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TIME TO BUY HOUSEBUILDERS

Valuations are cheap and dividends are generous

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- **GOLD** IS BACK IN THE SPOTLIGHT

The importance of having an open mind in investing

Don't get emotionally attached to stocks as you may be blind to big changes

It can be hard to change your opinion of a stock or a fund manager if you have an established view of something or someone. Having an open mind can, however, lead to better investment decisions if there is information that warrants rethinking your view.

This theme is central to our article on housebuilders in this week's edition of *Shares*. We correctly said to sell last summer and now we're saying to buy back in on a selective basis.

You may think we are crazy given all the headlines about slowing house price growth, the troubles people are having in selling homes, profit margins being squeezed across the industry, and the negative impact Brexit could have on the property market.

We agree, it does look gloomy. Yet we've weighed up the facts and looked at the financial situation of housebuilders, together with valuations, and concluded that the risk/reward balance swings in favour of owning the shares.

You're likely to make most of your money through dividends rather than share price gains as it is hard to see what would spark a massive rally in the sector, apart from a smooth Brexit agreement pushing up the pound or a sudden property market recovery.

On the flipside, if the Brexit process gets even more complicated the housebuilding sector could fall in value as its shares are heavily influenced by market sentiment towards the UK and its currency.

Our change in stance provides a good reminder that you should challenge your thinking and ask if something successful is now a 'sell' or something unsuccessful is now a 'buy'.

Don't get emotionally attached when you buy a share. If someone has backed a winner, many investors stay committed when times get harder and are blinkered to problems when they emerge.

Many fund managers don't think twice about selling a great business if the shares have gone into excessive valuation territory, or they consider a purchase if valuations have slumped into bargain territory. They follow a process and don't let emotions get in the way of their decision-making.

Financial analysts can also change their mind on stocks if there is enough evidence to warrant a reappraisal.

For example, Shore Capital analyst Robin Speakman has been cautious on outsourcing group **Serco (SRP)** for some time, but his research notes have been quite balanced, flagging both positives and negatives.

Quite often analysts with a neutral or negative stance on a stock can be too dismissive of a business and one-sided in their commentary.

After careful consideration and more than two years of having a 'hold' rating, Speakman finally switched his rating to 'buy' on 9 January following a material contract win. 'This bring greater visibility of profit improvement and the return to positive cash generation. This allows us to consider fundamental valuation criteria for the first time since the group entered its major restructuring programme in 2014,' he says.

Many investors wouldn't dream of touching Serco given a history of setbacks, yet having an open mind can mean you pick up on ideas which, if successful, are often missed by the market until months later.

By **Daniel Coatsworth** Editor

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*Source: Morningstar, share price, total return as at 30.09.18. †Ongoing charges as at 31.03.18. Your call may be recorded for training or monitoring purposes.Scottish Mortgage Investment Trust PLC is available through the Baillie Gifford Investment Trust Share Plan and the Investment Trust ISA, which are managed by Baillie Gifford Savings Management Limited (BGSM). BGSM is an affiliate of Baillie Gifford & Co Limited, which is the manager and secretary of Scottish Mortgage Investment Trust PLC.

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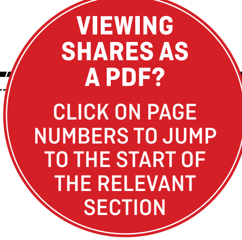

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What Theresa May's historic Brexit defeat means for markets

All outcomes remain possible with the UK's scheduled exit from the UK just weeks away

In the immediate aftermath of the devastating defeat of Theresa May's Brexit plan in the House of Commons on 15 January sterling, the key market barometer on Brexit, went up in value.

Investors will have priced in a vote against the deal, which was widely predicted across the board, but the scale of the defeat, unprecedented in modern parliamentary history, likely means May cannot return to MPs offering a similar deal with only slight tweaks.

Judging by the initial reaction in the pound, there are hopes this will be a catalyst for a softer Brexit outcome but really very little has changed with a deal, no deal, general election, second referendum and even no Brexit all still on the table.

As we write May is widely predicted to survive a motion of no confidence brought by Labour leader Jeremy Corbyn. Attention will then turn to Monday 21 January when she will need to update MPs on her plans.

Even if she loses the vote or if there is a change of leadership forced by her own party the parliamentary arithmetic means her successor would face a very similar challenge.

You should expect sterling to rally on any sign that Article 50 is to be extended as this would remove the immediate cliff edge created by the scheduled departure date of 29 March, though it would also prolong the uncertainty.

WOULD 'NO DEAL' AT LEAST OFFER CERTAINTY?

Some observers think the relatively certainty provided by a no-deal Brexit would make it a preferred outcome for markets.

