.

The reasons for this lie in the specific characteristics of infrastructure companies, as can be seen in the example of several toll road operators.

The road concessions awarded by a regulator often contain appropriate clauses for adjusting tolls. Regulatory framework conditions, concessions and long-term contracts can explicitly link the revenues of the infrastructure company to inflation.

The SPDR Morningstar Multi Asset Global Infrastructure ETF tracks the Morningstar Global Multi Asset Infrastructure index which is equally weighted (50/50 split) between equities and bonds that fall within infrastructure-related industries. The index rebalances on a quarterly basis.

The fund has £1.31 billion of assets and an ongoing charge of 0.4% per year. While materially more expensive then vanilla trackers which match the performance of a stock index like the FTSE 100, these charges look undemanding given the greater complexity involved in tracking an index of infrastructure assets.

The two largest sector weightings are utilities (20.9%) and industrials (20%). Energy and real estate account for 4.4% and 2.9% of fund weightings respectively.

From a country perspective the US accounts for the majority of asset exposure at 49.3%, followed by Canada (6.8%), France (5.5%) and the UK (3.5%).

On a one-year basis the fund has delivered a sterling return including dividends of 4.4%. On a three-year basis returns are 8.7%. The current dividend yield is 2.01%.

INFRASTRUCTURE DEFINED

Regardless of sector, the common shared attributes of most infrastructure investments are:

- High barriers to entry
- Resilience to economic cycles
- Long duration
- Relatively inelastic demand
- Relatively stable and predictable cash flows
- Positive correlation to inflation

By **Mark Gardner** Senior Reporter

Performance and costs of selected ETFs with inflation-busting qualities

ETF	One-year performance	Three-year performance
iShares Index Linked Gilts	−16.1%	−9.5%
Invesco Physical Gold	11.0%	21.6%
SPDR Morningstar Multi-Asset Global Infrastructure	4.4%	8.7%

Table: Shares magazine • Source: JustETF 4 August 2022. Based on sterling returns and includes dividends

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How to transfer your nil-rate band and avoid a potential inheritance tax hit

Britons are paying record amounts of IHT but there are things you can do to limit your tax bill

As a nation we're paying a record amount in inheritance tax, as the value of property and has risen but the tax-free bands for inheritance tax (or IHT for short) haven't.

Government figures show that in the year to April 2022 we paid £6.1 billion in inheritance tax, a record sum and a 14% jump on the previous year's figures – marking the biggest percentage jump in seven years.

Inheritance tax has even become part of the current Conservative leadership election debate, with candidate Liz Truss hinting at reforms to the system and saying she wants to review the tax. With more estates being dragged into paying inheritance tax, it's important to make the most of tax breaks on offer.

MAKING A TRANSFER

One big area is the ability to transfer your nil rate band to a spouse, but often the rules are complicated and can be underused. Here's everything you need to know.

Everyone currently has a £325,000 inheritance tax allowance, meaning they can leave an estate worth up to that amount without paying any inheritance tax. After that the tax is paid at 40% on everything above that amount. What's more, someone leaving a home to a direct descendant as part of their estate gets an additional allowance of £175,000, called the residence nil rate band.

However, complications can occur when one half of a couple dies before the other. The benefit of the nil rate band is that it can be transferred to a spouse or civil partner, so any unused part of the allowance can be carried over.

This means that the surviving spouse could leave an estate worth up to £650,000 without having to pay inheritance tax. If a home is part of the estate, they could leave a total estate worth up to £1 million free of IHT.

There's a couple of things to note: first, you must have been married or in a civil partnership when the first death happens, so it can't be used by those who are divorced or those who planned to marry but hadn't tied the knot yet.

The second is that HMRC must be told that you're transferring the nil rate band within two years of the death of the surviving spouse – otherwise the estate could be landed with an unexpected tax bill.

WORKING OUT YOUR ALLOWANCE

In order to work out how much of the allowance you can use you work out the percentage used by the partner who died first. The IHT allowance has changed over the years, so this method of working out the percentage means that if the threshold has increased over that time the surviving spouse can still benefit from the newer, higher threshold for both themselves and their spouse's transferred allowance.

The simplest route is for the first person who dies to leave their entire estate to their spouse. This means that 100% of their unused allowance is available for their spouse and so they get double whatever the inheritance tax-free allowance is when they die.

If someone died and left their whole estate to their partner, regardless of what the allowance was when they died, 100% of the current allowance would be transferred to their partner. Meaning at current rates their partner would have £650,000 nil rate band to use. However, some people want to leave gifts to family or friends when they die, regardless of whether their spouse survives them or not.

For example, if the allowance was £250,000 when the first spouse died and they left £125,000 to their friends and the rest of their estate to

their partner, they would have used 50% of the allowance.

