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# MONEYWEEK

MAKE IT, KEEP IT, SPEND IT

9 SEPTEMBER 2022 | ISSUE 1120

## Truss takes over

A towering to-do list  
Page 8



MEILL

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# SECURITY

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## From the editor-in-chief...



What a thing it must be to unexpectedly find yourself prime minister – or chancellor. What a thing it must also be to find yourself in one of those situation when it's all going wrong. Prices in the UK are still rising fast (see page 27 for energy bill madness). Economists used to think inflation would peak around 10% – and that was considered a bit out there. Now forecasts of 20% aren't considered out there at all (analysts at Goldman Sachs are forecasting 22% by next year). Interest rates are set to keep rising (perhaps to an almost historically normal sounding 4% or so). House prices are beginning to stall in response (flattish in July and August on the latest numbers from Halifax).

There could be a sterling crisis under way (see page 4). The stockmarket isn't exactly covering itself in glory: the FSTE 250 is down 21% year to date and the latest data from the Investment Association shows money pouring out of UK equities. Total outflows from UK open-ended funds by retail investors come to some £11.5bn this year already. We think there is significant value in the UK equity market (valuations are far from challenging). Clearly not everyone agrees.

Liz Truss would have known as she stepped through the door of No.10 this week that she hasn't got much time to have a bash at sorting things out. In a sense that



Prepare for radical policies

### *“Liz Truss will know that she hasn't got much time to sort things out”*

gives her a huge opportunity to be radical: with two years left to a general election and her party very behind in the polls what's the downside (for her at least) to being radical? We look at her first attempts at this in politics (for more on the great energy freeze, see page 8), but are also watching to see what might come next.

### **A good time for a holiday**

Tiny silver linings for you. First savings rates have risen a little: turn to page 26 for more on the thrilling news that it is now possible to get 3.5% on your savings (a mere seven percentage points or so less than inflation!). Second, the Daily Mail has come up with an utterly brilliant way for you to save money. Leave the UK. Not for ever, of course, but for at least a few weeks of what looks like it will be an unpleasantly expensive (and angry) winter.

If you go to Valencia, you can apparently pick up a three-week cruise to Dubai for £775 a head all inclusive. That looks pretty good (too good to be true?) if you consider that the average monthly household budget in the UK based on 2.4 people is around £2,500 – and that's before taking into account inflation. Otherwise there is a nice looking 17-night cruise from Genoa to Port Canaveral for £749. Or perhaps, if you want to stay closer to home and cut the travel-to-boat cost, consider a ten-day round trip from Marseille (taking in Lisbon at one end and Sardinia at the other) for just £789. None of these will feel like the most luxurious trip you've ever been on (think cheap wine and an inside lower deck cabin), but I'm not sure staying at home is going to feel that good either.

*Owing to the postal strikes over the next fortnight your copies of MoneyWeek may be delivered later than usual. While you wait you can read the magazine for free online at [reader.moneyweek.com](http://reader.moneyweek.com). You will need your customer number to sign in. If you don't have it to hand, call 0330 333 9688, or email [subscriptions@moneyweek.co.uk](mailto:subscriptions@moneyweek.co.uk)*

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### Flop of the week



The publicly funded £120m “Festival of Brexit” has fallen far short of expectations, says the Daily Mirror. The programme – officially known as “Unboxed” – consists of events across the UK to celebrate both British creativity and our exit from the European Union. These included PoliNations (pictured), a garden celebrating diversity in Birmingham's Victoria Square, which opened last week. The cost of the festival to the taxpayer was budgeted at four times the £28m bill for the Queen's Platinum Jubilee, with a target of 66 million visitors, says politics magazine The House. However, by last month, just 238,000 people (0.4% of the target) were known to have attended an event since the first ones opened in March.

### Good week:

Writer and actor **Phoebe Waller-Bridge** (pictured) earned £20m last year, according to accounts for her business filed with Companies House last week, says The Daily Mail. Waller-Bridge, who rose to fame when she wrote and starred in BBC sitcom *Fleabag*, has a £16m per year deal with Amazon Studios to create and produce new shows and also worked on the script for *No Time To Die*, the latest James Bond film.

**UK cinemas** sold a record 1.46 million tickets on Saturday 3 September thanks to “National Cinema Day” where most tickets cost just £3, says Variety. Admissions were three times the pre-pandemic norm for the same day of the year and beat the previous high of 1.34 million admissions set during a £1 ticket offer in 1997. A \$3 ticket promotion in the US on the same day also saw a record 8.1 million admissions.

### Bad week:

Conservative MP **Andrew Bridgen** has been evicted from his country home and ordered to pay £800,000 in costs after losing a dispute with his family's potato business, says The Times. Bridgen has been in a legal battle with AB Produce, which is co-owned by his estranged brother Paul. In the latest ruling, he was ordered to vacate a £1.5m property owned by the business, where he reportedly lived without paying rent or bills since 2015.

**Rosmah Mansor**, wife of former Malaysian prime minister Najib Razak, has been sentenced to ten years in prison and fined MYR970m (£188m) for taking bribes to help a company secure a solar-power supply contract from the government in 2016 and 2017, says Reuters. She will remain free on bail pending an appeal. Her husband is now serving a 12-year sentence for a multi-billion dollar corruption scandal at state development fund 1MDB.





# Are we heading for a sterling crisis?



**Alex Rankine**  
Markets editor

“Financial markets express their faith – or lack of it – in a country” through its borrowing costs and the value of its currency, says Russ Mould of AJ Bell. In the UK, investors “do not like what they see”. On Monday the pound slumped close to its lowest level against the dollar in 37 years, trading as low as \$1.14.

Rapid interest-rate hikes in the US have seen the greenback strengthen against most currencies this year – it recently hit a 24-year high against the Japanese yen. But sterling has done especially poorly of late. In August the pound lost 4.5% against the dollar, its worst monthly performance since October 2016, and also fell almost 3% against the euro.

The pound’s fall comes despite the fact that the Bank of England has been raising interest rates, a move that would normally strengthen a currency. “Until August, there had never been a month when sterling fell by as much as 4.5% against the dollar and ten-year gilt yields rose by more than 90 basis points,” according to data going back to 1971, say William Schomberg and Dhara Ranasinghe on Reuters.

The fact that gilt yields are rising (see below) even as the currency falls “is indicative of overseas investors losing confidence in the UK”, says Mike Riddell of Allianz Global Investors. “I think the UK and the gilt market are in a degree of danger.”

## A toxic cocktail

Traders are reacting negatively to Liz Truss’s proposed “cocktail of especially loose fiscal policy, attacks on the central bank and conflict with the EU”, says Hugo Dixon



High inflation heralds an autumn of widespread industrial action

on Reuters. If she’s not careful “the pound could be clobbered”. Truss is not alone in wanting to spend more on the energy crisis, but the trouble is that the UK is especially vulnerable to inflation, says Ian Johnston in the Financial Times.

Core inflation is running at 6.2% here, compared with 4% in the eurozone. That means that “pound for pound, euro for euro, fiscal spending by governments will be more inflationary in the UK” than elsewhere in Europe, says Antoine Bouvet of ING. The UK’s large current-account deficit – which hit £44.2bn, or 7.1% of GDP, on an underlying basis in the first quarter – leaves it vulnerable to the whims of financial markets. The gap needs to be covered by foreign capital. If global investors lose confidence in Britain then

a “balance of payments crisis” and sharp sterling devaluation cannot be ruled out, says Shreyas Gopal of Deutsche Bank. “We estimate trade-weighted sterling would need to fall by a further 15% to bring the UK’s deficit back to its ten-year average.” Such a scenario is not unprecedented: the UK had to turn to the International Monetary Fund for an emergency loan in 1976 following “aggressive” spending, a nasty energy shock and a decline slide in the pound.

Goldman Sachs analysts recently warned that UK inflation “could soar above 22% next year”, says Liam Halligan in The Daily Telegraph. Price pressures herald an autumn of “widespread industrial action and even civic unrest”. Britain’s sliding pound risks becoming “a symbol of economic weakness and a broader lack of governance”.

## The bond bear market will get worse

Ten-year UK gilt yields hit 3% on Monday for the first time since 2014. Rising yields are a reminder that there are limits to government borrowing, says The Times. With “the ratio of public debt to GDP... close to 100%, policymakers need to be wary”. For all Liz Truss’s talk of faster growth, “there is ultimately no route to national wealth by inflationary public financing and currency depreciation”.

Bond yields move inversely to prices, so it has been a miserable year for fixed income. The Bloomberg Global Aggregate Total Return index, which tracks global investment-grade government and corporate debt, has lost more than 20% since peaking last year. A decline of that



Higher gilt yields are a reminder that there are limits to Britain’s borrowing

magnitude marks a bear market. This is the first time the index has entered a bear market since its inception in 1990. Bear markets are “virtually unknown in bonds”, says David Randall on Reuters. Between 1990 and its January

2021 peak, the global bonds index “delivered an aggregate total return of nearly 470%”. This year has thus proved a rude awakening, says Steve Goldstein for MarketWatch. This is likely to be “the worst year for US fixed income since

at least 1928”. Bonds are widely considered to have been in a “secular” bull market since the mid-1980s, say Garfield Clinton Reynolds and Finbarr Flynn on Bloomberg. Yet soaring inflation and tighter monetary policy may have finally slain the bond bull. Bonds in Europe have led the sell-off, with a Bloomberg index that tracks investment-grade sterling bonds also falling into a bear market last week.

There could be more pain to come, says Jack Denton in Barron’s. “If there is a recession but inflation persists, forcing the Fed to keep turning the screws on financial conditions, the bond bear market might only get hairier.”



## US and China settle listing spat

US and Chinese regulators have struck a deal that may prevent more than 200 Chinese firms from being kicked off US stock exchanges. US law “requires that publicly listed companies provide” regulators with access to their audits, say Bethany Allen-Ebrahimian and Felix Salmon on Axios. But “Chinese companies often haven’t complied, citing Chinese national security law” that prevents data from being shared with foreign governments. The deal paves the way for American officials to “review the audit records of US-listed Chinese companies”.

The threat of delisting has helped send the Nasdaq Golden Dragon index, which tracks many US-listed Chinese firms, down by 40% in a year. The “rare agreement” between Beijing and Washington shows that “China still needs Wall Street”, says Michelle Toh on CNN. And delisting stocks with a combined market value of more than \$1trn would be very disruptive for financial markets. As Drew Bernstein of accounting firm Marcum Asia CPAs puts it, “The US-China relationship reminds me of conflict-ridden relationships where at the end of the day, they realise they can’t afford to get divorced”.

The deal could still fall through if regulators are not granted the promised access, says Reshma Kapadia in Barron’s. “The chance of every single inspection now going smoothly,” says Thomas Gatley of Gavekal, “seems low.”

# Brazil will bounce back

In Sao Paulo, “there is a constant, oppressive hum over the skyscrapers”, says Bruno Meyerfeld in Le Monde. Brazil’s financial elite use helicopters to get to work. In 2018 these “one-percenters” overwhelmingly backed Jair Bolsonaro to be Brazil’s president. Now many are disillusioned. Apart from pension reform in 2019, “no major law has been passed”, says Pedro Wongtschowski, chairman of oil and gas distribution giant Ultrapar. Bolsonaro’s endless “outrages and the ransacking of the Amazon” have “ruined Brazil’s image and closed many markets to us”, he says.

Many ordinary Brazilians also hold the president responsible for their hardships, says Bryan Harris in the Financial Times. Brazil has suffered the second-highest Covid-19 death toll globally and inflation is running at more than 10%. Millions of people are going hungry. Bolsonaro is on course to lose the presidential election next month, says The Economist.

Polling gives his leftist rival Luiz Inácio Lula da Silva, who served as president between 2003 and 2010, 47% compared with 32% for the incumbent. “Since Brazil’s return to democracy in 1985, the candidate who leads polls two months before the election has gone on to win.” Rhetoric from Bolsonaro about vote



President Jair Bolsonaro: the “Trump of the Tropics”

fraud suggests that the “Trump of the Tropics” may not accept the result. If he attempts a coup, “people are not sure what the [military] top brass might do”.

### A post-election boom?

International observers shouldn’t worry, investment manager Dynamo Administração de Recursos told Vinicius Andrade and Felipe Marques on Bloomberg. “Our experience tells us that Brazil will remain pretty much the same following the vote... without major ruptures.”

The local Ibovespa stock index soared almost 17% in the first three months of the year along with the commodity rally, but has fallen back 9% since it peaked in April. In June local stocks were trading on their cheapest level since 2008 on a forward price/earnings (p/e)

basis. Soaring interest rates – up 11.75% since March last year – have prompted investors to sell stocks and buy fixed income.

For now, investors are braced for more volatility, says Craig Mellow in Barron’s. Yet things may improve in 2023. Lula’s choice of a centrist politician as his running mate is a sign that he intends to run a fiscally responsible government. The central bank has “ample room” to slash interest rates from current levels should inflation start to ease.

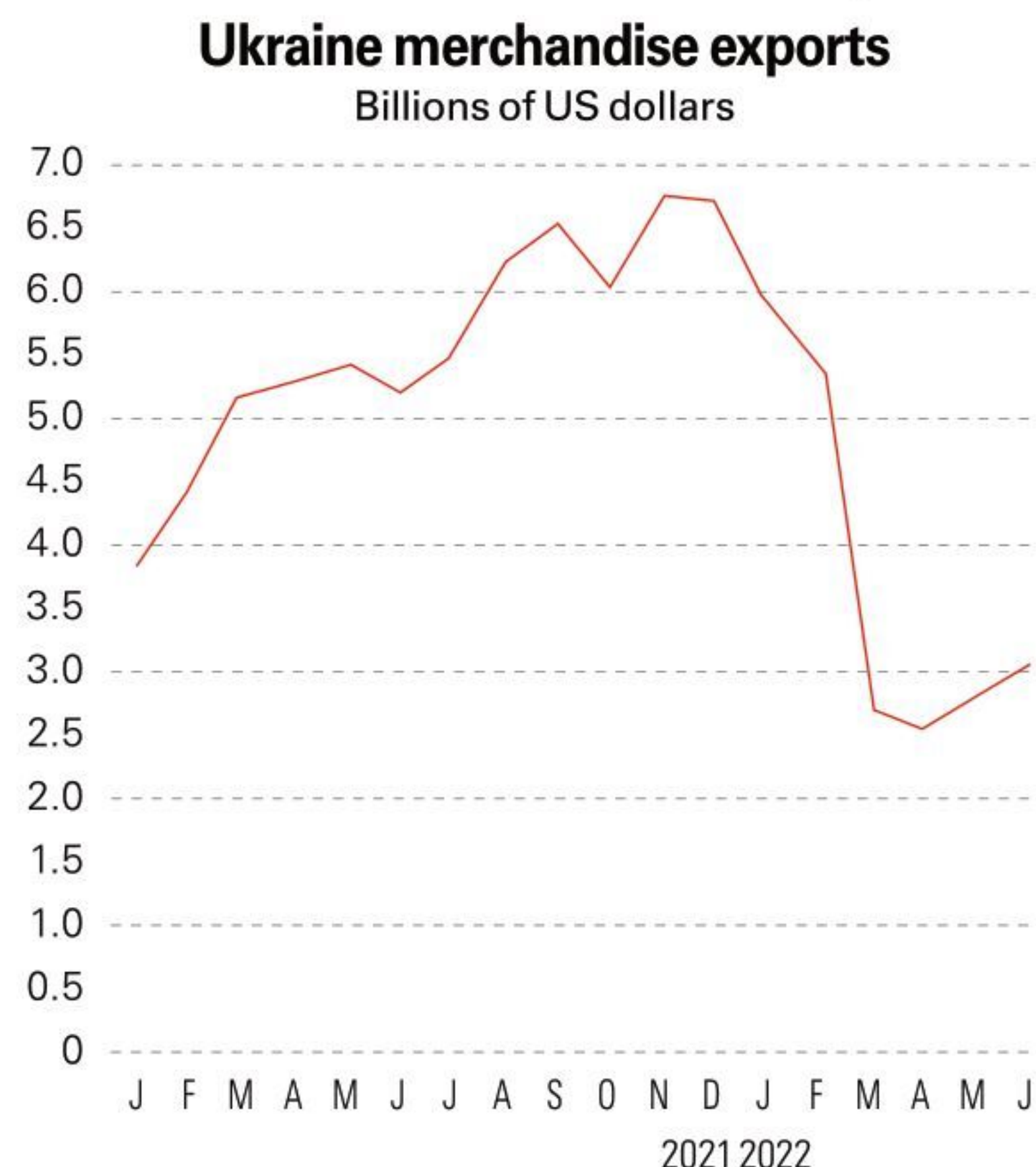
The stockmarket boasts “a wealth of well-run companies” that have been dragged down by sell-offs. Brazil is notorious for “promising a bright future that never quite materialises”. Yet “during the intervals when hope outweighs disappointment, market returns can be explosive”.

## Viewpoint

“A small, dedicated cult of ‘chartists’ or ‘technical analysts’ believes that the movement of [assets] can be divined by... charts. Their methods are... wackily named. A ‘death cross’ is when a short-term moving average of an asset’s price falls below a long-term moving average. ‘Fibonacci retracement levels’ rely on the idea that an asset climbing in price will fall back before rising again... These methods, though patently mad, have attracted attention lately... On 16 August [the S&P 500] peaked at... 4,325, a whisker away from... a supposedly critical technical level... To chartists... it is an indication of a bear-market rally... Much as people who are feeling restless about the direction of their lives are more prone to become interested in astrology, investors... uneasy about the direction of the markets will reach for the easy reassurance of an eye-catching diagram.”

Buttonwood, The Economist

## What Putin’s war is costing Ukraine



Russia is waging an economic war against Ukraine, say Mehul Srivastava and Roman Olearchyk in the Financial Times. Putin’s assault has targeted oil refineries, power plants and steelworks. The naval blockade in the Black Sea has prevented Ukraine from shipping steel, coal and fertiliser out to global markets, though some grain is finally being allowed through now. Ukrainian merchandise exports fell by 40% in the year to June. GDP could slide by 50% this year, while the government is running a \$5bn budget deficit every month, forcing foreign donors to step in. Russian missiles and artillery are estimated to have caused \$130bn-worth of physical destruction to Ukrainian infrastructure.



# Cracks in the chip model

New US restrictions on exporting semiconductors to China could take a big bite out of Nvidia's sales. Matthew Partridge reports

New US restrictions on exporting computer chips to China, designed to prevent them being used by the Chinese military, have prompted a sell-off in shares of Nvidia, says Callum Jones in *The Times*. The chip giant's stock fell by more than 10% last week.

The new rules will hit sales of Nvidia's A100 chip and H100 chips in particular, reducing sales by an estimated \$400m a quarter (sales reached \$6.7bn in the latest quarter). Nvidia isn't the only company affected, with shares in rival AMD falling by 4.4% after it revealed that it has also been ordered to stop exporting its top artificial intelligence (AI) chip to China.

Technically, the ban isn't absolute, say Don Clark and Ana Swanson in *The New York Times*. The rules allow Nvidia to ask for a licence to sell restricted items to specific customers. But Nvidia admits that this is unlikely to be an effective work-around. The problem is that the US government believes that many high-technology goods are being sold through civilian supply chains, only to end up going "toward military uses, like weapons, aircraft and surveillance technology".

## A devastating blow

The scale of the fall in Nvidia's share price suggests that the impact may not be limited to lost sales of the two chips, says Lex in *the Financial Times*. There is a good chance that the "increasingly fractious relationship between the US and China" could prompt Washington "to widen the scope of its export ban" further. In the worst case of a complete ban on all chip exports, the loss of sales to the People's Republic could prove a devastating blow for the company as China "is one of Nvidia's biggest markets". It accounted for \$7.1bn in revenue, or 26% of the group total, last year.

Ironically, the move could also lead to Nvidia facing more competition, as existing restrictions have already accelerated efforts by both Beijing and Chinese firms to produce their own chips,



The US doesn't want the Chinese military using its chips

says Rita Liao on TechCrunch. Huawei "has been doubling down on smartphone chip development ever since Washington put it on an export blacklist over national security concerns in 2019". At the same time a "swathe of domestic semiconductor start-ups" are netting "hefty investments from VCs and government-guided funds". The licensing requirement "may also trigger an exodus of Nvidia's China-based talent". They may head for domestic alternatives.

The latest US measures come at a particularly bad time for Nvidia, as the chipmaker's business is "being hit hard by growing inventory and slipping demand – particularly in its key videogame segment", says Dan Gallagher in *The Wall Street Journal*. And while tech giants such as Amazon, Microsoft and Google are still interested in buying its chips for their data centres, even they are now "feeling the pinch of the global economic slowdown". No wonder Nvidia's shares have fallen by 28% over the last month and by more than half this year.

## Vistry Group swoops on Countryside

Despite growing evidence that the property market is starting to slow "amid rising interest rates and a jump in energy bills", housebuilder Vistry Group has agreed to spend £1.25bn on rival Countryside Partnerships, says James Warrington in *The Telegraph*. The deal represents a 9.1% premium to Countryside's pre-bid price, and comes after several major Countryside investors called for a "shake-up of the business amid unrest over its failure to capitalise on the pandemic property boom". However, the price is lower than two bids Countryside rejected earlier this year, including one from US investor Inclusive Capital worth up to £1.5bn.

Many of Countryside's troubles can be ascribed to its "poorly timed" decision to focus on "higher-return contracting work", says Lex in *the Financial Times*. This led to "collapsed completions and profits" last year and the subsequent departure of its CEO in January. All this has caused the share price to drift even lower over the past few months. Still, Countryside's "long-suffering" shareholders, who will own a third of the merged company, have some grounds for optimism, especially given that Vistry's CEO, Greg Fitzgerald (pictured), has "form" in integrating new acquisitions. Indeed, the cost savings from Vistry's purchase of Linden Homes in 2020 have risen from the £35m initially expected to £44m.

Fitzgerald is optimistic about the housing market, says Alistair Osborne in *The Times*. He thinks that while interest rates may be going up, they are still at "historically low" levels, with "job shortages", and "a shortfall of two million homes" ensuring strong demand. Even if interest rates jump by more than he expects, Countryside's exposure to the affordable sector, which will make up 55% of the enlarged Vistry group, "brings resilience in a housing slump as it is not mortgage-driven".



## Can Reckitt's CEO fix Starbucks?

Shares in health and hygiene group Reckitt Benckiser fell by 5% last week after Laxman Narasimhan (pictured), its CEO, "took the market by surprise" by announcing that he was leaving the FTSE 100 group after only three years, says Alex Ralph in *The Times*.

Narasimhan will become the boss of Starbucks, the world's largest coffee chain, working alongside founder Howard Schultz. Nicandro Durante, a former CEO of British American Tobacco, will replace Narasimhan as an interim CEO.

Narasimhan seems to have done well during his time at Reckitt, helping "to reverse a long trend of diminishing percentage growth of its... like-



for-like sales", says Lex in *the Financial Times*. The company also reported "promising vital signs" in its interim results, just six weeks ago, with "healthy operating profit margins" as well as the prospect of improved sales and profitability for the full year. Reckitt's shares have done well, climbing 13% over the past year.

Reckitt shareholders may not be the only ones who end up regretting Narasimhan's departure. Narasimhan faces a "steaming hot challenge" in turning around the coffee-shop chain, says Amanda Gomez on *Breakingviews*.

Not only does he have to wait until April before taking the top job, but he also has to deal with a "restless workforce": staff at 200 US stores recently unionised. With the price of inputs rising and customers making more orders through the mobile app, the company "needs to be prepared to reshape the barista culture on which Schultz grew the firm and move towards automation".



# MoneyWeek's comprehensive guide to this week's share tips

## Three to buy

### Made Tech Shares

Made Tech helps the public sector update its digital technology. Its lucrative contracts with the likes of NHS Digital bode well. The company has been challenged by wage inflation and the need for "costly contract staff" to meet its £38.2m order backlog, but it has managed far better than the market predicted. Revenue jumped by 120% for the year to 31 May 2022 and sales bookings rose by 115% to £51.1m. There appears to be

"substantial scope" for a share-price rerating. 35p

### National Express

*The Sunday Times*  
Demand for cheaper alternatives to rail and plane travel is good



news for bus and coach operator National Express. While the company is struggling with inflationary pressures as well as rising wage and fuel costs, two thirds of its revenues come from signed contracts with annual inflation adjustments built in. The company also has a new business pipeline of £2.1bn in annual revenues over the next 18 months, up from £1.5bn last October. The shares look reasonably valued and there is a chance the company will be subject to a takeover. 170p.

### Volex

*The Mail on Sunday*  
Power-cable and electrical-kit maker Volex provides equipment for everything from electric cars to ventilators. Customers "prefer to remain anonymous but are thought to include Tesla, Amazon, and Siemens as well as... government defence contractors". CEO Nat Rothschild has made a "deliberate push" into higher-value areas, which has facilitated the resumption of dividend payments. 263p

## Three to sell



### Fever-Tree

*Investors' Chronicle*  
Premium-mixer producer Fever-Tree became the largest company on Aim in 2019 just five years after listing.

However both its immediate and longer-term outlooks "seem increasingly cloudy". The company has turned into one that "consistently over-promises". Labour shortages in the US, higher sea-freight costs and the restricted availability and increased cost of glass have led to repeated reductions in gross-margin targets, while July's profit warning has hardly helped matters. The stock has fallen by nearly 70% from its peak but it is still trading at a significant premium to its sector. Sell. 905p

### Lookers

*The Telegraph*  
Avoid car retailers as interest rates rise; around 90% of new cars are bought on credit. The cost-of-living crisis also means people will postpone or forgo changing cars. All of this makes Lookers very vulnerable. Nearly half of its used car sales are to customers who pay with a loan. What's more, "online disrupters" are digitalising the process of buying a car and major car brands are seeking to exclude dealers from new car sales. Sell. 80p

### Tesla

*The Times*  
Tesla will have to scale up its production volumes quickly if it hopes to justify its "beefy profit multiple". It hopes to produce 20 million cars a year by 2030 and is planning to deliver 1.5 million from its four factories this year, which would require "consistently excellent execution", according to CEO Elon Musk: no mean feat when supply chains are unreliable. Competition in the electric-vehicle sector is also intensifying. Avoid. \$270

## ...and the rest

### Investors' Chronicle

Building contractor Costain's shares have slumped as problem contracts have resulted in repeated losses. But "the tide finally looks to be turning". The company reported a first-half pre-tax profit of £11.2m, 42% higher than the year before. The stock is unlikely to fall much further and the company could be taken over. Buy (41p).

### Shares

Impact Healthcare Reit's diversified portfolio of residential and nursing

care homes amount to a "resilient... business to ride out the current uncertainty". Demand for care homes is growing but capacity is limited, which has increased fees. Its leases are also inflation-linked. Buy (119p).

### The Telegraph

Tyler Technologies is a leading provider of software to the public sector in the US. The company has created a



niche for itself and has a customer retention rate of nearly 100%, making it "all but impossible" for rivals to muscle in on its business. It should be a profitable growth story over the years ahead. Buy (\$374). Oil services and equipment and engineering expert Hunting's latest trading update revealed that orders have doubled since December. It has also returned to profitability and increased its interim

dividend. The stock remains good value. Buy (277p).

### The Times

Private-equity investor 3i Group is trading at a rare 14% discount to net asset value (NAV), the lowest discount in its sector. However over the last ten years 3i has generated a 750% share price return, higher than any rival. Buy the dip (1,150p). Life-insurance consolidator Chesnara is set to raise its dividend for an 18th consecutive year, implying a yield of 7.6% for this year. Buy (323p).

## A German view

Medical-technology group Carl Zeiss Meditec is thriving, says Boerse Online. The group focuses mainly on the ophthalmology and microsurgery markets; products range from surgical microscopes to lasers and lenses for eye treatments. New orders expanded by 36% to €1.75bn in the first nine months of the group's financial year. The debt-free group has plenty of money for acquisitions, and is currently concentrating on bolstering its presence in the US. Gradual expansion in the region should boost its pricing power. Sales in the Americas jumped by 8% to €330m in the first nine months. There should be plenty more growth ahead as populations age and eye problems become more frequent.

## IPO watch

The number of initial public offerings (IPOs) worldwide has slumped by two-thirds this year compared with the same period in 2021. But the Asia-Pacific IPO market has notched up its second-highest August total on record, says Bloomberg. Regional listings totalled \$14.9bn last month, thanks to share sales in Hong Kong and mainland China, where all but two IPOs raised over \$100m. The region's "laxer" liquidity environment – Beijing's interest rates are lower than America's – has fuelled confidence. Meanwhile, Western markets have slumped as central banks have tightened monetary policy. Europe's IPOs raised just \$510m in August; America's a mere \$637m.



# Liz Truss takes the reins at No. 10

The new PM's to-do list is formidable, and she will have to move quickly. Emily Hohler reports

New prime minister Liz Truss faces a “sea of troubles”, says the Financial Times. “Soaring energy prices and broader inflation, spreading strikes, dysfunctional public services and hostilities with Moscow.” In her first brief, businesslike speech, she laid out her policy priorities: to tackle the energy crisis, kick-start economic growth through tax cuts and reform, and put the NHS on a “firm footing”.

Her plan for dealing with the energy crisis is a “blatant U-turn” for a woman campaigning on a pledge of “no more handouts”, but “brute necessity will be Truss’s handmaid”, says Simon Jenkins in *The Guardian*. Households and businesses are “screaming in agony”. Documents seen by Bloomberg suggest UK taxpayers will be “on the hook for as much as £200bn over the next 18 months” to cover the cost, says Bloomberg’s Philip Aldrick.

Energy suppliers will receive subsidies to cover the difference between wholesale market costs and what they can legally charge customers; £130bn will go towards freezing household bills until April 2024; and there is a further discount scheme for business that could cost up to £67bn over 12 months. For households, this means that energy bills will be frozen at around £2,500, says Ben Riley-Smith in *The Daily Telegraph*. It looks as though all 28 million households will be protected until 2024. The existing £400 discount for every household will remain, bringing the average bill closer to £2,000, just above the current £1,971 price cap.

The scheme will not only increase government debt by an estimated 10%, but it also helps the rich more than the poor and will undermine market forces and prolong the crisis, says Ross Clark in *The Spectator*. It would be preferable to preserve the incentive to save energy, as Germany has, by



New prime minister Liz Truss: “brute necessity will be her handmaid”

capping a basic amount of energy use rather than freezing overall bills, says *The Times*.

## Kick-starting a stalled economy

In addition to this massive spend, Truss wants to cut taxes (so far, all she has said is that she will reverse April’s increase in national insurance and scrap next year’s planned rise in corporation tax) and “kick-start a stalled economy with some pro-growth reforms”, says Kate Andrews in *The Spectator*.

Fears that the markets will “punish” Britain with “far higher borrowing costs” for letting the “deficit take the strain” rather than raising taxes are rejected by Julian Jessop, chief economist for the Institute of Economic Affairs and one of the economists closest to the Truss campaign. Jessop believes that “the markets will recognise a strategy for higher growth” and be happy to finance a transition to a “stronger economy and stronger public finances” in the long term. Truss’s apparent plan – “pumping

money into the system to induce a sugar rush of growth before too many households and businesses are ruined by inflation and rising interest rates” – will involve “riding out a winter of industrial strife” and also relies on the markets not deciding that the whole plan is “bananas and junking Britain’s currency and its debt”, says Rafael Behr in *The Guardian*. For now, sterling continues to fall and markets are betting interest rates will rise to more than 3% in December, notes the FT’s Chris Giles. A risk premium is also starting to re-emerge on gilts.

“Short-term generosity with public money seldom did a prime minister any harm,” says Jenkins, but the next election is a different matter. Truss’s politics will have to evolve fast and much will depend on how chancellor Kwasi Kwarteng and Therese Coffey, deputy PM and health secretary, perform in their new roles. In terms of the next election, Kwarteng now holds the “key to Tory fortunes”.



A zero-Covid policy continues to take its toll on China’s economy

## A darkening outlook for China

Centuries ago, China was the world’s biggest economy, and until recently many economists assumed that China would overtake America and return to “pole position” by 2030, says *The Economist*. Since China’s population is four times larger than America’s, its GDP per person only needs to reach a quarter of America’s for its total GDP to surpass it. Last year, in dollar terms, its GDP was \$17.7trn compared with America’s \$23trn. But a sharp slowdown in Chinese growth over the past year is prompting many experts to reconsider whether it will happen at all.

The outlook for China’s economy has “darkened”, with factors such as the ongoing

crisis in the property sector, which accounts for 20%-30% of GDP, its zero-Covid policy (an estimated 13% of GDP is currently under some form of lockdown) and ageing demographic (the workforce could shrink by 15% over the next 15 years) all taking a toll. A “rare bright spot” – exports – also “significantly missed expectations in August”, say Cheng Leng and William Langley in the *Financial Times*. Analysts say this is the “beginning of the end of the export boom” that has been a “lifeline” since early 2020.

And that’s not all, says Megan Greene, also in the FT. “Manufacturing contracted in July, retail sales, industrial

output and investment all slowed and youth unemployment reached nearly 20%.” On top of this, drought has brought the Yangtze River to its lowest level since 1865. Nearly 90% of China’s electricity is dependent on water; blackouts are causing factory closures; 50% of China’s rice output has also been affected. It’s not only Beijing that should be worried. China remains “heavily integrated into the global supply chain” and one of the biggest potential markets for foreign goods and services. In a world “beset by multiple crises”, officials may be overlooking the “biggest threat of all”: China pushing us “into a new global downturn”.



# “In life, ‘us’ is more important than ‘I.’”

When your name's on every one of 800 million bakery products sold each year, it would be easy to let it go to your head. Not to mention when you've starred alongside the likes of George Clooney and Kermit the Frog. But Jonathan Warburton grew up with a simple bit of Northern advice, handed down from his parents, that has always kept his feet on the ground. 'In life, 'us' is more important than 'I', his father would say. This isn't just about keeping your ego in check or thinking about the needs of others, it's sound advice which has fuelled the family's success. A reflection of their family values and a testament to the power of good advice. The kind of advice that comes from someone who knows you well. The kind of powerful good advice that you can expect from Evelyn Partners. Because we take the time to truly understand you. What motivates, inspires and drives you. To help you flourish.

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# Putin turns off the gas

Russia has weaponised its energy exports. Matthew Partridge reports

Russia was accused of “weaponising” its oil and gas exports amid a “growing energy crisis” in Europe when it halted gas supplies through the Nord Stream 1 pipeline at the end of last week, says the Financial Times. Russia at first claimed that the decision to shut the pipeline – which took place just hours after the G7 agreed in principle to impose a price cap on Russian oil exports – was prompted by “technical faults” with a turbine.

The move was, however, widely seen as a “ruse” and Russia later confirmed that the pipeline will not reopen until the West removes sanctions imposed on the country in response to the invasion of Ukraine.

## A heavy blow for Europe

Russia hasn't technically cut off all exports, as there is still some gas flowing to Europe through alternative pipelines, via Ukraine and Turkey, says David McHugh of Associated Press. However, Russian gas exports have now fallen by 89% compared with last year, and experts are warning that “Europe needs to be ready for zero Russian gas this winter”. Such a complete cut-off “could deal an even heavier blow to an already troubled economy” – Europe has been struggling to contain an energy crisis that could lead to “rolling blackouts, shuttered factories and a deep recession”.

The move will also hurt Russia as the country will of course lose the revenue from gas sales, says Jack Smith in *The Spectator*. But the very fact that Vladimir Putin is demanding that the West remove sanctions suggests that they are doing their job of imposing pain on the country in retaliation for



Another hawkish move from Putin

its invasion. Indeed, Western sanctions are creating major problems for the Russian military, which is running out of the components needed to make guided munitions. Russia has also indicated more openness to negotiations, suggesting that, with a Ukrainian counterattack now in full swing, it may be aiming for a “take-and-hold ceasefire” rather than further conquest.

## The West's counter

The West has economic weapons of its own to counter the gas embargo, says *The Washington Post*. Until now, Russia has been able to at least partially offset the impact of sanctions by taking advantage of the higher oil prices caused by geopolitical turmoil. However, British and European firms' domination of insurance enables them to prevent Russian tankers from carrying crude oil priced above a certain level; the West can thus create a “buyers' cartel” that slashes the amount of revenue the Russian oil industry can bring in, and help keep inflation down too.

The proposed price cap, which is due to come into effect by the end of the year, is a good idea that is likely to make “life more complicated for the Kremlin”, but it is “unlikely to be a knockout blow”, says *The Economist*. Russia may simply refuse to accept the lower price, “preferring instead to attempt to export its oil through networks of non-Western traders, ships and financiers”. The G7 accounts for less than half of world GDP, so the club would have to rely on the support of other larger countries, such as China, India and Indonesia, which may well not want to be bound by Western foreign policy, sanctions and embargoes.

## Betting on politics

New prime minister Liz Truss has barely returned from her trip to see the Queen, but already bookmakers are opening markets on how long she will remain at Number 10. Ladbrokes is offering a market on the date on which she will be replaced, with 6/5 (45.4%) on her leaving in 2024, 7/4 (36.3%) on her surviving until 2025 (or later), 10/3 (23.1%) on 2023 and 33/1 (2.9%) on her leaving this year. They are also offering 1/3 (75%) on her still being the Conservative leader at the next election.

Outgoing PM Boris Johnson, meanwhile, hinted in his swansong speech that he would be following in the footsteps of Roman leader Cincinnatus, who made a comeback after stepping down as dictator of Rome, but punters aren't convinced he will be successful. With £6,443 matched on Smarkets, he is at 12



(8.3%) to become the next Conservative leader and 14.5 (6.8%) to become the next prime minister. Indeed, with £1,597 matched on Smarkets, you can get 2.38 (42.1%) on a by-election in his Uxbridge and South Ruislip constituency before the next election.

I'd think instead about Michael Gove (pictured). With £1,385 matched on Smarkets, punters put the odds of a by-election in his Surrey Heath constituency this year at 7.2 (13.8%), with the odds against at 1.28 (78.2%). Gove's political fortunes may be at a low ebb, but I believe he still has dreams of being a force in the Conservative party, especially if Truss runs into trouble. I'd bet on him staying in the Commons, at least for a few more months.

## Chile rejects leftist wish-list



Boric endures a slap in the face

Voters in Chile overwhelmingly rejected a proposed new constitution to replace the old one drawn up by former dictator Augusto Pinochet. The military-era constitution has been repeatedly amended, but mass protests that rocked the nation in 2019 led to calls for it to be scrapped, says the BBC. A replacement was duly drafted by

a constitutional convention, but when that was put to a vote on Sunday, almost 62% voted against it, more than polls had suggested, representing a “slap in the face” for the president, Gabriel Boric, who had backed it.

The convention that drew up the document was “beset by scandal” and of doubtful legitimacy, says *The Economist*. And the 170-page document it came up with would have enshrined more than 100 fundamental rights, ranging from the “bizarre” – a right to “nutritionally complete” food – to the “worrying” – “an unfettered right for trade unions to strike”. It would also have weakened property rights and created, for Chile's indigenous

peoples, autonomous territories with their own justice systems. Economists estimated it would cost 9% to 14% of GDP per year.

It's clear that the left-dominated constitutional convention “overreached”, says Ariel Dorfman in *The Guardian*. Still, reform remains inevitable given that more than 80% of the population voted to ditch the old constitution two years ago, and even opponents of the new one are supporting some sort of change. This leaves the government with “a thorny and complicated path” to finding something the country can accept while at the same time dealing with rising crime, violent conflict between indigenous activists and the state, and inflation.



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## London

**Bounce Back fraud:** More than £1bn of taxpayer-funded loans made to UK businesses under the government's pandemic Bounce Back Loan scheme have been identified as potentially fraudulent, according to official data. The government figures show that £1.1bn of loans are being treated as a scam by UK banks, and that the banks have so far claimed or received £3.8bn in state money to cover defaults.

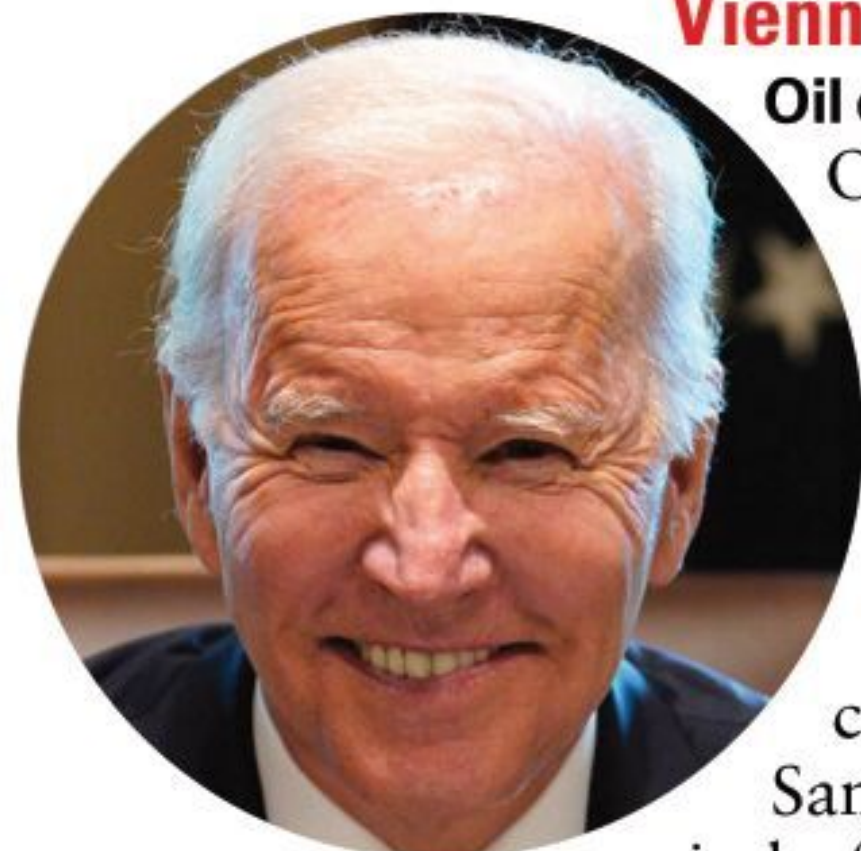
Under the Covid-support scheme, state-backed loans worth more than £46bn were given to companies "with only light checks on eligibility to encourage banks to lend quickly", says Daniel Thomas in the Financial Times. But estimates of the total that will eventually be deemed lost to fraud range as high as £5bn. Banks have been criticised by ministers for not doing more to tackle the problem, while the banks say they were simply following the

government's hastily-constructed lending rules. Either way, the mess is a headache for both sides, says Reuters. The worst-affected of the big banks is Lloyds, with 3.6% of its £8.5bn in loans categorised as under suspicion, with Barclays not far behind with 2.4% of a £10.8bn loan book. But the smaller online lenders have the biggest problem. Capital on Tap and Conister Bank report 27% and 24% respectively of their loans as suspected fraud.