Fast-forward to today and the allowance is £325,000, which means their spouse would get an additional allowance of 50% of £325,000 – so £175,000. That means that together with their own nil rate band the surviving spouse can leave an estate worth £525,000 before any inheritance tax is due.

THE LENGTH OF THE PROCESS CAN VARY

The process of how to claim the estate depends on how big the estate is, how much of the allowance you're transferring and how long ago the first person in the couple died. For deaths before the start of 2022, you can use form IHT217 if you're transferring the entire unused threshold and the estate meets the criteria of an "excepted estate" – you can check out whether it does here.

However, if you're only transferring part of the unused band *or* if you're not eligible as an 'excepted estate' you'll need to make a full return of estate, which means more paperwork and involves filling out both form IHT400 and IHT402.

For deaths after 1 January 2022 you don't need to fill in those forms, and instead you just declare that you've transferred the allowance when you apply for probate.

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

Is now a bad time to take my pension tax-free cash?

Key things to consider and alternative routes to take

I'm 62 and not planning to take a retirement income until state pension age. I'm worried about the rise in energy prices and want to bolster my rainy-day fund. However, my fund has fallen by around 10% this year, so am I selling at the worst possible time?
Harriett

Tom Selby, AJ Bell Head of Retirement Policy says:

Millions of households are under financial strain, with inflation close to 10% and expected to hit 13% in 2022. By January next year, the average annual energy bill is predicted to be £3,600, up from £1,400 in October 2021.

It is inevitable some will turn to their savings and potentially their pensions to make ends meet. If you are aged 55 or older and have a defined contribution pension, you are entitled to access your pot as and when you choose, with a quarter available tax-free and the rest taxed as income.

You should think very carefully before raiding your retirement pot. Once you take your pension tax-free cash you cannot reverse that decision. If you sell your investments at a low point in the market, then the amount of tax-free cash you receive will be lower.

Let's take the example of someone over 55 who at the start of 2022 had a pension pot worth £100,000, meaning at that point their tax-free cash entitlement was £25,000. If their fund dropped in value by 10% to £90,000, their tax-free cash entitlement would also drop to £22,500.

If they chose to take all their tax-free cash at that point in time, their existing fund would not be able to generate any new entitlement – even if it subsequently grows. It's only new contributions that would build up an additional tax-free cash entitlement.

There are other issues to consider. You are taking money out of a tax-advantaged environment and exposing it to inflation. Money outside your pension counts towards your estate for inheritance tax purposes, whereas money within a pension can potentially be passed on tax-free to your loved ones. If you spend your pension too early, you'll increase the risk of running out of money in retirement.

Make sure you've properly reviewed your finances and have no other way of getting the money you need before dipping into your savings.

If accessing your pension is genuinely the only option, it is possible to take part of your available tax-free cash rather than the whole amount.

For example, someone with a £100,000 fund who needs just £1,000 of tax-free cash could just take that £1,000, with £3,000 going into drawdown. This would give the £96,000 'uncrystallised' portion (including the tax-free cash element linked to it) the opportunity to grow, along with the £3,000 in drawdown.

Another option would be to take an ad-hoc lump sum, with a quarter of the lump sum tax-free and the remaining 75% withdrawal taxed as income. Remember, if you do this you will trigger the money purchase annual allowance, which reduces your annual allowance from £40,000 to £4,000.

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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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results:

15 August: MTI Wireless Edge, Thungela Resources. **16 August:** Tremor International, Impact Healthcare REIT, Tribal. **17 August:** Persimmon, Essentra, Plus500, Kenmare Resources, Balfour Beatty. **18 August:** Helios Towers, Intelligent Ultrasound, Antofagasta.

Half-year results:

12 August: 888 Holdings, Flutter Entertainment. **16 August:** BHP. **18 August:** Rank, Eco Animal Health, Omega Diagnostics.

Trading updates

16 August: Watches of Switzerland.
17 August: Gem Diamonds.

WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

EDUCATION EDITOR Martin Gamble @Chilligg

SENIOR REPORTER: Mark Gardner

CONTRIBUTORS Danni Hewson, Laith Khalaf, Russ Mould, Tom Selby, Laura Suter

COMPANIES EDITOR Ian Conway @SharesMagIan

ADVERTISING
Senior Sales Executive
Nick Frankland
020 7378 4592
nick.frankland@sharesmagazine.co.uk

PRODUCTION
Head of Design: Darren Rapley
Designers: Rebecca Bodi, Kevin Sharpe

CONTACT US:
support@sharesmagazine.co.uk

Website: sharesmagazine.co.uk
Twitter: @sharesmag

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