## Woonsocket, Rhode Island

**Bloated valuation:** US drugstore chain CVS is buying home-health and technology-services provider Signify Health for around \$8bn as it continues to "expand beyond its retail origins", says Bloomberg. CVS is paying \$30.50 a share for Signify, which offers patient care through virtual and in-person appointments, after it fended off rival bidders Amazon, UnitedHealth Group and Option Care Health. Mergers and acquisitions (M&A) "fever is burning up the healthcare sector", says Lex in the FT – and CVS's successful bid shows that "for all Amazon's ballyhooed intention to disrupt the high-cost US healthcare industry, incumbents still have plenty of spending power and fight left in them". The problem is that the agreed price is such a generous 106% premium to Signify's undisturbed three-month share price to 1 August (when reports of deal talks first emerged). The valuation – 28 times Signify's estimated 2023 Ebitda – looks positively "bloated", agrees Robert Cyran on Breakingviews. By comparison, the market values CVS itself at only 9.5 times. The high single-digit return on invested capital that CVS is projecting appears strikingly "modest", while another concern is that more than a third of Signify's revenues come from health insurers that are direct rivals to CVS's own Aetna insurance. That will raise anti-trust worries as the US regulators take sterner views on the "intersection of health care and data". It seems "swallowing this Signify supplement" could be "an unhealthy way to bulk up".

## Vienna



**Oil cartel cuts supply:** The Opec+ grouping of leading oil-producing nations has announced a cut in output from next month to bolster prices – a move that has surprised energy markets "at a time of considerable turmoil", says Sam Meredith on CNBC. It is the first reduction in a year, and reverses last month's increase in output of around 100,000 barrels a day. At the time, the small scale of that increase was seen as something of a rebuff to US president Joe Biden (pictured), who had urged Saudi Arabia to "pump more to cool prices and help the global economy". But even that modest rise has now been reversed, pushing Brent crude up 4% to \$97 a barrel on Monday. Opec+ comprises

the Opec cartel and other producers, led by Russia, which together pump more than 40% of global supplies – roughly 100 million barrels per day. Such is their scale that it is tempting to dismiss the Opec+ cut as a "tiny adjustment", says Clyde Russell on Reuters. In fact, it's an important signal of the group's "intent to defend crude oil prices". Prices have fallen by around a quarter since early June thanks to growing concerns over a global economic slowdown, and the group appears to be trying to defend a target price above \$90 a barrel. That's understandable, but problematic. With the global economy probably heading into recession, it "raises the risk of being forced to take stronger action to defend \$50 in six months' time after demand is smashed".



## The way we live now... New York goes to pot



More Americans now smoke marijuana than cigarettes

"Holy smokes, Batman! New York, the model for the fictional Gotham City – where law enforcement is prompt and vigorous – has leant back and lit up," says The Sunday Times. New York state decriminalised recreational cannabis last year, and while it's not yet legal to sell marijuana, its smell was everywhere in the Big Apple this summer, with unlicensed dispensaries freely tolerated by police. Now, the first legitimate outlets are due to be granted licences within months, and New York is poised to open a cannabis market worth around \$10bn a year – and with growth potential, given that more Americans now smoke marijuana (16%)

than cigarettes (11%) according to a Gallup poll. More than 200 farmers have already been granted licences – they began planting in April – and 15 "processors" have been selected who will prepare the product for sale. And rather than punishing potheads, the state is now giving them preferential treatment. The new licensing regime favours "justice-involved applicants" with past convictions for cannabis-related offences alongside two-plus years of running a business – while expunging their criminal records. The crime-fighting "Caped Crusader" would certainly not have approved, but it's a "novel approach to rehabilitation".



## Wolfsburg

**Porsche fires starting gun:** After years of “largely ignoring investors’ pleas to unlock value”, Volkswagen AG has finally pulled the trigger on an initial public offering (IPO) of its very profitable Porsche sports car unit. “Really? Now?” asks Chris Bryant in Bloomberg. Europe is experiencing one of its “bleakest periods” ever for market debuts, with rising interest rates, rocketing inflation and energy shortages all rocking consumer confidence. Yet Volkswagen’s board is pushing for a Porsche IPO by October this year at the latest – albeit one that aims to sell off only 12.5% of the Stuttgart-based premium marque. If it pans out as hoped, valuing the whole business at around \$80bn and selling a slice worth \$10bn, it would rank as Germany’s second-biggest flotation, behind Deutsche Telekom’s \$13bn public debut in 1996, says Joe Miller in the Financial Times. That’s a big ask, but the market reaction (VW shares rose 3% on the news) suggests it may not be unrealistic. Moreover, excessively focusing on value may “miss the point”, says Neil Unmack in Breakingviews. Viewed from the Porsche and Piëch clans’ perspective, they’re getting a cash boon and more direct control over the family business, since the new shares will carry no voting rights. “Even if the listing price disappoints, some shareholders will still get what they want.”



Volkswagen has finally pulled the trigger on a Porsche listing

## Tokyo

**Honeymoon over:** Public support for Japan’s prime minister Fumio Kishida, who took office last October and won a convincing election victory in July, has slumped dramatically – dashing investors’ hopes of a new era of political stability. One poll shows that 48% of voters now disapprove of the Kishida government, says The Japan Times, up 9% in a few weeks. Another poll found an even bigger leap, 17 points in a month, in the proportion of naysayers. Until a few weeks ago, says Gearoid Reidy on Bloomberg, the talk was of a “golden three years” in which a dominant Kishida could govern unchallenged. That has now all changed. Kishida’s problems are partly economic: inflation is high, wage growth anaemic, and the yen is down to a 24-year low against the US dollar. He has also earned a reputation as a “flip-flopper” – making a “brave” commitment to new nuclear reactors, then backtracking. But the top issue spreading discontent is the ongoing scandal, following the assassination of ex-PM Shinzo Abe, over alleged links between the ruling LDP and the Unification Church (Moonies). In truth the accusations are unspectacular, and Kishida’s own links to the church “non-existent”. But whereas Abe was able to push such “affairs off the front pages by taking control of political narratives through policy, Kishida has few such accomplishments to fall back on”.

## Mumbai

**Tata billionaire killed:** Cyrus Mistry (pictured), the 54-year-old billionaire and former chairman of Tata Sons, India’s largest conglomerate, was killed in a car crash last Sunday. Witnesses said the car, in which Mistry was a passenger, was trying to overtake at high speed on a bridge roughly 100 kilometres north of Mumbai, says NTDV’s Sunil Singh. The accident has renewed debate about traffic safety as well as the state of India’s roads, says Anurag Kotoky in Bloomberg. India has the world’s second-largest road network, covering 3.7 million miles, but build quality and maintenance are often poor. In 2019, the country accounted for 11% of all crash-related deaths globally, but just 1% of the world’s vehicles. Mistry, who belonged to one of India’s best-known business families, was ousted as chairman of Tata Sons in 2016 following criticism of his performance. Although he challenged the decision, it was upheld by India’s top court, says The Guardian. A former student of Imperial College London and the London Business School, Mistry owned an 18.4% stake in Tata Sons and had accumulated an estimated \$29bn, making him one of the richest men in India.



## Hong Kong

**KPMG sued:** The accountancy giant KPMG is being sued for \$830m over allegedly “appalling” audit work that allowed China Medical Technologies, a US-listed Chinese biotech company, to carry out a “brazen” \$400m accounting fraud before it ultimately collapsed in 2012, says Tabby Kinder in the Financial Times. The Chinese firm’s liquidator, Borrelli Walsh, claims KPMG failed to ask “obvious” questions that would have “easily exposed the fraud”. These include not questioning China Medical’s acquisition of a Chinese diagnostics business worth \$155,000 for \$176m. China Medical raised \$426m from international investors between 2008 and 2010 before filing for liquidation in 2012. Five years later, US prosecutors charged its founder and CEO Xiaodong Wu, and chief financial officer Samson Tsang, with fraud – but the men have yet to stand trial. The whole episode should serve as a warning that “dealing with Chinese companies, troubled or otherwise, often takes longer than Western investors might expect”, says Jennifer Hughes on Breakingviews. The case against KPMG has taken five years to make it to court owing to legal arguments over mainland China’s rules on access to audit papers. Bondholders owed money by defaulted mainland developers such as China Evergrande and Kaisa will no doubt “find the twists and turns and sheer frustrations” of the China Medical case instructive.



# The rise of modern India

The country has come a long way since independence, but early mistakes and now a divisive leader are holding back the economy's potential. Simon Wilson reports

## What's happened?

India has marked 75 years of independence by overtaking the former imperial power, Britain, as the world's fifth-biggest economy. According to figures published last week by the International Monetary Fund and based on calculations in US dollars, it edged past the UK in the final quarter of 2021 and extended its lead in the first quarter of 2022. With a projected growth rate far higher than Britain's – including 7.4% growth this year, the highest of any big economy – its GDP is expected to be a fifth larger than ours within five years. It's also entirely possible that over the next decade India could pass Germany and Japan to become the world's third-biggest economy (after the US and China).

## So things are going well?

Fairly well. At the time of independence, India was an impoverished nation with GDP around \$20bn and life expectancy of just 37 for men and 36 for women. Only 12% of people were literate. Now India is a near-\$3trn economy. Average life expectancy has near-doubled to 70, and the literacy rate is 82% for men and 65% for women. The World Bank has promoted India from low-income to middle-income status, meaning gross national income per capita of between \$1,036 and \$12,535. The country has a thriving IT sector and more than 140 billionaires, more than anywhere except the US and China. It has about 100 unicorns (unlisted start-ups worth over \$1bn), placing it third behind only the US and China. But all that gives a rather misleading picture of a country where only 20% of women are formally employed (half the average level for comparable economies), youth unemployment is estimated at 40%, and the average income per capita is only \$2,200. India is no richer, relative to the rest of the world, than it was at independence.

## Due to socialism?

Yes. In 1947, India was the world's sixth-largest economy, but an extremely poor country, with average income 18% of the world average. By the early 1990s, it had become the world's 12th biggest economy, and was even poorer relative to the rest of the world – but since then has climbed back up to 18%. This “distressingly V-shaped development path is a legacy of India's original choices”, and the dominance of socialist planning in the post-independence decades, says Ruchir Sharma in the Financial Times. In other developing nations in Asia the state often granted economic freedoms first, political freedoms later. “In India, the state granted a poor nation political freedom first, but in a socialist economy that has never fully embraced economic freedom.”

*“India has edged past its old imperial master to become the world's fifth-largest economy”*

China is five times bigger and richer.

## What has Modi done?

In 2014, when Narendra Modi became PM, India was the world's tenth-largest economy, and the years since have seen a steady expansion – growing 40% in the following seven years. That growth was second only to China, among big economies, with 53% over the same period. Modi and his political party, the BJP, have thrived electorally by “deftly blending Hindu nationalist identity politics with welfare for the poor and a pro-business platform”, says Benjamin Parker in the Financial Times. But it has been far from plain sailing. A botched demonetisation policy in 2016 caused chaos. Agricultural reforms were scrapped last year after fierce, sometimes violent, opposition from farmers. Even before



Modi: a divisive figure who may hamper national renewal

©Getty Images

## What changed in the 1990s?

An acute debt crisis and soaring inflation forced a rethink of the socialist model of protectionism and state intervention, says Rhea Mogul on CNN. Economic reforms introduced by prime minister PV Narasimha Rao and his finance minister Manmohan Singh opened the country to foreign investment – helping to “turbocharge” direct investment by US, Japanese and Southeast Asian companies in major cities including Mumbai, Chennai and Hyderabad. In the past three decades, India has moved up the rankings of the Heritage Foundation's “economic freedom” list. But even now, it remains in the bottom 30%. And even though India has seen GDP grow tenfold since 1990 to \$3.2trn, and per-capita income rise more than fivefold, it has been outstripped by China on both counts. In 1990, the two countries were roughly comparable on both measures; now

the coronavirus pandemic and India's especially chaotic lockdown plunged the economy into a historic recession in 2020, its growth rate had halved from more than 8% in 2016 to just 4% in 2019.

## What's the situation now?

India is recovering reasonably strongly post-pandemic thanks to the resilience of core sectors such as construction, mining, electricity and manufacturing, as well as hotels, recreation and transport. However, inflation and the global slowdown are major concerns. As the pandemic recedes, there are “four pillars” that will support growth in the next decade, says The Economist: the forging of a single national market in a vast country with strong regional differences; an expansion of industry; continued pre-eminence in IT; and a high-tech welfare safety net (“tech stack”) for the hundreds of millions left behind by all this. But there are also considerable risks.

## What are the risks?

Modi's government has got a lot right, but its “abhorrent hostility” towards India's large Muslim minority, its desire for linguistic and cultural conformity in a vastly diverse country, and its “sinister tendency to undermine rival sources of power”, for example by bullying the press and the courts – all risk inflaming political and economic instability and even fostering secessionist pressures in wealthier states. Meanwhile, the BJP's ambivalence towards foreign capital means its “campaign for national renewal risks regressing into protectionism”. There's a risk, over the next decade, that Modi's dominance “hardens into autocracy”. India's “Rockefellers and tech stars are hoping that the country's economic modernisation and unification will survive his divisive politics”.





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# Macron Air should be grounded

The French president's plan to create a new EU-wide air monopoly would be a disaster for the industry



**Matthew Lynn**  
City columnist

Its nuclear power plants have been closed for maintenance over much of the summer. Australia cancelled a huge submarine order in a blow for its defence industry. And its car manufacturers suffered a blow when Renault was forced to sell its Russian unit. This has not been a great few years for French industrial policy. Yet undeterred, its leaders are eyeing a lucrative new target: a virtual monopoly on European air travel.

Over the last week it has become clear that France is determined to create a major new force in global aviation. It emerged that the Italian government has chosen a group led by the private-equity firm Certares, and crucially backed by Air France-KLM, to take a majority stake in ITA, the national flag-carrier rescued out of the bankrupt and little-missed Alitalia. The Italian government turned down a rival offer backed by Lufthansa, and the takeover may well be completed over the next few months: it has enough problems on its plate without hanging on to a struggling airline for any longer than necessary.

## France is pulling the strings

It is the involvement of Air France that is most interesting, however. You hardly need to be Sherlock Holmes to work out what is about to happen. Air France has already orchestrated a merger with the Dutch airline KLM. Now it is intent on taking creeping control of ITA. Behind the scenes, French president Emmanuel Macron and his government are clearly pulling the strings. Only last year, France massively increased its stake in the airline, and it now owns 29% of the group, three times the Dutch government's shareholding. The airline



*Macron: the next step for French industrial policy must be resisted*

received massive bailouts to help keep it afloat during the pandemic. Now the plan appears to be to add Italy to its growing empire. Who's next? Perhaps one or two of the smaller European airlines, or even another major national player.

The prospect is of France creating a protected EU flag carrier under effective state control, with a virtual monopoly on European travel. Once that is established, we can expect the British Airways owner IAG, along with its Spanish partner Iberia, to be frozen out of the market. Germany's Lufthansa, which was beaten out of the bidding for ITA, will be left with little more than its domestic market to serve. And the budget airlines such as Ryanair

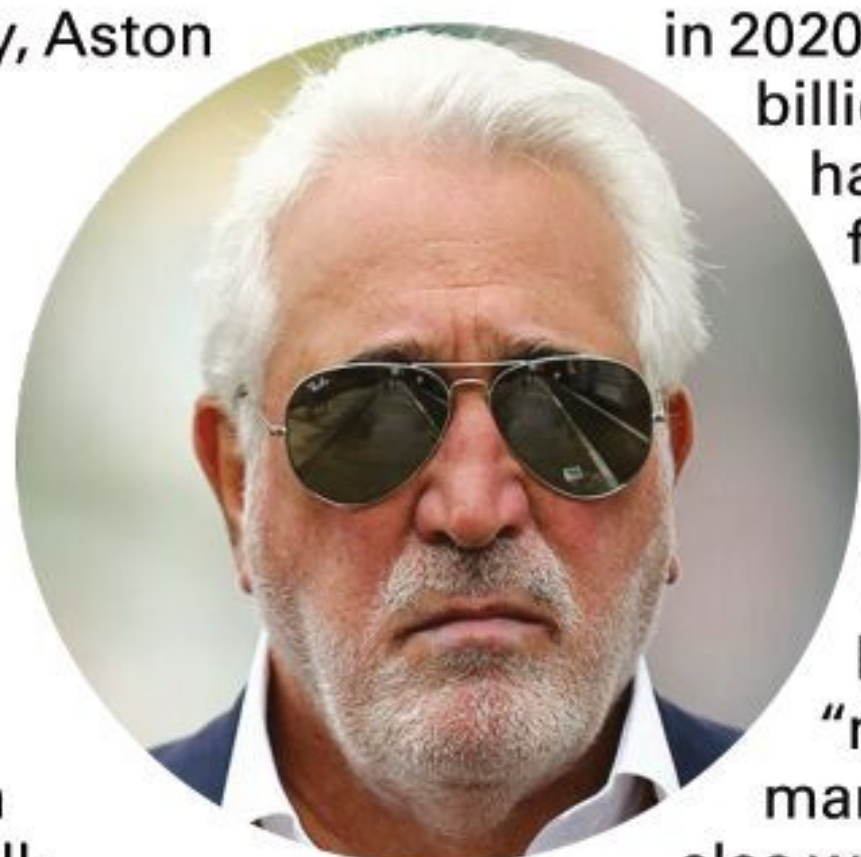
will find life tougher and tougher, excluded from prime landing slots and left to serve a tourist market at secondary airports. We will be right back with a 1970s-style airlines industry, with big prestigious state-controlled carriers dominating the business and long-haul markets, and charging sky-high prices, along with a few cheap carriers for everyone else. That might be profitable for France – although the state-controlled airlines of the 1970s were inefficient and kept alive only with massive subsidies from their governments. But the question is, why should this be tolerated by anyone else? So far, the EU's competition authorities, so fierce when it comes to regulating the US tech giants, or policing rivalry with the City of London, are sitting on their hands.

## The world must react

There's no point expecting them to curb Air France or its ambitions to dominate the European market. But that is no reason for the rest of the world to put up with it. Under World Trade Organisation rules, the UK could take legal action against the airline. The US could demand a stop to it and threaten to retaliate with selective tariffs. Or a group of the other major economies around the world could place restrictions on its landing slots unless the market were opened out. Macron Air, as it should probably be known, would change the way the whole industry operates. It would raise prices for consumers, simply by setting benchmarks and by controlling so many of the major airports. And it would raise the prices of planes, too, since it would always buy Airbus rather than Boeing, making equipment more expensive for everyone else. The relatively free, open and deregulated airline industry of the past 30 years would effectively be brought to an end. This should not be allowed to stand.

## City talk

● Back in February, Aston Martin's executive chair Lawrence Stroll (pictured) said the carmaker didn't need more money. "The messaging, to put it mildly, has moved on," says Nils Pratley in *The Guardian*. The firm has launched a "full-octane" rights issue for £576m, more than its market value. Half of the proceeds will pay down debts (£1.23bn at the last balance sheet date), cutting interest by £30m, but the real test will be when it has to refinance borrowings taken on at "nose-bleed rates" before Stroll launched his rescue bid



in 2020. The Canadian billionaire is halfway through a five-year turnaround programme, and can point to progress: at least the group has stopped "making too many cars". He has also won backers such as Saudi Arabia's sovereign wealth fund, which invested £78m in July. Yet the challenge of making Aston Martin "the most desirable ultra-luxury British performance brand" looks "formidable" and the day when it turns profitable – pencilled in for 2024-2025 – is a long way off.

● Cake Box, the Aim-listed egg-free cake-shop chain, has come out with a very "gooey number", says Alistair Osborne in *The Times*: a "crackerjack" profit warning that saw house broker Shore Capital slash forecasts from £7.2m to £5.5m. CEO Sukh Chamdal blames a 2.8% drop in underlying sales for July and August of 2.8% on hot weather, while higher raw material prices, energy bills and labour costs are all hurting margins. The shares have collapsed 30% in response – a fresh shock for investors after errors in the accounts in January and a data breach last year. At least the firm is sitting on a few million in net cash, but "it's hard to say that it looks particularly tasty".

● Royal Mail "got through nine years of privatised life without a national strike", says Cat Rutter Pooley in *The Financial Times*. Now that's over: staff have walked out after being offered a 2% pay rise, plus a threat to split the UK business from its international arm GLS unless progress is made on modernisation. Chair Keith Williams says the firm must change or decline, but it's not clear how he can bring unions onside. The idea of spinning off GLS "is hard to take too seriously" as a bargaining chip: it would increase risks for the remaining business and it's difficult to imagine politicians permitting that for "critical national infrastructure". All told, it's "a right royal mess".



# Rollercoaster ride for rates

Mortgage pricing shows that markets are still betting on a return to low inflation and low rates



**Cris Sholto Heaton**  
Investment columnist

Anybody who has been looking at mortgages recently may have noticed something surprising. If you want a two-year fixed-rate deal on a 60% loan-to-value mortgage, you could get 3.82% from First Direct, for example. However, if you want a five-year fix, you'd pay 3.58% at the same lender – ie, a lower rate. And if you're going for a ten-year fix, the offer is 3.83% – only 0.01 percentage point more than the two-year. I'm using First Direct here because it's a clean example of the point – the terms across its mortgages are similar and there aren't huge differences in early redemption charges or other nuances. But the same applies at many other lenders as well.

This is really not what you would expect. The basic principle behind a yield curve (see below) is that lenders expect higher rates for lending for a longer period. Occasionally yield curves on government bonds may be very flat or even invert slightly, but such a small difference between the five-year and ten-year rates on mortgages is uncommon. I reckon the gap of about 0.25 percentage points in the example is about one-third of what it's been over the longer term.

## Pricing in a return to lower rates

So what's going on? You can see the answer pretty clearly if you look at what's called the overnight index swap (OIS) forward curve, the data for which can be found on the Bank of England website. The OIS forward curve is essentially the forecast for what interest rates will be at a given point in the future. They are not the interest rate for lending for that long – they are simply what the rate is predicted to be at that point, implied from market pricing of interest-rate derivatives.

## I wish I knew what the **yield curve** was, but I'm too embarrassed to ask

Most bonds pay the holder a regular interest payment (coupon), which is a fixed percentage of the face value of the bond (principal) that will be paid back when the bond matures. However, bonds trade on the open market, which means the price rises or falls depending on market conditions and can be very different to the face value. So the yield that a bond investor can get if they invest today depends on the coupon and on the current purchase price.

The change in the yield on a single bond over time will be affected by the outlook for interest rates, inflation and the credit risk of the bond. However,

we may also want to look at the yield curve, which compares the yields on bonds of the same credit quality, but different maturities. For example, the Treasury yield curve charts the yields on everything from three-month US government debt to the 30-year Treasury. The curve normally slopes up from left to right, because longer-dated bonds typically yield more than shorter-term ones. That's because money today is usually worth more than money in a year's time. For taking the risk of waiting for longer to be repaid, investors want more interest. If the yield curve starts to flatten – in other words, the gap (or "spread")

between yields on short-term bonds and long-term ones narrows – then it suggests that investors believe inflation will fall (and so they don't demand as high a yield from longer-term bonds); or that short-term interest rates will rise (driving up the yield on shorter-term bonds).

A flat yield curve may give way to an inverted one. This suggests that investors expect interest rates in the future to be lower than today, meaning they are happy to lock in today's yields on longer-term bonds, because they expect them to be even lower tomorrow. That in turn suggests they expect the economy to slow down, forcing the central bank to cut rates to boost demand and get growth going again.



Thus the Bank of England OIS forward curve now suggests that interest rates will be at around 4.5% in the middle of next year. That's a sharp rise from what it was implying just a month ago (around 2.5%-3%) and vastly up on expectations of around 1.5% six months ago. But the curve then predicts that rates will drop back sharply and will be around 3% by late 2025. That's also up on forecasts from a month ago – when rates were expected to be 2% in 2025 – but has gone up by much less than expectations for rates next year.

That's the explanation for why mortgage rates look so back-to-front: the market expects much lower long-term rates, and so loans for longer periods are pricing that in. This may happen – or it could suggest that markets are being too slow to recognise whether we are moving from a low-inflation/low-rate regime to one where both are at more historically normal levels. We won't know for a while, but if markets are wrong, this will have huge consequences for the pricing of all sorts of assets. However, for anybody looking for long-term mortgage security, the gap between five-year and ten-year rates looks notably low – and might not last much longer if expectations change.

## Guru watch

**Robert Shiller,**  
professor of  
economics,  
Yale University



There's a growing chance of a US recession as a consequence of a "self-fulfilling prophecy" of scared investors and consumers fearing a downturn, Nobel-winning economist Robert Shiller tells Bloomberg. Consumer sentiment hit its lowest level in a decade last month according to the University of Michigan Consumer Sentiment index, showing that an increasing number of households are concerned with inflation.

The US Federal Reserve's efforts to rein in inflation by raising interest rates is likely to affect the housing market, says Shiller. Initially, buyers may rush to buy houses and lock in low mortgage rates before they go up further. However, if the market then buckles as policy gets even



tighter, it could rekindle memories of the last housing boom and bust in 2008.

The US population has already been psychologically bruised from the high domestic death toll in the pandemic, as well as the stark political divisions that have wracked the country in recent years. While some analysts think fears of a downturn are overblown – in part because the US job market remains extremely strong – Shiller argues that inflation has more of an impact on consumers' state of mind than the labour market does, given the widespread and very visible nature of its effects.

"Inflation affects everyone," he says. "Every time they go to the store they see inflation and it makes them angry." As a result, Shiller thinks the chance of a recession in the next two years is "much higher than normal" at 50%.



## The risks in going nuclear

David Fickling  
Bloomberg

Faced with a serious energy crisis, the world is turning to nuclear power, but we should “take care”, says David Fickling. If developed countries want to “count on atomic energy as a reliable source of zero-carbon power”, they need to start “locking down” the mineral resources now. Rich nations and their allies provide just 19% of the uranium oxide needed to fuel their reactors. China, the former Soviet Union, Iran and Pakistan accounted for 62% of production last year; India and Africa produce the rest. Landlocked Kazakhstan, which alone supplies 40%, is dependent on the “goodwill of neighbours”, which include Russia and China, to transport its materials out of the country. There are alternative sources. More than 25% of the world’s uranium is in Australia, with another 9% in Canada. So far, the economic case for extraction hasn’t been compelling enough. The current lack of commitment to building new reactors is “unlikely to encourage investors that funding marginal uranium mines is a good use of their money”. Unless that changes, dependence on the former Soviet Union will “only grow more entrenched”. Governments are discovering the folly of taking energy security for granted. They shouldn’t repeat their mistake.

## Biden’s chip strategy may backfire

Douglas Fuller  
Nikkei Asia

US president Joe Biden is right that the new “Chips and Science Act” will boost domestic semiconductor manufacturing, says Douglas Fuller. However, a “parallel effort to further restrict China’s access” to US chipmaking technologies – via proposed export controls on electronic design automation (EDA) tools – could well backfire. Until now, US allies have had little reason to invest in chip fabrication plants (fabs) free of US technology. Targeted US export controls meant they didn’t have to choose between serving China’s market and satisfying US security demands. Tech firms in China have been happy to rely on foreign-owned fabs too because creating domestic equivalents is so hard. The US had in effect “created, or perhaps stumbled, upon a rather Machiavellian strategy of keeping allies and implicit accomplices in China working towards the country’s continued reliance on the US and other techno-democracies”. The EDA proposal threatens to dismantle this “defacto united front”. Biden’s intention is to stop China using advanced chips for military purposes, but the act could end up creating “precisely the required domestic coalition of tech companies and state interests that China needs” to become self-reliant.

## Welcome the return of the unions

E.J. Dionne  
The Washington Post

Labour unions are staging a “remarkable comeback” in the US, says E.J. Dionne. Last week, Gallup reported that approval of unions hit 71%, “its highest level in 57 years”. It’s been a long time coming. The 2008-2009 financial crisis, followed more recently by the pandemic, have shifted attitudes away from “pure market individualism” in favour of labour. Workers have “felt inequality personally – and are responding to it”. Well-publicised union victories at firms such as Amazon are the visible part of a larger trend. Unions have won more representation elections than they have in 20 years; the number of strikers trebled between 2021 and 2022; and a “red-hot” labour market has afforded workers more bargaining power. Biden is vociferously pro-union. It’s not all plain sailing though. Efforts to make unionisation easier have failed “even in Congresses controlled by Democrats”. The decline in manufacturing jobs presents challenges. But the new labour story has much in its favour, not least its capacity to bring Americans together across “some very deep divides”. The “quest” of unions to improve so many lives with better “wages, benefits and working conditions” beats “empty, angry and divisive demagoguery any day”.

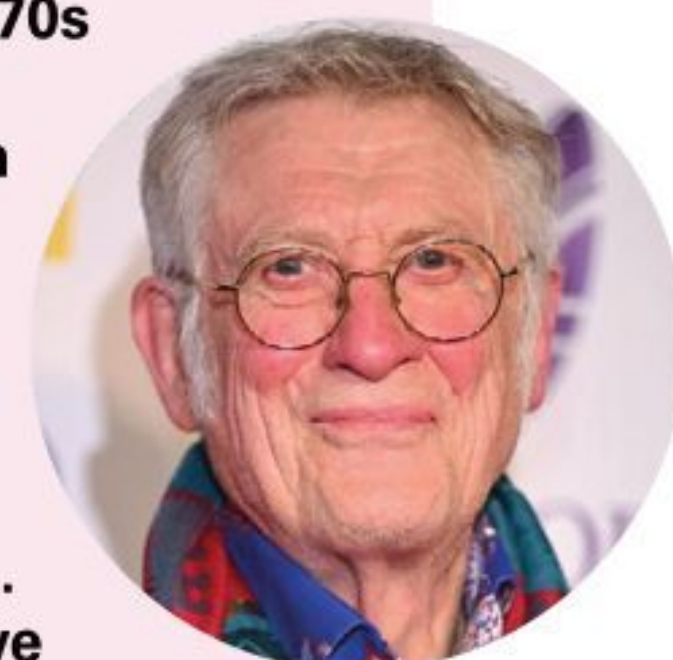
## Get a grip on scary new tech

Vivek Wadhwa and  
Mauritz Kop  
Foreign Policy

Artificial intelligence (AI) has become “dangerous to humanity” because, despite its widespread use by governments and companies, it remains little more than an “unintelligent system” for crunching “superhuman amounts of data” to automate decisions, say Vivek Wadhwa and Mauritz Kop. “Compounding the danger” is the lack of regulation and the power assumed by unaccountable technology conglomerates such as Meta. AI has given the world “algorithmic bias that hypercharges human prejudices” and “attacks on the institutions of democracy”. As the world confronts an “even more powerful” technology – quantum computing – this failure should “serve as a profound warning”. Though still in its infancy, if the various projects around the world succeed (notably those in China), these machines will perform in seconds tasks that would take conventional computers years. The implications are terrifying. In security technology circles, the “holy grail” is a system “capable of breaking much of the public-key cryptography that digital systems around the world use”. Before it’s too late, we “urgently need” to understand the potential impact of this, regulate it, and “prevent it from getting into the wrong hands”.

## Money talks

**“In the 1970s we made money from millions of record sales around the world. But what hits us? 93% tax.**



**One year we paid more tax than we earned, because we paid tax on assets as well. If we’d spent a year sitting on a Jamaican beach we’d have been financially better off. But we couldn’t... you had to keep momentum going.”**  
Musician Noddy Holder (pictured) of Slade fame, quoted in The Telegraph

**“I’m a good artist because I’m still doing it in my 30s and if you’re still doing the art thing in your 30s you’re either f\*\*\*ing wadded or good. And I’m both.”**  
Musician Matty Healy of rock band The 1975, quoted in The Guardian

**“My dance partner and I were once paid £10,000 each to stay in a luxury resort in Mauritius for a week and dance the cha-cha-cha at an event. Our dance lasted two minutes.”**  
Dancer Robin Windsor on whether he had ever been paid “silly money”, quoted in The Mail on Sunday

**“There is a story of my grandfather and grandmother being in some swanky hotel in Europe on the day the stockmarket crashed in 1929 and my great-grandfather walked into the living-room suite and said: ‘We’ve got to get the boat home – we’ve just lost \$20m,’ or whatever they lost. A sh\*\*load of money. How had they made it? They were investment bankers and robber barons, the usual way!”**  
Musician Loudon Wainwright III, father of Rufus, quoted in The Guardian

**“I wasn’t making that much but if I did, fair f\*\*\*ing play to me. Men aren’t asked about their salary like that.”**  
Television presenter Laura Whitmore on her alleged £600,000 pay packet for hosting *Love Island*, quoted in The Sunday Times

©Getty Images



# Why can't we all be rich?

[project-syndicate.org](http://project-syndicate.org)

The year 1870 represented a major turning point for humanity, says J. Bradford DeLong. That was the year that “the industrial research lab, the modern corporation and full globalisation fell into place”, and these were the institutions that would “supercharge technological progress”.

The global economy from then on generally doubled in every generation, “banishing the devil of Malthus”.

The post-1870 trajectory “rapidly surpassed anything that humanity had previously imagined would be necessary for achieving utopia”. We solved the problem of baking a big enough pie to satisfy everyone. One problem remains however – how to ensure everyone gets a slice of it. That problem has continued to “flummox” us. Four key thinkers help us to understand why.

## From Marx to Polanyi

The first is Joseph Schumpeter, who explained how modern technology generates wealth through “creative destruction” – progress requires that old industries, occupations and societal patterns be destroyed to make way for the new. It may be necessary – it’s also painful and is hence resisted.

The second is Friedrich Engels, the man mostly responsible for the Marxist idea of the “base-superstructure” model of political economy. Because the economic base (the relationships based on productive technologies) has been in constant ferment, the social superstructure of politics, culture and social institutions and so on are equally constantly being made obsolete.

The third is Friedrich Hayek, whose “magnificent insight” was that the market economy is an “unrivalled mechanism” for



coordinating all the forces that make for economic progress, provided that property rights are enforced. The trouble is that that boon comes at a terrible price – we cannot expect the market to provide social justice.

Which brings us to the final thinker, Karl Polanyi, who saw that Hayek’s vision of a “market-bestowed utopia” was not sustainable because it was “inhuman”. People want a say in how their society’s resources are used; they will demand that their and others’ incomes reach

some minimum dignified level; and they expect a certain level of stability. “People tend to resist the idea that their pattern of life can be single-handedly destroyed by some rootless profit-maximising cosmopolite half a world away.”

All these thinkers help us to understand why technological progress hasn’t automatically led to an “equitable and happy world”. That leaves for future generations the next big task: how to get better at slicing and distributing the pie.

# The Big Things shaping the future

[collaborativefund.com/blog](http://collaborativefund.com/blog)

Events have multiple causes, which is what makes forecasting so hard. But keep digging and you’ll eventually hit the “Big Things”, says Morgan Housel: the gravitational causes around which all things revolve. Pretty much everything about the modern world has its roots in the changes around World War II, for example, and you’ll struggle to understand how the biggest technologies got off the ground or the rise of modern welfare states without some grasp of the history of that time. So what are the Big Things operating in the present day? There are three main ones. The first is demographic. The share of young workers is declining, the share of older ones is rising, and that of the retired is surging. At the same time, the number of births is declining. It’s hard to overestimate what a Big Thing this is or the impact it will have on economies. The second is rising wealth inequality. We are heading for a new “Gilded Age”, and the last one gave way to a revolution where top income-tax rates went from effectively 0% to 94% within three decades. Finally, access to data. The telephone and the radio revolutionised society, but the changes wrought by the internet over the last ten years are without precedent. How all this will pan out will “be fascinating to watch” – “inspirational and terrifying” in equal measure.

## Are bankers really so bad?

[spectator.co.uk](http://spectator.co.uk)

“Finance in screen fiction is a realm of monsters,” says Martin Vander Weyer. From Gordon Gekko (pictured) onwards, banking has been portrayed as a world devoid of empathy or redemption. *Industry*, a British-made TV drama about life on a City trading floor, and written by two former bankers, is no exception. “There aren’t any nice guys.”

Vander Weyer asked the writers, Mickey Down and Konrad Kay, whether the reality was that bad. Not really, they said. Both found it stressful to work with “imposter syndrome” – Down struggled with the “foreign language” of balance-sheet analysis and Kay could barely add or subtract and “had to work really hard” to be average. But there were upsides – they “liked the dressing up” and the after-work drinks.

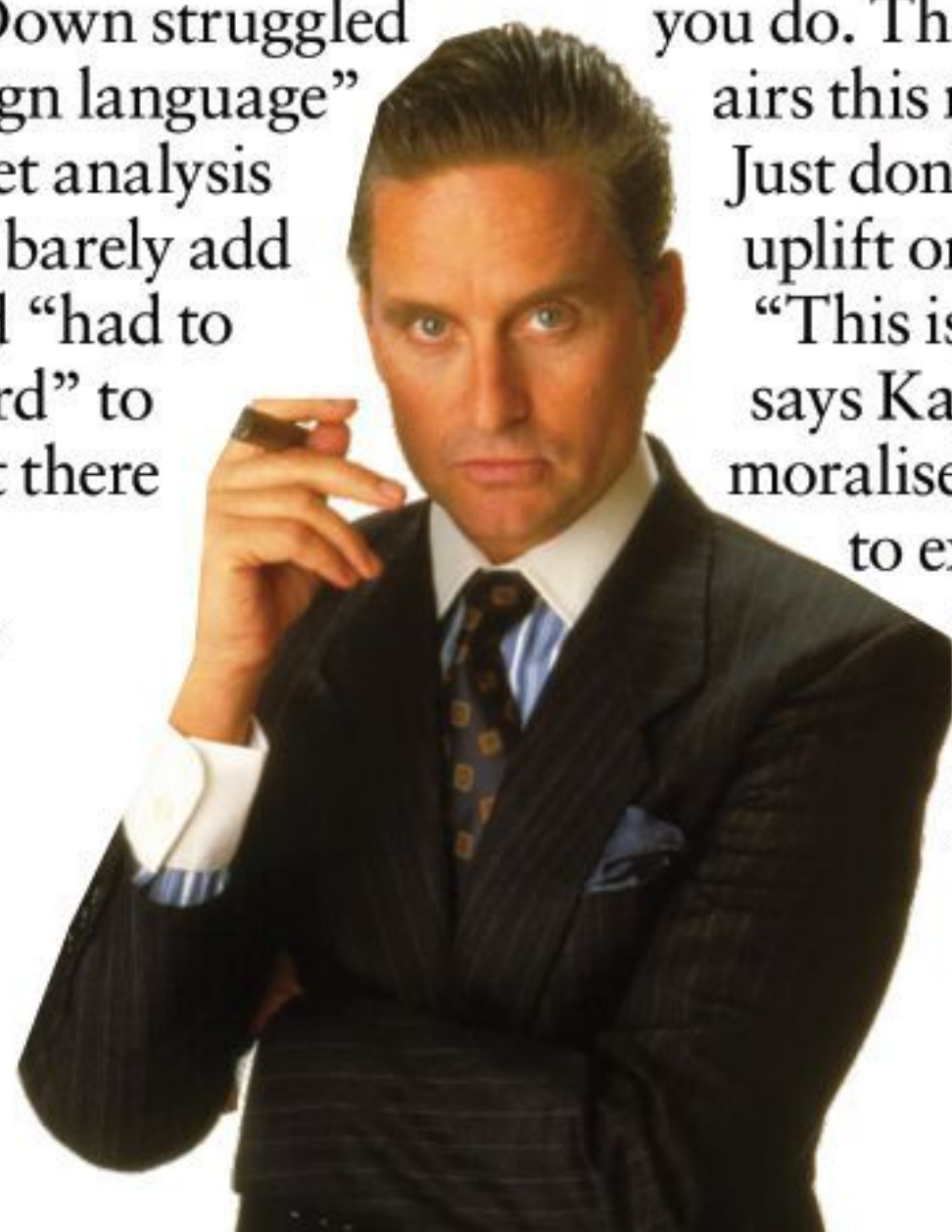
*Industry*’s portrayal of life in banking is “very authentic”, says Vander Weyer, down to the financial details which you don’t need to understand to enjoy the drama, but will make sense if you do. The second series airs this month on BBC1. Just don’t expect moral uplift or a happy ending. “This is a drama,” says Kay, “that never moralises and never stops to explain. We could write 20 series of it but good’s never going to triumph.”

## Why Batgirl was killed off

[aier.org](http://aier.org)

Film studio Warner Bros Discovery caused waves when it cancelled the release of the upcoming *Batgirl* movie, says Peter Jacobsen. Some of the stars of the film and many fans were bewildered. Why cancel a film you’ve already spent \$90m on? To ask the question is to “invoke one of the most common economic fallacies”.

People in business make decisions based on whether they think the benefits of a course of action will outweigh the costs. The costs and benefits that count are those we expect in the future; past – or “sunk” – costs should rationally have no place in decision making. So the question of whether or not to release *Batgirl* has nothing to do with that \$90m. That money is gone. What matters is whether the release of the film will bring in more money than the release would cost – costs including taxes, the opportunity cost of spending resources on promoting the film that could be used elsewhere, and the damage to the brand if it is deemed that the movie stinks. Given how valuable comic-book adaptations can be, that last point may have been decisive.





# Arm your portfolio with these stocks

Defence stocks have been in the spotlight for more than a year owing to geopolitical trends predating the Ukraine war and low valuations. Alec Cutler, portfolio manager of the Orbis Global Balanced and Cautious Funds, presents the bullish case

Investment professionals will usually define defensive stocks as those with steady and predictable earnings, competitive advantages that prevent rivals gaining a foothold in their sector, a strong balance sheet and a relatively stable share price. But in reality, what's considered "defensive" is whatever held up best in the last market sell-off.

In behavioural science this is called recency bias. It causes nervous investors to rush for what they wish they had owned in the last bear market, regardless of whether those companies are well placed for the current one. If market declines are brief enough, the very belief that a company is defensive can help it resist price falls and bolster its defensive reputation.

But when bear markets drag on long enough, actual operating results dictate share-price performance, and some erstwhile defensives prove anything but. Similarly, a new crop of companies emerge that demonstrate the attributes listed above.

As contrarian investors, we are always looking for attractively-priced companies with under-appreciated defensiveness. Often these are in industries that have inherently defensive characteristics and used to be considered defensive, but have recently fallen out of favour. Sometimes real negative change has occurred, and industries may never regain their defensive status.

Telecoms companies are a good example. The world has changed: they no longer dominate the flow of global information and they have to fight with more competitors for a pie that is shrinking owing to technology-driven efficiencies. When was the last time you placed a long-distance phone call?

However, sometimes our research supports the idea that a formerly defensive industry still deserves to trade at a premium defensive valuation, even if it isn't highly valued right now. We believe defence contractors fall into that category.

## China and Russia flex their muscles

Certain defence stocks attracted attention over a year ago, with interest sparked by two developments. Firstly, it was becoming clear that China's and Russia's geopolitical assertiveness and military build-up was more secular than cyclical, and that it would spark a similar response from those feeling threatened – as it has since the time of Thucydides.

Secondly, shares that were already inexpensive owing to years of falling defence budgets were, in the case of European companies, being pushed down even harder owing to the announcement of a new EU social taxonomy, which promised to increase the cost of doing business for companies whose activities don't contribute to the social goals of the EU. Defence companies were initially considered among the worst offenders.

In November of 1989, the Berlin Wall fell and the Cold War ended. With that, defence budgets dropped precipitously, as the West sought to cash in the peace dividend. As the chart opposite shows, defence

*“Most of these companies’ contracts are inflation-proof”*



Saab's Gripen fighter jet is cheaper than Lockheed's F-35

spending settled at very low levels for many countries, eclipsed by other social priorities. The vast majority of Nato countries are still below the Nato requirement to spend at least 2% of GDP on defence.

With Russia's second invasion of Ukraine and China's increasingly strident stance towards Taiwan, the peace dividend is now clearly eliminated. Some are saying we're entering a new Cold War, but for Russia and China, it actually never ended, and the profit-driven and optimistic West has been caught underprepared and underinvested in its deterrence against potential aggression.

Russia's invasion of Ukraine on 24 February ended the period of political rationalisation that followed its 2014 annexation of Crimea. In response, nearly every European country has announced a massive increase in defence budgets. These increases come in ways that signal a long-term shift in attitude, with increases in military force, long-term weapons programmes, and in the case of Germany, Sweden, and Finland, historic changes in their stance towards war.

## A crucial sea change

We do not believe that Wall Street analysts are even close to increasing adequately their earnings estimates to account for the coming torrent of defence spending. Looking at the chart, it is easy to see why. After more than 30 years of dropping revenues, it is incredibly





NLAW, an anti-tank weapon now in huge demand following its successful use by Ukrainian forces. BAE makes frigates, submarines, and the Typhoon fighter, all highly sought after, as well as the M777 howitzers recently supplied by the US to Ukraine. Thales, Rheinmetall, and Mitsubishi Heavy Industries have all been inundated with enquires about their hardware.

**Earnings forecasts will rise**

For all five companies, earnings expectations for 2025 have increased, but only modestly – by 10%-15% for BAE, Saab, and Thales, 30% for Mitsubishi Heavy Industries, and 60% for Rheinmetall (driven by Germany’s €100bn increase in defence spending). Following those revisions, the stocks now sell at a discount to the market on forward price/earnings, but we believe both the “p” and the “e” should change. On the earnings side, if our assessment of an intensified and protracted Cold War is correct, considerable increases in earnings expectations are likely.

On the price side, we see two compelling cases for higher valuations. Firstly, Russia’s invasion has spurred commentators on environmental, social, and governance (ESG) to rethink their negativity towards the defence industry. Some continue to view contractors as producing equipment that is used to kill people and destroy societies. But other ESG advocates now see the industry as providing the means for societies, especially those that are most aligned with ESG principles, to deter would-be attackers.

For free societies, a healthy advanced defence sector is something they need to have, not something they should just want to have, and recent events have made that obvious even to former critics of the industry. As more clear-eyed views of the sector prevail, this should remove a cloud over the stocks’ valuations.

Secondly, and more importantly, the defence contractors we hold are fundamentally defensive businesses. Most of their contracts are protected against inflation, and all but Rheinmetall have been less volatile than world stockmarkets over the long term. As those defensive characteristics come to be better appreciated, these firms should warrant a premium price. In a volatile and inflationary world, the real “defensives” may be in defence.

difficult for those covering the industry to register the full impact of the change we’re seeing today, or they are assuming what we’re currently experiencing is merely a brief spike.

We disagree. We don’t see an imminent Russian defeat or Putin disappearing, we don’t see China turning away from its regional goals, and we don’t see any sort of worldwide consensus to support the Western powers’ opposition to Russia. In fact, we think it more likely that the world will return to a mix of East and West blocs, and unaligned nations.

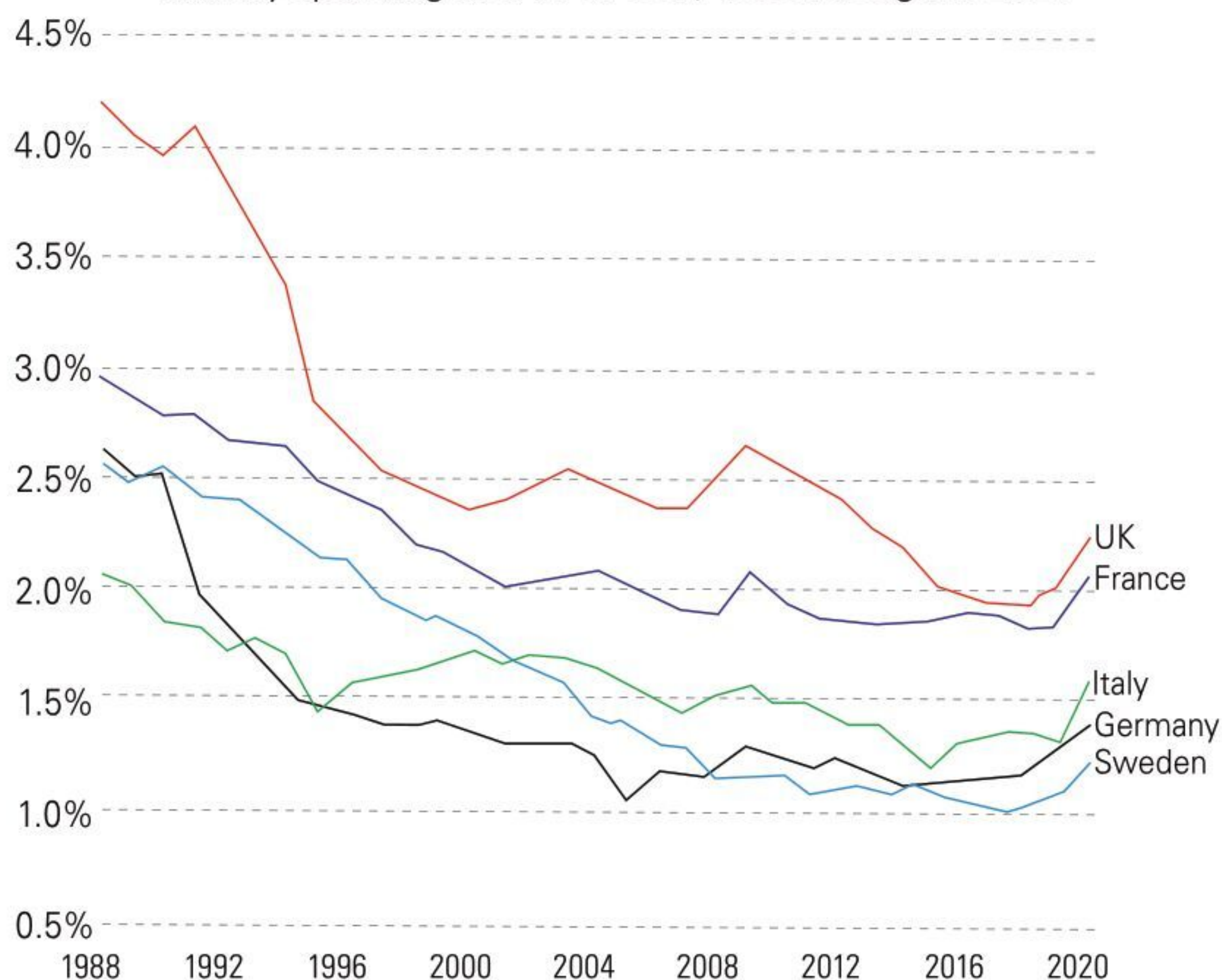
This is a recipe for significantly increased defence budgets that then grow steadily off that higher level, not just in Europe but also throughout the world. Korea, Japan, Australia and India have all recently announced increased spending on defence.

That has not gone completely unnoticed by the market, and our defence shares Saab (Stockholm: SAAB-B), BAE Systems (LSE: BAE), Thales (Paris: HO), Rheinmetall (Frankfurt: RHMD), and Mitsubishi Heavy Industries (Tokyo: 7011) are all up by 30%-60% so far this year, growing from small positions to represent over 5% of the portfolio.

Yet we believe they still have considerable upside. Saab AB makes the Gripen fighter jet, a highly capable and lower-cost alternative to Lockheed’s F-35, which is overbooked on orders, forcing countries to look for alternatives. The Swedish company also makes the

**Europe has slashed defence spending since the Berlin Wall fell**

Military spending as a % of GDP, 1988 through to 2020



Source: Stockholm International Peace Research Institute (SIPRI) Yearbook: Armaments, Disarmament and International Security



# Protect your profits – buy stocks with wide moats

Companies with attributes that give them an enduring competitive advantage tend to thrive over the long term. Dr Mike Tubbs explains how to identify these stocks and how to invest in them

One of Warren Buffett's best-known expressions is "economic moat". It refers to some companies' ability to maintain competitive advantages over their rivals, helping them protect their profits and market share. An example of a company with an especially wide moat is Coca-Cola, in which Buffett's investment vehicle, Berkshire Hathaway, has a \$24.8bn stake.

Buffett first paid \$1bn for a 6.2% stake in Coca-Cola in 1988 after the shares had fallen in the 1987 stockmarket crash. He felt it was a good company with a wide moat and was poised to recover. Buffett's confidence in the firm was well founded. Coca-Cola's shares rose 26-fold between May 1988 and April 2022. The company's wide moat is based on it having the world's strongest brand, while its massive size and geographic reach help it keep a lid on costs through economies of scale.

## Five crucial characteristics

The five main sources of a wide moat are intangible assets (brands, patents, exclusive licences and the like); a cost advantage; switching costs (that make it expensive or laborious for customers to change supplier); network effects (meaning a product or service becomes more valuable the more people begin to use it) and efficient scale (markets such as water supply that are best served by one or two companies in a given area). A firm with a wide moat often has two (Coca-Cola, for instance), or even three, of these factors contributing to its moat. The following examples illustrate these five sources.

Intangible assets include brands such as Coca-Cola or Diageo (with labels such as Johnnie Walker and Smirnoff) and patents. Pharmaceutical firms depend on patents to protect blockbuster drugs. For example, AbbVie's patent-protected drug Humira for rheumatoid arthritis was the world's best-selling drug from 2012 to 2020, when sales reached \$20.4bn. But patent protection is now ending and several cheaper generic versions are due to be launched in 2023.

Switching costs are the main element of Salesforce.com's wide moat. Salesforce was the first company to develop software as a service (SaaS) with its customer-relationship management (CRM) software on its Sales Cloud. This is now the best CRM package available. Firms switching would risk losing data and have to retrain their salesforce to use new software. That would be expensive, while revenue would also be forfeited during the upheaval caused by the change. Salesforce invests 20.7% of its annual sales in research and development (R&D) to ensure its products remain the best available.

Network effects are a major component of Alphabet's moat, along with its brands (Google search, YouTube, Android, and Maps) and intangible assets (brands, algorithms, machine learning and accumulated customer data). Network effects stem from its vast array of customers, which means it can collect much more data; in addition, this data and the large customer base enable advertisers to get value for money from their expenditures, so Alphabet entices more advertisers. Amazon benefits from network

effects (more buyers and sellers attract yet more buyers and sellers to its platform in a virtuous circle), but cost advantages, intangible assets and switching effects also contribute to its wide moat. Cost advantages are exhibited by Amazon (thanks to its purchasing power, logistics, and vertically-integrated structure) and by Coca-Cola through its scale and market share (it is a duopoly with Pepsi).

Efficient scale provides a moat for Enbridge, the Canadian pipeline company. UK utility companies, such as water companies, also have efficient scale but the regulator controls their profits, so they are unable to exploit their moats to achieve higher margins in the way some of the firms mentioned above do.

## The most competitive British blue chips...

Firms with wide moats form a small minority of FTSE100 companies, with just over one-fifth of the FTSE100's top 50 firms having this attribute. Nine are in the top 25 companies by market capitalisation. The nine firms with wide moats in the top 25 include AstraZeneca and GSK (thanks to patents, economies of scale and powerful distribution networks, and Unilever, Diageo and Reckitt Benckiser (brands and cost advantage).

There is also British American Tobacco (brands, cost advantage and regulations on advertising making it impossible for new entrants to challenge it); London Stock Exchange (a vertically-integrated financial exchange with comprehensive databases enhancing its switching costs and intangible assets); BAE Systems (switching costs, intangibles including technology and close relationships with defence ministries) and Experian (intangibles such as its database on consumers and businesses, and the difficulties confronting any new business trying to collect and amass such data).

## ... and their overseas counterparts

We have already mentioned Alphabet, Amazon, Coca-Cola and Salesforce.com as examples of firms with large moats. To these we can add several in other sectors, such as 3M (a diversified group with over 60,000 products, known for inventing Post-It notes); Adobe (the publishing software company); ServiceNow (SaaS software solutions to automate business processes); Ecolab (cleaning and sanitation products); Tyler Technologies (software for US local authorities); and Mercado Libre (the largest e-commerce marketplace in Latin America). In pharmaceuticals examples include Novo Nordisk (world leader in diabetes treatments) and Merck (strong in patented cancer immunotherapies, with drugs such as Keytruda).

## Keeping rivals at bay

It is important that a wide moat endure, ideally for many years after you invest in the company. For pharmaceutical firms relying on patent protection, a serious problem can arise if they are approaching a "patent cliff" – this occurs when the patents on a super-blockbuster drug, or several best-selling ones, are all due to expire over a short period. An example of how

*"Intangible assets, such as patents and illustrious brands, are a key advantage"*





*Coca-Cola boasts the world's strongest brand, which keeps competitors at bay*

a company can depend mainly on one (or few) drugs is AbbVie's reliance on its best-selling rheumatoid arthritis drug Humira. It was the world's top-selling drug, with sales rising from \$7.9bn in 2011 to \$20.7bn in 2021.

Humira accounted for 58% of AbbVie's sales in 2019 and 37% in 2021 as sales of new drugs emerging from the pipeline rose. Humira's US patent (most sales are in the US) expires in 2023, so it is just as well that newer drugs are coming onstream: Humira's sales will decline from 2023 as rivals introduce cheaper generic versions of the drug. Another potential problem for pharmaceutical companies is legal action over drugs' side-effects; witness the recent jitters at GSK and Haleon over Zantac, a heartburn drug that lawsuits allege is carcinogenic.

### Mistakes to avoid

Brands can suffer if a firm doesn't take good care of them. BlackBerry is a good example. It dominated the business smartphone market more than a decade ago, but did not keep up with Apple and Android, while its Playbook tablet failed. Blockbuster Video failed to move with the times. In 2000 Netflix approached Blockbuster, offering to sell itself for \$50m. Blockbuster turned down the offer and went bankrupt in 2010.

These examples also illustrate the way in which disruptive technological change can wreak havoc with established companies if they don't fully embrace change. Take Kodak. The first digital camera was invented in Kodak's R&D labs by Steve Sasson in 1975. The board treated it as an interesting experiment and chose not to publicise or pursue it. Kodak failed

to develop it and then embrace the internet and its possibilities for fear of cannibalising the profitable silver-halide photography business, in which it was the global leader. Kodak filed for bankruptcy in 2012.

Cost advantages from large-scale operations can dwindle if a company loses customers through poor service or a change in technology. For example, Nokia lost 96% of its once-dominant market share between 2007 and 2012 as it failed to compete with Apple and Android smartphones.

The reduced sales volumes meant it would have been hard to manufacture new, competitive products as cost-effectively as before even if it had managed to come up with them. However, Nokia reinvented itself as a provider of mobile-network equipment and is now the world's third-largest seller of such equipment.

### Top flops

Even large, respected companies with wide moats can launch products that flop. But most can survive when their flops affect only a modest proportion of annual sales – and provided mistakes are corrected and the company learns from them. Coca-Cola, for instance, which had been losing market share to PepsiCo's cola in the early 1980s, decided to change its formula and call the result New Coke. It was launched in 1985.

The new drink was greeted with public outrage and was withdrawn after a few months. The original formula was reintroduced and rebranded as Coca-Cola Classic. A second example is the Apple Newton, a

*“BlackBerry used to dominate the smartphone sector, but it couldn't keep up with Apple and Android”*

Continued on page 24



Continued from page 23

personal digital assistant launched in 1993, which sold only 50,000 in its first four months. The whole product line was discontinued in 1998.

### When patience is rewarded

It sometimes takes a long time for the merits of a firm with a wide moat to be recognised by investors, and hence for its share price to reflect its quality and potential. A good example is ASML, the market leader in precision lithography, which is the key step in making semiconductor chips. ASML has only one competitor, Nikon, and ASML's market share is 62%. It also has a monopoly on extreme ultra-violet (EUV) lithography systems, used to make the most advanced chips.

But ASML's share price was €71 in mid-2000, fell to €14 in late 2008 and did not regain €71 again until September 2013. The shares then powered on to a peak of €770 in late 2021 as it became obvious that EUV was a critical technology. However, ASML shipped the first prototype EUV system to a key customer in 2010 when the share price was under €30. ASML was then the only company developing EUV, so investors had plenty of opportunity to take the hint and invest. Those who did invest at €27 in late 2010 saw the share price increase by over 28 times to €770 by November 2021.

### What to look for

There are several key characteristics to look for when hunting for businesses with wide moats. These are the likely longevity of the moat, the odds of strong market growth continuing, high margins and low debt. And a company needs to avoid mistakes that can prejudice its reputation, brand or market share. We have seen how a wide moat can be impaired and a new disruptive technology can quickly cause problems for a global leader in an apparently impregnable market position.

Continuing sales growth with a consistently high margin is an excellent indication that a company's wide moat is intact and that its market niche is still growing. The importance of low debt is, firstly, that should interest rates rise, the company will not be saddled with rising payments that could reduce profits and limit strategic options. Secondly, low debt gives the company the financial flexibility to rectify any mistakes, such as a product flop.

### Three options for investors

There are three ways of investing in a diversified set of firms with wide moats. The first is to select your own set of companies with wide moats chosen from several sectors and with an eye to the dividend yield you are targeting. The second is to go for an investment trust with a substantial proportion of its holdings in such companies – preferably one trading at a discount to the value of its portfolio of companies (at a discount to its net asset value, or NAV, in other words).

The third is to choose an exchange-traded fund (ETF), such as the **VanEck Morningstar Global Wide Moat UCITS ETF (LSE: GOGB)**, which tracks companies investment research group Morningstar has identified as having wide moats.

This ETF consists mainly of defensive consumer stocks (Kellogg, Imperial Brands, British American Tobacco, Constellation Brands, Ambev), technology (Roper Technologies and Tyler Technologies) and healthcare companies (Gilead Sciences) in its top ten investments. This ETF was launched in mid-2020 and has risen by 29% since then compared with 21% for global large-cap equity ETFs over the same period. An example of a global investment trust with a yield in the 2%-4% range is Nick Train's **Finsbury Growth**



Kodak invented the first digital camera, but stuck with traditional photography

& Income Trust (LSE: FGT). Firms with wide moats make up 48% of the portfolio. The top ten investments include Diageo, Experian, London Stock Exchange and Unilever, together with enterprise-software provider Sage, snacks giant Mondelez and Remy Cointreau. The current discount to NAV is 4.2% and the dividend yield is 2.3%.

Another global trust, with less emphasis on the UK, is the **Bankers Investment Trust (LSE: BNKR)**. Among its top ten holdings are American Express, Microsoft and Oracle. Around 48% of the fund's holdings are firms with wide moats and the current yield is 2.6%. It is on a discount to NAV of 7.7%.

### A potential portfolio

The third alternative is to build your own portfolio of businesses with wide moats. Let us assume that an investor wants reasonable diversification through stakes in between ten and fifteen such companies from different sectors and wants to include some stocks paying dividends. Possible companies to select from include AstraZeneca (LSE: AZN), Merck (NYSE: MRK) and Roche (Zurich: ROG) in pharmaceuticals; Medtronic (NYSE: MDT) in health (medical devices); Diageo (LSE: DGE), McDonald's (NYSE: MCD) and Reckitt Benckiser (LSE: RKT) in consumer goods; Alphabet (Nasdaq: GOOGL), Amazon (Nasdaq: AMZN), ASML Holding (Nasdaq: ASML) and Microsoft (Nasdaq: MSFT) in technology; Experian (LSE: EXPN) and Visa (NYSE: V) in financials; and BAE Systems (LSE: BA) and Raytheon Technologies (NYSE: RTX) in defence.

All these companies except Alphabet and Amazon pay dividends. Yields exceed 3% at BAE Systems, Medtronic and Merck. In the 2%-3% range you will find AstraZeneca, Diageo, McDonald's, Raytheon, Reckitt Benckiser and Roche. Down in the 1%-2% range are ASML and Experian. Microsoft and Visa yield less than 1%. Seven of these companies (Alphabet, Amazon, ASML, Experian, Medtronic, Microsoft and Roche) have share prices well below Morningstar's estimate of their fair value; five others lie 1%-10% below fair value. BAE and McDonalds are 10% above fair value and Diageo is 22% above. One normally aims to buy when a company is below fair value.

If investing, take advantage of pound-cost averaging by buying shares in companies with wide moats or investment trusts/ETFs over an extended period to avoid a substantial investment at the top of the market. The exception is if you are presented with one of those once in a decade opportunities: market lows such as we saw after the financial crisis of 2008/2009, or at the start of the pandemic in early 2020.

*“Sales growth with a high margin is a reliable sign that a company's wide moat is intact”*



# Time to buy strategic metals

Weaker prices for key metals in the alternative-energy sector are an investment opportunity



**David Stevenson**  
Investment columnist

Given the increase in wholesale gas prices you'd expect that investment vehicles and companies involved in the energy transition would have shot up in value. However Tesla's share price is down by almost a third (-31%) year to date (YTD), while Umicore, a major player in recycling strategic metals, is down 13%. As for funds, L&G Battery Value-Chain ETF (LSE: BATT) has fallen 18% YTD while WisdomTree Battery Solutions ETF (LSE: VOLT) is down 21% over the same period.

The share prices of nuclear energy-related firms have also not moved that much given the renewed focus on nuclear. Yellow Cake (LSE: YCA), a London-listed uranium oxide physical holding company, has seen its share price advance by 20% YTD. However, Geiger Counter (LSE: GCL), which invests in uranium-exploration companies, has seen its share price fall by 3%.

There's also a handful of newly listed uranium ETF trackers. HANetf partnered with Canadian commodities giant Sprott to launch the HANetf Sprott Uranium Miners ETF (LSE: URNP), while Global X launched Uranium ETF (LSE: URNG). Over the last three months these funds have increased by between 24% and 16%



Uranium prices are set to heat up

respectively. Those numbers are certainly an improvement on the S&P 500's decline of 4% but they're hardly off to the races.

## Buoyant battery market

Part of the reason for these mediocre returns is that investors in the battery complex and nuclear-power spectrum have grown jittery about over-capacity and some short-term price weakness in key metals. Chinese nickel-sulphate prices peaked at RMB56,000 per metric tonne on 10 March, but have come down around 34% to RMB36,900/mt as of 12 July, according to Scott Yarham at S&P Global Commodity Insights. One contributory factor has been the weakness

of the steel sector in China – which accounts for more nickel demand than batteries, resulting in lower overall demand.

However, this analysis also points to a much more buoyant overall battery market. Lithium carbonate hit all-time highs of \$78,000/mt in April and at S&P's recent assessment was at \$71,000/mt, up nearly 450% year on year due to increased demand for electric vehicle batteries and tight supply.

Cobalt hydroxide prices have also increased nearly 32% year on year, while battery-pack costs have increased and battery makers have made public announcements that prices will increase, says Yarham. "This is very unusual for

battery costs, which have been consistently moving down for over a decade." Some lithium producers are said to be fully booked for 2022.

## Looking ahead

Short-term pricing pressures aside, it seems to me markets haven't priced in long-term structural drivers. There will be a huge increase in electric vehicle deliveries over the next decade. This will strain mining capacity, especially in lithium. Prices must rise to stimulate investment in new capacity.

That's also true for the uranium sector but with an added twist. Most deals avoid the spot market for uranium and opt for longer-term contracts. However capacity constraints will arise as demand from the developing world increases, forcing public sector buyers into the spot markets, which are thinly traded.

Finally both the battery complex and nuclear sector lack the capacity to refine raw materials. Too much lithium-processing capacity is in China and uranium processing in Kazakhstan and Russia. If these countries were to use this capacity for geostrategic ends, prices would jump.

In short, if you think we are embarking on a structural transformation to wean us off increasingly expensive hydrocarbons, then recent price weakness in these alternative energy niches might represent a real opportunity.

## Activist watch

Activist investors are expanding a "landmark" federal court case against Australian oil and gas firm Santos over allegations of greenwashing, says Bloomberg. The Australasian Centre for Corporate Responsibility filed a lawsuit last year alleging that Santos had misled investors in its 2020 annual report on clean energy. The shareholder organisation claims that documents produced during the legal discovery process raise further questions about Santos's plan to achieve net-zero by 2040, which involves unproven carbon-capture technology and mixing hydrogen into the natural gas network. "The case is being closely watched as a major test of greenwashing" at a time when "activists are increasingly trying to hold large polluters to account".

## Short positions... Trian set to wind up

■ **Jason Pidcock, manager of the Jupiter Asian Income fund, has responded to China's threats towards Taiwan by selling his fund's holdings in China and Macau, says the Mail on Sunday. The sales "represent a significant shift" for the fund, which used to have almost one quarter of assets in firms such as hygiene company Hengan, food manufacturers Tingyi and Want Want, and Macau casino Sands China. "On a sliding scale ranging from ally to enemy, China has clearly moved towards the wrong end," says Pidcock. "I don't want to take the risk of having money invested in China which I may not be able to get back if matters turn for the worse."**

■ **Terry Smith has sold Finnish elevator company Kone from his Fundsmith equity fund, says Citywire. Kone's shares have fallen 44% over the past 12 months amid a slump in the construction sector in China, which is its largest market. Smith had held the stock for more than a decade.**

■ **Nelson Peltz (pictured) is winding up Trian Investors 1, his £440m London-listed investment trust following challenges from activist shareholders,**

says the Financial Times. The move is "a role reversal for the usually pugnacious billionaire activist". A group of investors, who won a fight to eject the trust's chair last month, pushed Trian Investors to return cash to investors despite a 71% gain in net asset value over the last three years, amid concerns about changes to its strategy. Trian Investors will return at least 95% of assets to shareholders by June 2023 and will then be wound up.





# Where to stash your cash

Savings accounts have become more attractive thanks to higher interest rates, but beware of breaching your savings allowance



**Ruth Jackson-Kirby**  
Money columnist

Interest rates on savings accounts are higher than they have been for a decade. Returns on one-year savings bonds are now six times greater than they were 18 months ago. The best-buy account pays 3.5% over one year, compared with just 0.58% last March, according to research by Savings Champion.

Yet despite the big rise in best-buy rates, most savings accounts are still paying about 0.1%. So if you haven't moved your savings recently, it's time to shop around for a better return.

While you won't be able to beat inflation (for that you need to turn to higher-risk strategies such as investing), the more interest your money earns the less damage inflation will inflict.

Nonetheless, interest rates are still on the rise and further increases to the base rate are expected from the Bank of England, so you won't want to lock your money away for too long. At present you will also find that opting for a long-term bond doesn't give you a much better return than a shorter option.

For example, the best rate you can currently get on a fixed bond is 3.61% from Smart Save. But to receive that you need to lock up your money for five years and Smart Save will only allow withdrawals in "exceptional circumstances", such as bankruptcy, insolvency or diagnosis with a critical illness. You can't just ask for your money back because you've seen a better rate somewhere else.

However, you can get a rate of 3.5% on a one-year bond from Ahli United Bank. On a £10,000 deposit that's a difference of just £11, and you can shop around for a new, hopefully even better rate in 12 months' time. If you want easy access to your money you can still get a reasonable rate (in comparison with the pitiful interest offered in recent years) from Al Rayan Bank's Everyday Saver, which pays 2.1%.

## Turn to an Isa to avoid tax

However, there is one downside to rising rates: for some this raises the prospect of a tax bill. In 2016 the government gave us all a Personal Savings Allowance (PSA). This means that if you are a basic-rate taxpayer you can earn up to £1,000 interest on your savings before you have to pay income tax on the return. Higher-rate taxpayers get a £500 allowance, and additional-rate taxpayers get nothing.

In the past six years the idea of earning more than £1,000 a year in interest seemed absurd to most people. On an account earning 0.1% interest you'd need to deposit



Don't lock your money away for too long

over £100,000. But now that rates are rising just £29,000 would exceed the PSA in an account paying 3.5%.

If you do earn more interest than your PSA, the tax you owe will be taken through changes to your tax code. Those who pay tax via self-assessment can declare it on their form. The simple way to avoid exceeding your PSA is to deposit your savings into an Isa. The top-easy access Isa is Gatehouse Bank's, which pays 1.75%, or you could get 3% with a two-year fix from Darlington or Loughborough Building Societies.

## Check your NI record for missing credits

Thousands of mothers are being urged to look at their National Insurance (NI) record to make sure they are being paid the correct amount of state pension. The Department of Work and Pensions (DWP) has undergone its first full review of state pension fraud and error since 2006. It found that missing NI credits – or home responsibilities protection, as they used to be called – was the second-biggest error in the system.

The scheme has existed since 1978 with the aim of protecting parents from a reduced state pension owing to gaps in their National Insurance when they stopped working to raise children. You should receive NI credits for these periods.

If you haven't received the credits you could end up with a lower state pension. In one case a woman was paid a £4,000 lump sum after it was discovered she had been receiving a lower state pension due to missing NI credits.

"This error overwhelmingly affects women, and undoubtedly means that many thousands have been underpaid for years," says former pensions minister Steve Webb. It is expected to take years for the DWP to correct all state pension errors.

"Rather than wait for the government to fix the problem, I would encourage anyone who has received child benefit since 1978-1979 to check that the relevant credits are on their NI record," adds Webb. "If not this can be fixed by filling in a form, and the result could well be a higher pension and a worthwhile lump sum."

## Pocket money... scams target kids

● "Children as young as six are being targeted by fraudsters," says The Telegraph. Scammers are contacting children via social media and online games and convincing them to hand over a parent's bank or card details, pretending to sell currency or characters for games at a "reduced price". They then go on to steal thousands of pounds.

Action Fraud received almost 18,500 reports from victims aged 19 and under in 2020, a near-25% rise on the previous year.

● New research has found that nursery fees for children under two could reach £2,000 a month in some parts of the country.

A report by the Trades Union Congress (TUC) says monthly fees for full-time nursery places have soared by £3,000 a year over the past two decades and cost over £1,000 a month in

every English region. "Parents in Britain already pay the highest childcare costs in the developed world," says Tom Haynes in The Telegraph. "Almost a third of the average couple's income is now spent on childcare, three times the amount in Germany."

● "Households who cut energy usage this winter will spend 10% of their monthly bills on standing charges they can do nothing about," says The Sunday Times.

On top of big increases in the unit cost of gas and electricity, "the fixed fees you pay every day for having an energy supply" have also risen steeply. The fees are meant to represent the fixed-network costs of supplying energy, but also cover the cost of dealing with collapsed energy firms.

There were 29 firms that went bust over the past

year at an estimated cost of £1.8bn and the sum "is being recouped through these standing charges".

● "Britain's once-favourite mortgage deal has fallen out of favour", says The Times. Two-year fixed rate mortgages are being traded for longer deals.

According to mortgage platform Twenty7tec, only 23% of searches on its site last month were for two-year fixes, compared with 41% in January 2022.

Meanwhile searches for five-year fixes have been increasing. This is "partly because they have been as cheap as two-year deals" but also because "in an environment of rising interest rates and high inflation, five-year deals have an added advantage for homeowners in that they will keep their mortgage costs fixed for longer".



# Companies face an energy crunch

There are several ways to help mitigate the impact of soaring bills



**David Prosser**  
Business columnist

It is easy to overlook the problems facing small businesses amid the clamour for help for households struggling with soaring energy bills. But with no price cap on energy bills in the business sector, the country's 5.6 million small and medium-sized enterprises are facing huge pressure. The Federation of Small Businesses has warned that over half of all small firms expect to shrink, or even fold over the next 12 months owing to energy costs. Energy groups have called for pandemic-style support packages.

In the meantime there are some steps you can take to protect your business. Regulator Ofgem has implored any firm struggling with rising bills to get in touch with their energy provider as soon as possible.

Ignoring the problem will make it harder to agree

a manageable solution; the business could even be disconnected. The good news is that energy companies are prepared to negotiate long-term payment plans that will help you pay unaffordable bills over an extended period. If you already have such a plan in place you can ask for a second review. Some energy companies have a limited pot of hardship funds available to struggling small businesses, so ask about such resources and your eligibility. You may also be able to negotiate a payment break or reduction.

It's also worth checking that your bill is accurate. If it's based on estimated energy usage, businesses with fewer than ten employees and a turnover of less than £1.8m a year are entitled to certain consumer-style protections. You can't be billed for energy usage that dates from more than 12 months ago.

Many small firms get caught off guard: they agree extended fixed-price contracts so they only find out prices have risen as these come to an end. Plan ahead: know when your



Talk to your energy supplier before it's too late

contract expires, check what you are likely to have to pay, and begin looking for the best deals.

If your contract has ended, check whether rival providers are offering better prices. All providers have raised prices due to soaring wholesale gas costs, but there is some evidence that competition is beginning to

return to the market. Check on a price-comparison service.

## Where to seek help

If your current provider won't agree a repayment plan that works for you, take independent advice. Citizens Advice offers support to small businesses in this position. The Money Advice Trust's Business Debtline service can also help. There are also organisations that offer grants and loans to struggling small businesses. Your local

council may offer some support or links to organisations offering help in your area. The business finance and support finder tool on the gov.uk website is a useful directory too. Grants Online, covering support from charities and similar bodies, is also worth checking.

Ministers urging people to reduce their energy usage have been criticised, but it is definitely worth looking at how your company can cut its costs. The independent Energy Saving Trust offers useful tips on how businesses can use less energy and how they can switch to more sustainable energy sources over the medium to long term.

Finally, watch out for scams. Be very sceptical about contact purportedly from suppliers offering refunds, or from groups claiming they can help firms secure access to the energy grants being made available to households.

## Don't be afraid to collect debt

Are large companies seeking to ease cash-flow problems by passing the burden on to smaller suppliers? New data from accounting group Xero warns that the time it takes small businesses to get paid for invoices rose for the fourth consecutive month in July. On average, payments to small companies were 8.3 days late.

The squeeze on cash flow that late payments can cause could prove disastrous. However, you don't have to take poor treatment lying down. Many firms are now beefing up their collections and debt-recovery teams.

The law is on your side. The default is that customers must pay an invoice within 30 days of receiving it or within 30 days of receiving your goods or services if this comes after the invoice. Unless you have agreed to longer payment terms, you are entitled to interest on any amount outstanding after this time.

Don't be afraid to enforce your rights. Make it clear at the outset what your payment terms are, chase unpaid invoices as the deadline date approaches, and claim the interest you are due.

Small businesses are often reluctant to challenge large suppliers, but in the current market landscape, with many organisations focused on supply-chain risk and resilience, you may have more power than you realise.

## Petty cash... NatWest pays out

- NatWest Bank has been ordered to pay £600,000 in compensation to small businesses it illegally required to open business current accounts in order to secure loans. The Competition and Markets Authority (CMA) said around 700 small businesses had been affected over a three-year period. The firms had applied for loans, but were told the advances would only be forthcoming if they agreed to open bank accounts with NatWest that charged fees. Such "bundling" demands are against the law. The regulator said NatWest's breach was due to a technical issue and told the bank to "implement stronger controls around account opening and better staff training", says the Financial Times.

- More than one in ten small businesses have taken on borrowing specifically to fund sustainability improvements to their business,

research from the British Business Bank reveals. The finance has been invested in projects ranging from energy-efficiency initiatives to electric-vehicle fleets. The British Business Bank has highlighted the growing number of green loans and bonds now available from finance providers, including high-street banks, which often offer more favourable terms than traditional lending.

- More than three-quarters of small businesses would consider offering a four-day working week to staff, new research reveals, with employers arguing that the move could boost productivity as well as employees' well-being. The survey comes as the UK reaches the half-way point in a trial of four-day working at 60 companies, with the experiment due to report its results in December.



# Investing in magic mushrooms

COMPASS Pathways has produced a drug to treat depression based on a psychedelic substance



**Bruce Packard**  
Investment columnist

Rarely do investors have the opportunity to invest in a pharmaceutical company doing clinical trials where the drug awaiting regulatory approval has been in use for decades. The US government has already spent hundreds of millions of dollars researching the safety and efficacy of psychedelics.

Then Richard Nixon, alarmed at the association between LSD and opposition to the Vietnam War, ignored the scientific research and declared his disastrous “War on Drugs”. Psychedelics have since been available, although not legally, and millions of people have experimented with these substances outside clinical settings.

More recently, psychedelics have found a champion in David Nutt, professor of neuropsychopharmacology and head of Imperial College’s Centre for Psychedelic Research. This is the professor dismissed by the Labour government in 2009 for comparing the relative harm done by the illegal drug ecstasy (a mixture of MDMA and amphetamines) with horse riding. Neither his data nor analysis was incorrect, but the home secretary, Alan Johnson, said it was not possible to be both a government adviser and campaign against government policy.

Now investors have the opportunity to invest in companies trying to



*Psilocybin is found in some fungi*

commercialise the use of psychedelics. UK-headquartered COMPASS Pathways (Nasdaq: CMPS) was founded in 2016 by George Goldsmith, who has a background in software and worked as a McKinsey adviser, and Ekaterina Malievskaia, his wife, who is a research professor in public health.

The company listed on America’s Nasdaq in September 2020, with an initial public offering (IPO) that raised \$120m; the group then raised a further \$150m in May last year. As of 30 June the company had \$207m of cash, which it thinks should see it through to 2024. The shares have fallen by 49% in the last 12 months, but have more than doubled from their low in May this year of \$7.

COMPASS has developed COMP360, a crystalline formulation of psilocybin that it has patented in the US and UK and believes will

benefit those struggling with treatment-resistant depression (TRD). It also owns patents related to its manufacturing process. A rival company, Terran Biosciences, alleges that CMPS has stolen trade secrets related to psilocybin.

## How ketamine failed

Effective drugs can still fail trials. For instance, ketamine is used as an anaesthetic in hospitals, looks promising as a psychedelic and is popular as a recreational drug. Yet ketamine failed a drug trial in 2012 because it did not outperform the placebo group when given to cancer patients for pain relief in conjunction with opioids.

COMPASS Pathways has a couple of phase-II trials (the second of three stages of clinical trials) in progress to assess COMP360’s effectiveness. One phase II-trial has already finished and the results were announced in November last

year. The initial reaction was disappointment, with the share price down 16% on the day, because some of the patients reported serious adverse affects, including contemplating suicide. That said, COMP360 looks very positive compared with existing treatments for TRD. COMPASS Pathways expects to begin a phase-III trial – the final phase in the approval process – in the fourth quarter of 2022. That phase-III trial will test COMP360 in conjunction with a traditional selective serotonin re-uptake inhibitor (SSRI) – see explanation below – for TRD.

Even if approval is granted, the path to profitability may not be straightforward. Although COMPASS has a patent on its COMP360 compound, psilocybin itself occurs naturally in 180 species of fungi, so it can’t be patented.

The company warns that it competes with non-profit organisations willing to provide psilocybin-based products at cost, or even for free. There are also companies such as ATAI Life Sciences (also listed on the Nasdaq) seeking to develop new psychedelic compounds, which may prove to be more effective than COMP360.

A further risk to the group’s business model is possible decriminalisation of psychedelics. A subculture already exists of people who obtain psychedelics illegally for therapeutic use with informal “trip-sitters”. Even as Nutt and others make progress to rehabilitate psilocybin, the commercial opportunities could remain some way off.

## How do psychedelics work?

Psychedelics such as psilocybin and LSD are class-A drugs, and anyone caught in possession faces a prison sentence of up to seven years. Unlike traditional anti-depressants, psychedelics appear to work by suppressing the brain’s default mode network (DMN). The DMN is an accidental recent discovery from neuroscience research.

The term was coined in 2001 to describe what the brain does when not consciously occupied with tasks. Researchers using an fMRI scanner wanted to examine which parts of subjects’ brains were active when solving problems or similar focused tasks. To establish a base line for neural activity they asked subjects to relax and not think of anything. To the

researchers’ surprise, they found the brain was only slightly less active in this resting state, yet different areas were in action, which they named the DMN.

Psychedelics appear temporarily to suppress the DMN, then rewire the brain’s connectivity, which means they are particularly effective against TRD and can also treat addiction. A traditional selective

serotonin re-uptake inhibitor (SSRI), a type of antidepressant, might be taken daily, but with a therapy session as infrequently as once every three months.

In COMPASS Pathways’ phase-II trial patients received a single 25mg dose of COMP360 psilocybin with psychological support. The benefit lasted up to 12 weeks. This has implications for

the business model of any company seeking to commercialise its use. In addition to selling COMP360 at a profit, COMPASS also aims to develop a scalable therapy training programme, which could prove expensive. With 100 million TRD sufferers worldwide, psychedelics have huge potential, but making them profitable may prove an uphill struggle.



# Consumed by the cloud

Digital Realty's data-storage business model is moribund. Short the shares



**Matthew Partridge**  
Shares editor

One of the key developments in technology in recent years has been explosive growth in the amount of data produced worldwide. For instance, more photographs have been taken this year than during the entire history of film cameras. Similarly, an estimated 306.4 billion emails and 500 million tweets are sent every day. While much of this digital information will go straight into the electronic equivalent of the recycling bin, a significant portion will be saved. No wonder, then, that demand for data storage has been booming. Over the past two decades, this has been good news for **Digital Realty Trust (NYSE: DLR)**, a real-state investment trust. It builds large data centres, which it then leases to companies who want to store their data.

## Big tech muscles in

However, as short-seller Jim Chanos and others have pointed out, while this model has allowed Digital Realty to grow its share price nearly tenfold since it floated in 2004, the company is increasingly under threat from the rise of "cloud computing", which allows firms to store the data over the internet in servers run by large tech companies such as Microsoft, Google and Amazon. While these firms still need to build physical centres, the huge economies of scale associated with having the centres in one location, as well as the cash-rich tech giants' ability to build and finance them more cheaply, represents an existential threat to Digital Realty's business model.

There are signs that after years of growth, demand for traditional data centres is slowing, with Digital Realty starting to find it more difficult to find enough customers to fill its existing infrastructure. Occupancy rates have fallen from a peak of 93.5% in mid-2015 to 83%. Revenue, having grown by an annual 15% over the last two decades, is henceforth expected to expand by just 5%-7% a year.

*"Occupancy rates at the group's data centres have slid in the past seven years"*



*More photographs have been taken this year than during the entire history of film cameras*

©Getty Images

Perhaps the most compelling reason to be bearish on Digital Realty, however, is that it still trades at 71 times 2023 earnings, a valuation you'd associate with a company growing much faster – not a mature one whose best years are behind it. While it still delivers a solid dividend yield of around 4.2%, this is only possible because it has been paying a dividend greater than its earnings, which is not sustainable in the long run. This relatively high payout has only been possible because the group has kept adding to its debt, an approach that is under threat from rising interest rates.

From a technical perspective, it looks as if the market has soured on the company. It has fallen by around a third from its 52-week high at the beginning of this year and is also trading well below its 50-day moving average. I therefore suggest shorting it at the current price of \$118 at £20 per \$1. I would cover the position at \$167, giving a total downside of £980.

## How my tips have fared

The last fortnight has not been kind to my long tips, with five of the seven falling. Telecoms group Airtel Africa slipped from 138p to 132p, triggering the stop-loss at 135p.

Industrial and construction-equipment rental company Ashtead declined from 4,380p to 4,162p, while Hays Recruitment fell from 120p to 116p. Dunelm dipped from 741p to 723p and Netflix retreated from \$227 to \$226.

The only two exceptions were JD Sports, which advanced from 118p to 126p and Pets At Home, up from 332p to 324p. Counting Airtel Africa, my long tips are making a total profit of £524, down from £823.

The good news is that my short tips have put in a better performance, with three falling and only one rising. Remote medicine firm Teladoc fell from \$32.71 to \$29.97 and digital-currency exchange Coinbase declined from \$71 to \$65.26.

DWAC, the holding company for Donald Trump's social-media venture, depreciated from \$29.95 to \$24.99.

Although Chinese real-estate company KE Holdings rose from \$15.67 to \$16.42, my short tips are making a total profit of £4,140.

My short and long tips are making a total profit of £4,664. There are currently 11 open positions in my portfolio. I am long Ashtead Group, JD Sports, Hays Recruitment, Dunelm, Pets at Home and Netflix; and short Teladoc, KE Holdings, DWAC, Coinbase and Digital Realty.

I suggest that you increase the stop-loss on Ashtead to 2,100p (from 2,005p) and Dunelm to 610p (600p).

In addition, you should cut the price at which you cover Teladoc to \$45 (from \$50), KE Holdings to \$19 (\$20), DWAC to \$40 (\$44) and, finally, Coinbase to \$75 (\$78).

## Trading techniques...using the fear index

One indicator traders pay attention to is the CBOE Volatility index, known as the Vix or the "fear index". This is derived from the price of call and put options, which respectively give you the right to buy or sell an asset at a set price at a set time – in this case the S&P 500 futures on the Chicago Board Options Exchange.

Because the price of the options is determined by the amount of price volatility that traders expect, you can use the price of the options to work out the implied volatility: how risky traders consider

the stockmarket to be. However, there is disagreement over how to interpret the Vix index. Traditionally, a high Vix reading was seen as a sign of negative sentiment, implying that you should sell. But contrarian investors (who like to go against the crowd) frequently argue that it can be a sign of excessive caution, suggesting that there are buying opportunities.

The Vix itself can also be very volatile, so many people prefer to take a rolling average, rather than just the daily figure. On balance the data favours the contrarian interpretation. A study by Schrodgers found that

a strategy of moving to cash whenever Vix hit a level greater than 32.9 (which it has less than 5% of the time) would have underperformed the market by around 2.5% a year between 1990 and 2020. Still, while buying during the spikes in 1998, 2010 and 2011 would have been very profitable, buying at the all-time high in October 2008 would have pushed you into the subsequent market crash. During the pandemic Vix started to spike in late February, although by the time it peaked a few weeks later in March 2020, the market had bottomed out.



# Top-quality companies solving global problems



A professional investor tells us where he'd put his money. This week: Ben Ritchie of the Dunedin Income Growth Investment Trust picks three stocks

At Dunedin Income Growth Investment Trust we focus on delivering both real income growth and attractive total returns from a portfolio of UK equities combined with a few select overseas holdings.

We have a focused portfolio of high-quality companies that meet our sustainable and responsible investment criteria, and also offer attractive potential rates of return. These principles help us mitigate risk by excluding companies we believe face significant threats. It also allows us to identify opportunities for businesses to benefit from the same trends.

## Leading the energy transition

Most oil and gas firms do not make it through our screening process. However, **TotalEnergies (Paris: TTE)** is adapting to the energy transition and making enough progress on lower-carbon energy sources and renewables to allow us to invest. Over half the volume of its production is from natural gas. It also has one of the world's leading liquefied natural gas (LNG) operations in what is an important transition fuel.

Its renewable-energy portfolio is substantial, with plans to more than triple it by 2025. It also has minimal unconventional production, such as shale.

The Transition Pathway Initiative, a global initiative assessing whether firms are ready to transition to a low-carbon economy, estimates that TTE's emissions-reduction target aligns with the Paris Agreement's commitment to limiting global warming to 1.5 degrees. It is one of very few energy companies to meet that target. We're engaging with it to help accelerate its shift towards becoming a firm with strong prospects across LNG, renewable-energy generation and green hydrogen.

*"TotalEnergies plans to triple its renewable-energy portfolio by 2025"*

## Making medicines work better

Speciality chemicals group **Croda International (LSE: CRDA)** is a world leader in supplying active ingredients to the personal-care and life-sciences markets. It operates in niche segments, which, combined with its culture of innovation and strong relationship with clients, has long delivered profit and dividend growth. An example of a recent success is its excipients, the substances that work alongside the active ingredient of a medication. These were central in the deployment of the Pfizer BioNTech Covid-19 vaccine.

Croda's ambition is to be the world's most sustainable supplier of innovative ingredients. This approach gives it a critical edge, exemplified by its new bio-based surfactant plant in Delaware. It's the first of its kind in the US and allows the substitution of oil-based ingredients with natural alternatives.

## Tackling a top global health crisis

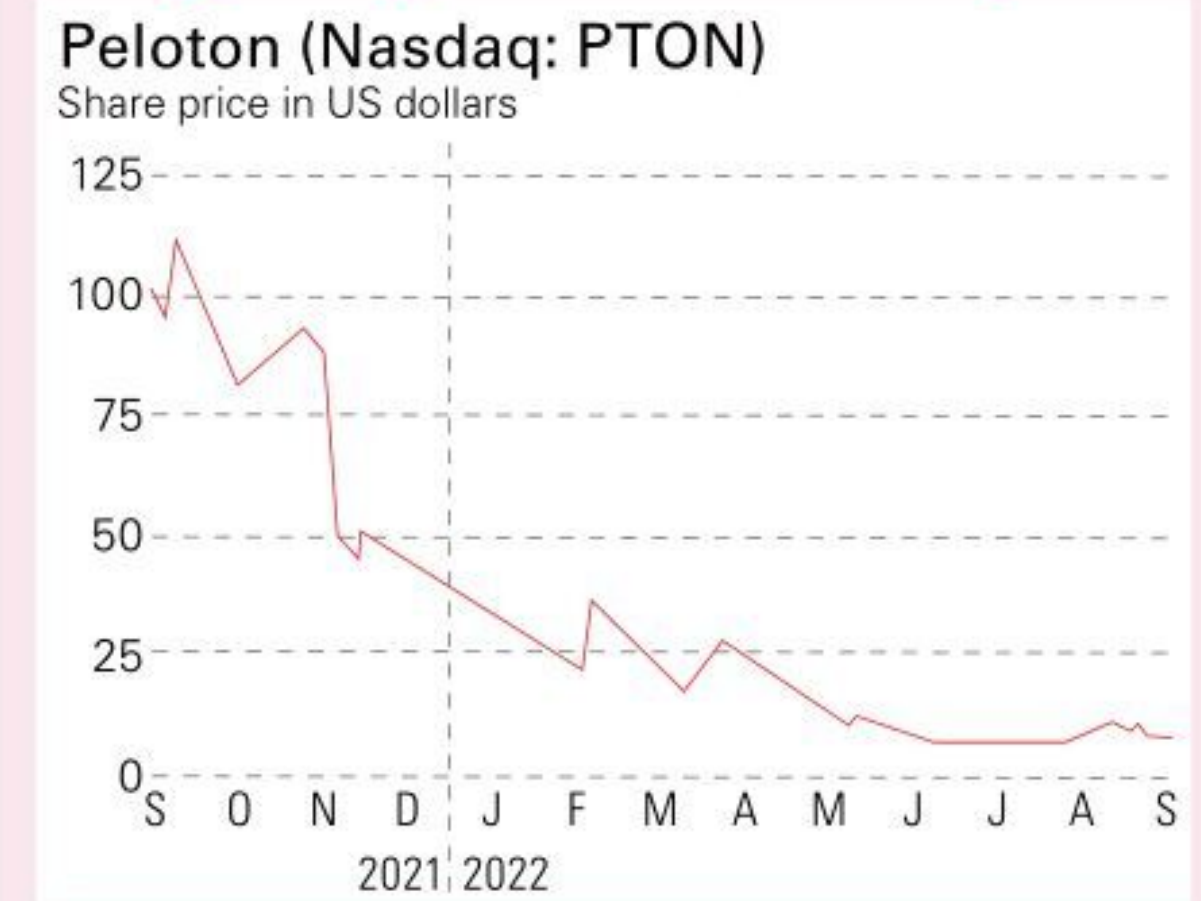
**Novo Nordisk (Copenhagen: NOVOB)** is a world leader in treating diabetes and obesity. Around 500 million people worldwide have diabetes, and eight out of ten live in low- and middle-income countries; less than half of these sufferers are treated. Novo has a critical role to play both in broadening access to treatment and in innovating to provide better care. Control by the Novo Nordisk Foundation ensures a long-term perspective. It has consistently spearheaded the discovery of new medicines, most recently producing the ground-breaking obesity treatment Wegovy. Novo aims to provide access to medicine and solutions to one of the most significant global health challenges while simultaneously building a sustainable, growing business.

## If only you'd invested in...



Discount footwear retailer **Shoe Zone's (LSE: SHOE)** share price has bounced following a rise in profits owing to an increase in sales of back-to-school items and summer shoes, says iNews. The firm said that pre-tax profits for the year to 2 October 2022 would total at least £10.5m. It had already raised forecasts in June and July as the heat wave boosted demand for summer sandals. The business is currently experiencing a significant turnaround after being battered by a £14.6m loss in 2021 during the pandemic. Shoe Zone's stock price has gained 106% over the past 12 months.

## Be glad you didn't buy...



The share price of home-exercise specialist **Peloton (Nasdaq: PTON)** has crashed following losses of \$1.2bn for the quarter to 30 June, says The Guardian. The group has been in the red for six successive quarters. There has been a collapse in demand for its \$1,400-exercise bikes, which were popular during lockdowns but are no longer sought-after now that gyms have reopened. The company is valued at \$3.6bn, a far cry from its 2021 peak of \$50bn. Sales for the three months to 30 September are expected to fall short of estimates. Peloton's share price has slumped by 90% in a year.





# Meme king who sparked a frenzy

Ryan Cohen was credited with saving a clapped-out videogames retailer with little more than a knack for whipping up a social-media storm. His latest intervention has backfired. Jane Lewis reports

The extraordinary rise and fall of Bed Bath & Beyond, the latest hyped US “meme stock”, has had terrible real-world consequences – the firm’s CFO, Gustavo Arnal, was found dead at the foot of his Manhattan building last week, having apparently jumped. His death is a reminder that “there’s more on the line” than a stock price, says *The New York Times*. But the episode has also shone a spotlight on the activities of “meme baron” Ryan Cohen (pictured) – a billionaire investor with a large following of amateur traders and a frightening ability to move markets due to the unshakeable faith of some of his acolytes.



*“Cohen was the man supposed to end Wall Street’s profiteering, not join it”*

## “Did panic... bought more”

Cohen, 37, is the chair of GameStop – the clapped-out videogame store chain at the centre of the January 2021 meme stock frenzy – and he clearly hoped to pull off a similar coup at the struggling homeware retailer. At the start of last month, Bed Bath & Beyond was already one of the most discussed stocks on Reddit’s WallStreetBets social-media channel and shares began surging on reports of Cohen’s involvement, says the *Financial Times*. But when, on 15 August, he filed documents detailing the prior purchase of a large number of call options on the stock, things went into overdrive. Shares shot up 30% in a day, only to start plunging on 17 August when Cohen disclosed he was selling his entire stake. By the time he’d fully closed his position, pocketing some \$68m, Bed Bath & Beyond had suffered the worst one-

day pullback in its history. Some traders got out in time. A 20-year-old student at the University of Southern California reportedly crystallised a \$110m gain after the shares quadrupled in a month. Many others lost their shirts. That didn’t faze loyalists. One trader wrote that it just “wasn’t like him” to “pull the rug out” from under his followers. “Not gonna lie... did panic... but bought more. I have faith in him and this will make sense soon,” said another. But a class-action lawsuit has alleged a “pump and dump” scheme, says the *Daily Mail*, claiming that “a majority shareholder” had approached the CFO with “a plan to control shares of the company” so both could profit. A week later Arnal was dead – leaving Cohen “to face the music”.

Not much is known about the early life of Cohen – beyond the fact that he was raised

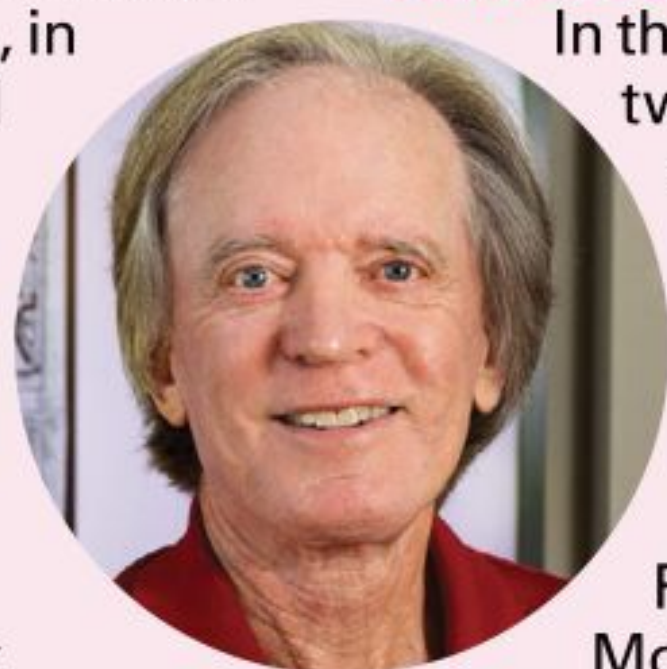
in Montreal, never attended college, and cites his father, Ted, who ran a glassware importing business, as his chief mentor. He struck business gold young, starting Chewy – an online e-commerce business devoted to pets – in 2011, when he was in his mid-20s. Cohen had to work hard to persuade investors to bite – most couldn’t get past the two hurdles of competing head-on with Amazon and the failure of Pets.com after the dotcom crash. But he rode the boom in fancy pet goods and scaled up the business, making headlines when he sold to PetSmart for \$3.35bn – then, “the largest e-commerce acquisition ever”.

## The man with the tendies

Given that track record, it was no surprise that GameStop embraced Cohen when he bought a 13% stake in 2020 and joined its board in 2021, says the FT. “Reddit traders, already interested in the stock because of its heavy interest from short sellers and its low price, saw him as a harbinger of an ecommerce turnaround.” In fact, there’s not much evidence he changed the fundamentals there. What mattered was “his social-media savvy”. Traders felt a sense of “camaraderie” with Cohen, partly because he “hodl’d” his GameStop shares – held on for dear life – in the “mythologised fight” against short sellers. “He was the meme king, the silverback ape, the man with the tendies” who was “supposed to end Wall Street’s profiteering, not join it”, says Vice. (“Tendies” is a slang term for gains or profits.) Instead, he cashed in, leaving many followers feeling betrayed.

## The best trades in history: betting on a bailout

Bill Gross (pictured) was born in Middletown, Ohio, in 1944, and graduated from Duke University in North Carolina. After reading a book on card counting he spent a summer in Las Vegas, making \$10,000 on blackjack before spending three years in the Navy. Later he did an MBA at UCLA and then joined Pacific Mutual Life as a credit analyst, rising through the ranks to the point where he was invited to start a subsidiary, Pacific Investment Management Company (Pimco), where he spent most of his career.



### What was the trade?

In the 1990s and 2000s two US government-sponsored enterprises – the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) – bought and underwrote large numbers of subprime mortgages to help those on low-incomes buy a home. When the subprime market started to collapse, worries about these agencies’ solvency led to a collapse in the value of their debt. Gross, however, felt that the size and

importance of Fannie and Freddie to the US economy meant that the government would be forced to bail them out. He bought large amounts of their debt for Pimco’s main fund.

### What happened?

Gross then called on the US government to bail out the agencies, warning that they were about to collapse and that, without additional support, funds such as Pimco’s would be unwilling to roll over the bonds that were about to mature. This seemingly worked – both agencies were bailed out on 8 September, less than a week before Lehman Bros collapsed. Shareholders and some junior

debt holders were wiped out, but bonds held by Pimco (and others) were not affected.

### Lessons for investors

The value of Pimco’s main fund surged by \$1.7bn on the day that the bailout was announced and Gross also profited from other Fannie and Freddie securities, and from those in AIG and General Motors, at deep discounts. It’s estimated that Gross’s investments in mortgage-backed securities made \$10bn in profits for the Total Return fund over three years. Betting big on an institution considered “too big to fail” can pay off – but it’s a highly risky strategy.



# A beautiful oasis in the Namib desert

An apparently barren landscape can be full of life and grand drama, says Holden Frith

Ten days in the desert may sound more like a punishment than a luxury break, but a trip to Namibia will transform your preconceptions. The dunes and plains of the Namib desert are astonishingly beautiful – and alive with the wildlife that ekes out an existence under the sun.

Nowhere is the line between life and death drawn more clearly than at the twin salt pans of Sossusvlei and Deadvlei. At one, the desert has erupted into life. Underground streams support a lean yet varied ecosystem, including chameleons, sidewinder snakes, springbok, zebra, oryx and ostriches. Leopards too, although you are unlikely to see them. A few hundred yards away, the precarious nature of the oasis is laid bare. No one knows why Deadvlei dried up 900 years ago, but the effect was profound. Plants died and animals departed, leaving only a spectral forest of scorched tree trunks poking up from the pan like dark skeletal fingers.

As you stand among them, your hand on the rough wood and the heat reflecting off the sand, you might be forgiven for craving a little indulgence. It is fortunate, then, that a short drive through the dunes leads to Little Kulala, an elegant sanctuary in the heart of the desert. The camp, run by Wilderness Safaris, consists of 11 timber-and-glass cabins, each with air-conditioning, a plunge pool and a rooftop sundeck. Unlike at other safari lodges, game drives aren't the main draw here. Although you will see wildlife, the real attraction is the desert itself. You can drift above it in a hot-air balloon, blast through it on quad bikes or wander on foot.

What separates Sossusvlei and the Namib from other great spectacles – the Grand Canyon, for example, or Victoria Falls – is that you must share those experiences with busloads of tourists. In Namibia, it's often just you and the desert.



Little Kulala: an elegant sanctuary from the heat

## A bleak excursion

Our next destination, the Skeleton Coast, was even more remote. Modern navigation has reduced the risk of shipwrecks, which gave this northwestern shore its name, but it remains a bleak and unsettling place to visit. A sense of dread hangs in the air, drifting in the wind

laid out like rippled silk. When we had finished exploring, we flew by light aircraft to Hoanib Skeleton Coast, an elegant cluster of canvas-roofed cabins that sit lightly on their desert landscape.

This part of the desert is home to some of Africa's most enigmatic animals. We had been lucky to see a herd of desert-adapted elephants the previous day, a long way off across the floodplain. With smaller bodies, longer legs and broader feet than their African

up by the tyres of passing 4x4s. Most predators live somewhat precarious lives, the odds stacked against them, but the lions of the Namib desert take this to an extreme. They rely on their prey for moisture as well as food, drinking blood to supplement what little water they can find. A lucky few have found the seal colony on the coast, but the one we were tracking had not yet discovered that extravagant buffet.

She tried her luck a couple of times, stalking a distant springbok and sending a herd of oryx scurrying across the dry river bed – but to no avail. Dusk would bring another opportunity to hunt, another role of the dice for predator and prey. And the next morning, the sun would rise again over the rock and sand on which this grand drama unfolds.

*“Although you will see wildlife, the real attraction is the desert itself”*

bush elephant relatives, they can more easily cover the long distances between watering holes. We had seen hyenas too (pictured below right), but a long search for desert lions had turned up nothing but tracks. The next morning would be our final chance.

As it happened, we were barely out of camp when our guide brought the 4x4 to a sharp stop in the pre-dawn gloom. In front of us, sprawled across the track, was a sleeping lion. She looked vulnerable, laid out in the sand, without the tall grass I associate with a big cat in repose. Instead, she had to make do with sand stirred



with tendrils of mist that rob the sun of warmth and cast an odd, flat light.

The only population of note is a vast colony of seals, whose plaintive barks at first offered relief from the barrenness of neighbouring beaches, home to nothing but sun-bleached whale bones. Soon, though, the noise (and smell) drove us inland. The eeriness dissipated as we escaped the fog and found ourselves in a field of dunes



*Holden was a guest of Wilderness Safaris. Its Natural Wonders of Namibia itinerary includes two nights at Sossusvlei and four on the Skeleton Coast. From £14,700 for two, full board, including activities and internal flights within Namibia. International flights extra. Email bookings@wilderness-safaris.com*



# The charm of old-fashioned motoring

Enjoy a classic 1950s Austin-Healey revamped with all mod-cons. Jasper Spires reports

**“Y**ou may well know the recipe by now,” says Alistair Charlton in Forbes – “take one iconic, classic car, remove almost everything and replace it by way of the very finest engineering you can lay your hands on. Add in several hundred thousand dollars, limit the production run to a handful, and charge healthily for the end result.” The result is a “restomod” – in this case the Caton, a lovingly-revamped take on the classic 1950s Austin-Healey that has lost none of the original’s charm.

It may not be all that fast by modern standards – the top speed is just 120mph and the 0-62mph time a leisurely eight seconds – but from the cockpit it feels a lot faster than it is. Caton has rightly focused on handling above power, making for the kind of motoring experience you’d expect from a classic car. The “meaty motor” fires into life with “an unapologetic rasp as it clears its throat”, says Stuart Gallagher in Evo. From that moment on, the “magic” of this small, light, responsive car washes over you, delivering an “all-encompassing” driving experience.

*“There’s never a time when the Caton doesn’t feel like a true Healey”*

It demands attention – “on a warm day you’re working up a sweat, feet jumping across pedals to perfect heel and toe downshifts, right arm commanding the shifts when both hands aren’t required on the busy steering wheel” – but the rewards in terms of fun more than make up for it.

“The further I drive, the more the new touches are appreciated,” says David Lillywhite for Hagerty. “The engine is sublime... The ride is excellent for a sports car of this era... Same goes for the brakes. No tricks, just straightforward, straight-line, wheel-locking stopping power... There’s never a time when the Caton doesn’t feel like a true Healey.” It’s “beautifully finished” too, says Matt Prior in Autocar, and a looker. The limited production run of 25 models will be able to be customised to their new owners’ specifications, but all will enjoy a roomier interior than the original, introducing you again to the pleasures of old-fashioned motoring.

Price: £475,000 (plus donor car). Contact: [caton.uk](http://caton.uk)



## Wine of the week: Champagne Charlie's £500 bottle of fizz

**Charles Heidsieck, Champagne Charlie, Cellared 2017, France**

£590, [hedonism.co.uk](http://hedonism.co.uk);  
£550, [thefinestbubble.com](http://thefinestbubble.com)



**Matthew Jukes**  
Wine columnist

It might seem rather unfortunate that this epic bottle of super-pricey Champagne is launched while we are in the grip of a global recession, and rumours of 15% inflation are circling ominously. But important wine releases have a tempo of their own, so if you are in the market for a wine of this calibre, then sky-rocketing utilities costs are unlikely to be troubling you. You will already know that Charles Heidsieck is a sensational Champagne house. This



year marks the bicentennial of its founder, Charles-Camille Heidsieck (1822-1893), nicknamed “Champagne Charlie” by his friends and customers in the US, where he built a huge following for his Champagnes. This wine has been released as a paean to his indomitable character. Made from a blend of 52% chardonnay and 48% pinot noir using a mighty 80% matured reserve wines back to 1998 with 20% taken from the recent, brilliant 2016 vintage, this is one of the finest wines I have tasted this year.

Only 5,500 bottles were made, and it is designed to be drinking on release, but

there is so much energy here I feel it has another two decades in the tank if you want to see how it evolves. Champagne Charlie was released before – in 1979, 1981, 1982, 1983 and 1985 – but we have waited 37 years from the last bottling for this glorious wine to see the light of day, and it is truly spectacular. Designed to have a profound depth of flavour coupled with incredible freshness, the art of blending has been all but perfected in this wine. It lives up to the hype.

*Matthew Jukes is a winner of the International Wine & Spirit Competition’s Communicator of the Year (MatthewJukes.com)*



This week: properties for around £800,00 – from a renovated house in the hills above San Stefanos, C



▲ **Rose Cottage, Coughton, Ross on Wye.** An updated period property approached via a private, shared lane, with large gardens that include an extensive vegetable garden. It has exposed beams, wood-burning stoves and a large kitchen overlooking the garden. 4 beds, 2 baths, 2 receps, workshop, outbuilding. £750,000 Fine & Country 01989-551093.

▶ **Woodside House, Waberthwaite, Millom, Cumbria.** This traditional farmhouse in the Lake District National Park is now in need of some updating. It has exposed beams, a wood-burning stove, and comes with an attached stone barn and an outbuilding. 4 beds, 2 baths, recep, kitchen, 2.3 acres. £750,000 Finest Properties 015394-68400.



▶ **Tritsi House, North East Corfu, Ionian Islands.** A renovated property in a traditional village in the hills above San Stefanos. It comes with a one-bedroom cottage, a mill and a separate storage area. The house retains its beamed ceilings, old wooden floors and has a covered verandah with views across the sea towards the mountains. 3 beds, 2 baths, recep, kitchen, terrace, gardens, 0.85 acres. £648,000 Chestertons 07824-448700.





torfu, to a three-storey maisonette in a period building in the Clifton area of Bristol



▶ **Manfield, Darlington, County Durham.** A 19th-century village house set behind a large front garden surrounded by mature trees, on a plot of just over half an acre that includes a garage and stables. The house has high ceilings, sash windows, period fireplaces and a fitted kitchen opening onto the dining room, with dual-aspect windows and an Aga. 4 beds, 2 baths, 3 receps, study, playroom, garage, workshop, gardens, 0.58 acres. £795,000 Savills 01904-617821.

▶ **Prince of Wales Road, London NW5.** A spacious, two-bedroom apartment in a mock-Georgian development in Chalk Farm. It has wood floors, underfloor heating and an open-plan living area with a fitted kitchen and bifold doors leading onto a patio garden. 2 baths. £800,000 Dexters 020-7483 6390.



▶ **Oakfield Place, Clifton, Bristol.** A renovated, three-storey maisonette in a period building in Clifton, directly opposite Clifton Lido and close to the shops in Clifton Village. Period features include sash windows that retain their original working shutters, open fireplaces and a ceiling rose in the principal bedroom, which has windows that open onto a balcony. 4 beds, 3 baths, recep, dining kitchen. £795,000 Savills 0117-933 5801.



▶ **The Cottage, Tysoe, Warwick.** A Grade II-listed cottage in a popular village with cottage gardens that include a home office and a brook with a little bridge across it. The house has flagstone floors, beamed ceilings, a sitting room with a large inglenook fireplace and a wood-burning stove, and a triple-aspect kitchen with a Rayburn. 4 beds, bath, recep, garden room, study, breakfast room, greenhouse. £750,000 Hayman Joyce 01608-651188.

▶ **The Pound House, Blagdon Road, near Totnes, Devon.** A renovated, Grade II-listed, 18th-century former cider press. It retains its original, fully operational cider press and has flagstone floors, beamed ceilings, a large sitting room with a beamed, vaulted ceiling and an inglenook fireplace with exposed stonework and a wood-burning stove, and a kitchen with a vaulted, beamed ceiling. 3 beds, 2 baths, 2 receps, study, workshop, terrace with pergola, gardens. £750,000 Marchand Petit 01803-847979.





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## Bridge by Andrew Robson

### Fair's Fair

Should West really reveal his hand (via the Unusual Two Notrumps) when he is unlikely to declare? Declarer took full advantage.

Dealer South

Neither side vulnerable

♠ 72	♠ AJ10	♠ K9654
♥ 10	♥ Q953	♥ KJ8
♦ J10863	♦ A92	♦ Q75
♣ KQJ96	♣ 874	♣ 53

	N	
W		E
	S	

♠ Q83
♥ A7642
♦ K4
♣ A102

### The bidding

<b>South</b>	<b>West</b>	<b>North</b>	<b>East</b>
1NT	2NT*	Dbl**	3♦
3♥***	pass	pass§	pass

- \* Unusual, showing five-five in the minors.
- \*\* Looking to penalise.
- \*\*\* Unorthodox. When partner has suggested doubling the opponents, technically you have two choices: double (with good Trumps), otherwise pass (hoping partner can double).
- § Too flat for Four Hearts, plus North now knows that suits will split poorly.

Declarer ducked West's King of Clubs opening lead and won the Queen of Clubs continuation with his Ace, exhausting East (as declarer knew from the bidding). He cashed the Ace of Hearts, but before he led a second Heart, he took the necessary step of eliminating the Diamonds, cashing the King, crossing to dummy's Ace, then ruffing the third round.

At Trick Seven, declarer led a second Heart and was not surprised to see West discard. East beat dummy's Queen with the King and cashed the Knave. Then, however, thanks to declarer's duck in Clubs and elimination of Diamonds, East was forced to switch to a Spade.

This Spade lead around to dummy's ten was not in itself fatal, as East still had a third-round winner. However, declarer cashed dummy's Ace of Spades and was now in the pleasing position of being able to endplay either opponent.

Declarer could exit with a third Spade to East's King, forcing him to give a ruff-and-discard (a Club going from one hand, a ruff in the other). Fair's fair, he thought, as he opted to endplayed West. Leading a third Club to West's Knave, he could ruff the minor-suit return in one hand, and discard a Spade from the other. Nine tricks made.

For Andrew's four daily BridgeCasts, go to [andrewrobsonbridgecast.com](http://andrewrobsonbridgecast.com)

## Sudoku 1120

	9	5		4	7			
			2	7		1		
7	1				3			
5			1					8
			8	2				
6				5				9
		9			8		4	
	6		7	1				
		7	5		6	9		

To complete MoneyWeek's Sudoku, fill in the squares in the grid so that every row and column and each of the nine 3x3 squares contain all the digits from one to nine. The answer to last week's puzzle is below.

5	3	8	2	6	1	9	4	7
9	1	7	3	4	8	2	6	5
2	4	6	5	9	7	3	8	1
1	8	9	7	3	6	5	2	4
3	2	4	8	5	9	1	7	6
7	6	5	1	2	4	8	3	9
8	9	2	6	7	5	4	1	3
6	5	1	4	8	3	7	9	2
4	7	3	9	1	2	6	5	8

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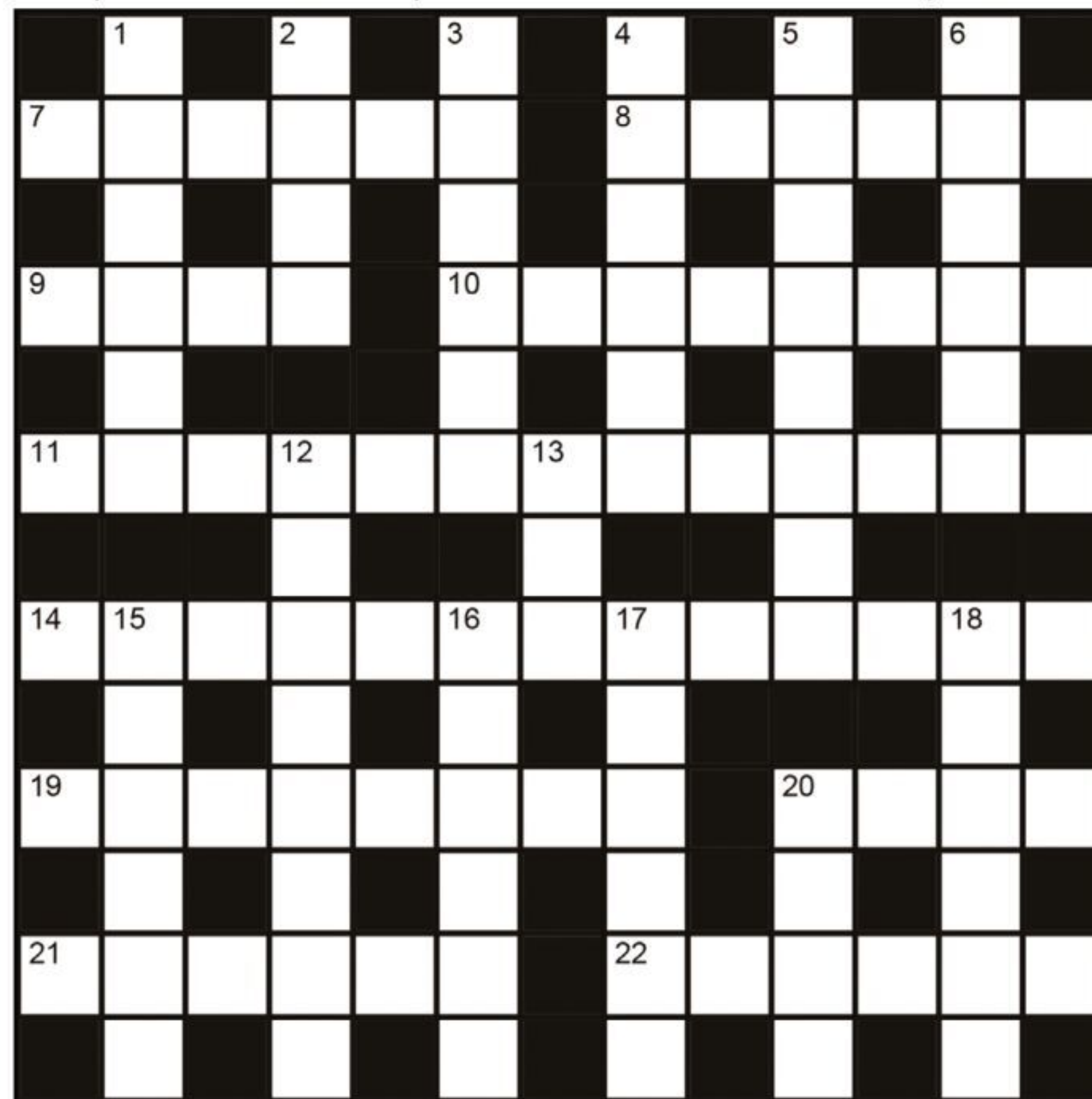
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## Tim Moorey's Quick Crossword No.1120



**TAYLOR'S PORT**

A bottle of Taylor's Late Bottled Vintage will be given to the sender of the first correct solution opened on 19 Sept 2022. By post: send to MoneyWeek's Quick Crossword No.1120, 121-141 Westbourne Terrace, Paddington, London W2 6JR. By email: scan or photograph completed solution and coupon and email to: [crossword@moneyweek.com](mailto:crossword@moneyweek.com) with MoneyWeek Crossword No.1120 in the subject field.



Across clues are mildly cryptic while down clues are straight

### ACROSS

- 7 Father has cut sweet potato and tropical fruit (6)
- 8 A test of heart cavity (6)
- 9 Tropical disease - not mine by the sound of it (4)
- 10 Couple watch, perhaps, for unfaithful partner (3-5)
- 11 Starter that should contain eggs? (5-4, 4)
- 14 Not all notices in order for lots of stars (13)
- 19 Say nothing following change - could be me! (5, 3)
- 20 Cut legs going west (4)
- 21 Name on the door? (6)
- 22 Sounds like pub row under control (2, 4)

### DOWN

- 1 African republic (6)
- 2 Student festivities (4)
- 3 Weasel-like mammal (6)
- 4 Renowned (6)
- 5 Christmas present for boys (5, 3)
- 6 A French cake (6)
- 12 Climbs down (8)
- 13 Slippery fish (3)
- 15 Lubricant container (6)
- 16 Western English city (6)
- 17 A short casual visit (4-2)
- 18 The East (6)
- 20 Town in Greater Manchester (4)

Name .....

Address .....

email .....

### Solutions to 1118

**Across** 7 Delegate *homophone Delhi-gate* 8 Step reversal 9 Roulette wheel *deceptive definition* 10 Trotter *r inside totter* 12 Basil *two definitions* 14 Evita *hidden* 16 Garland *deceptive definition* 19 Britney Spears *anagram* 21 Dada *DA DA* 22 Turnover *deceptive definition*.

**Down** 1 Lego 2 Merlot 3 Waltzes 4 Beret 5 Ischia 6 Venetian 11 Reversal 13 Hansard 15 Titian 17 Lie low 18 Perth 20 Rues.

The winner of MoneyWeek Quick Crossword No.1118 is: John Coombes of Dibden

Tim Moorey is author of *How To Crack Cryptic Crosswords*, published by HarperCollins, and runs crossword workshops ([timmoorey.com](http://timmoorey.com))

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# Jay Powell tightens the taps

But will he really turn so tight as to cause a credit drought? We doubt it



**Bill Bonner**  
Columnist

Federal Reserve chief Jerome Powell has been hinting that he intends to “pull a Volcker” – that is, to emulate Eighties Fed chief Paul and get a grip on inflation by massively tightening monetary policy. We still don’t believe it. For now, Powell can pose as a steadfast inflation fighter without taking casualties. Employment is high. Stocks are high. Interest rates are still low. And houses are still selling near their peak prices.

But it is only by getting lending rates above the level of consumer price hikes that the Fed can control inflation. At today’s 8.5% CPI, that would mean interest rates around 10%. And if applied to all the debt outstanding that would cost the US economy \$9trn per year – or more than a third of

total GDP. It’s not going to happen. What can happen is that the Fed’s

gradually increasing interest rates will put the economy into a deeper recession. Then, people stop buying, businesses fail, jobs are lost and prices fall. Most likely, we’ll see the two converge – rising rates from the Fed coming up to meet falling consumer prices – leaving us with positive (above zero after inflation) interest rates.

At the same time, the Fed is also stepping up its “QT” programme – instead of buying bonds, in other



*Powell: pulling a Volcker will lead to pain*

words, the Fed will be selling them (or letting existing bond holdings expire). And here is where the battle against inflation becomes a fight for survival. It’s where the pain really begins and where the Fed begins to fear for its own safety, because if the

Fed isn’t buying US bonds, who will? And if fewer buyers appear at the Treasury bond auctions, bond prices will fall, and bond yields will rise. And as Treasury yields go up, mortgage rates will go up too. And soon, there will be angry mobs forming with Powell in their sights.

Without the Fed there to buy up bonds (providing more cash and credit, more “liquidity”), borrowers will have to depend on real savers. But the savings rate has been going down since the Covid-19 panic and now stands at around 5% – or

less than \$1trn per year. The US government is still running deficits and expects to borrow more than \$1trn in the 2022 financial year.

You can do the maths as well as we can. If all the available savings are gobbled up by the federal government, private corporations, local governments and mortgage lenders will be starved of credit. Then we will see something we haven’t seen for many years: a bidding war – not for houses, not for meme stocks, not for petrol, but for scarce credit. In effect, the Fed is doing to the US credit market what the Russians are doing to the European gas market – cutting off supplies. The price is going to go up. Mortgage rates will go up. The price of housing will go down. And the whole economy will tip into a deeper recession. Then we will see what stuff Jay Powell is really made of.

**“To put a lid on inflation rates would have to go to 10%. Not going to happen”**

Fewer buyers appear at the

## The bottom line

**\$386m** The sum spent on a scheme to help retrain US military veterans left unemployed by the Covid-19 pandemic. It aimed to give at least 12 months of tuition to applicants who had served in the US armed forces. The scheme was a flop. Only 6,800 veterans enrolled and just 397 individuals have landed jobs as a result.

**£250,000** The value of 264 gold coins, dating to the reign of King James I, found buried beneath a Yorkshire couple’s floor. The discovery was made at their 18th-century detached property as the

homeowners relaid their kitchen floor. London auctioneers Spink & Son think the coins were pressed sometime between 1610 and 1727.

**£942m** The value of a 1,800kg stash of methamphetamine, or “crystal meth”, found inside a shipping container that arrived at Port Botany, Sydney. The drug was disguised in crates of imported marble slabs and in a 1960s Bentley.

**\$3.6bn** The reported operating profits of entertainment giant Disney, marking a 50%

year-on-year rise. A key driver was increased demand for theme-park holidays over the summer, despite fears that inflation would dampen consumption.

**£883** The cost of completing the latest Panini Football World Cup sticker album. You need to collect 670 stickers, and a pack of five costs 90p. But accounting for the probability of buying stickers you already have means the total cost could be more like £883.

**£1m** The compensation demanded from Simon Cowell’s entertainment company SyCo for the alleged mistreatment of *X-Factor* contestants. Five solo acts and one group claim that they suffered bullying and neglect of their mental well-being during their time spent on the talent-scouting show.



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