Franklin Templeton's head of European fixed income David Zahn, who puts the chances of a no-deal outcome at 30% to 35%, says: 'Two and a half years ago, with all the options for a negotiated

Brexit on the table, a hard Brexit seemed to be the worst-case scenario.

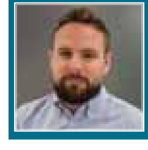
'Now, markets may feel that it's preferable to bring an end to the uncertainty and accept the short-term pain.'

Ahead of the vote hedge fund manager Crispin Odey, who was a significant donor to the Brexit campaign, said he expected Brexit to be abandoned and was positioning for a rally in sterling.

Ultimately the situation remains highly unpredictable, although one thing is clear. Without fresh legislation or a delay to, or rescinding of, Article 50 the UK will leave the EU on 29 March.

This is the scenario with the path of least resistance, while all other outcomes will require *something* to happen.

And until there is greater clarity on what comes next, sterling and UK-focused assets, including the shares of housebuilders, UK real estate firms and banks, are likely to remain volatile.



By **Tom Sieber** Deputy Editor

Gambling stocks under pressure on threat of further regulatory clampdown

Two developments in the UK and US have weighed on shares in betting companies this year

A potential clampdown on using credit cards to gamble in the UK and a possible ban on online gambling in the US may put UK-listed gambling companies under even more pressure this year.

Gambling companies have been struggling with an intense regulatory clampdown both overseas and in the UK as authorities aim to help and protect problem gamblers.

UK culture secretary Jeremy Wright has warned credit cards could be banned for making bets in a bid to reduce people betting with money they may not actually have.

Approximately one fifth of deposits are funded by credit cards according to Canaccord Genuity analyst Simon Davies.

'There would undoubtedly be an impact and it is unhelpful for sector sentiment, suggesting scope for a further regulatory squeeze,' he comments.

The UK Government is currently working on ways to reduce problem gambling by looking at risks for both online and offline activities.

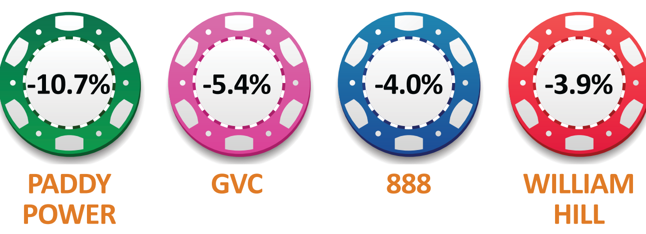
Matters have not been helped by apparent failings in the self-exclusion scheme GamStop as an investigation revealed people could still place bets despite banning themselves from online platforms.

POTENTIAL US ONLINE GAMBLING BAN

This is not the only headwind facing the gambling sector as the US Department of Justice has changed its interpretation of the 1961 Wire Act, according to reports.

Initially under the Wire Act, which applies to transactions across state borders, only sports betting was illegal. A change in interpretation could make all online gambling illegal over state borders, not just sports betting.

UK-QUOTED GAMBLING SECTOR 1 WEEK SHARE PRICE DECLINES



8 Jan 2019 market close to 2pm 15 Jan 2019

Peel Hunt analyst Ivor Jones says the implications of the department's change of heart may not become clear until the US government returns from shutdown or if prosecutions start.

There is little official information with Peel Hunt currently relying on unofficial sources as US government websites are currently not being updated in the shutdown.

Jones flags it will be a challenge keeping every aspect of internet gambling within a state. Problems could emerge with payment processes, inter-state poker and daily fantasy sports, which partly operate across state borders.

The Department of Justice's U-turn comes at an odd time as the US recently legalised sports betting in individual states, offering embattled gambling operators an attractive growth opportunity. Many UK operators have subsequently made in-roads to exploit this new market.

The US sports betting market could be worth up to $9bn in gross gaming revenues according to gaming consultant Global Market Advisors.

By **Lisa-Marie Janes** Reporter

Updates from recruiters imply resilient UK jobs market ahead of Brexit

Hays, PageGroup and Robert Walters provide insight into UK recruitment activity

We have a better picture of how the UK jobs market looks as we approach Brexit now that all three big UK-listed recruitment firms have reported quarterly results.

At **Hays (HAS)**, the UK's biggest recruitment firm, UK net fee income was up 3% in the most recent quarter, the same rate as the previous quarter.

At **PageGroup (PAGE)** UK net fees grew by 2.1%, better than the previous quarter, while at **Robert Walters (RWA)** UK net fees were up 2% against 4% in the previous quarter.

For Hays, the public sector is the main driver with permanent hiring up sharply on last year. The NHS is a major client with Hays supplying IT professionals to the service at all levels.

Demand from private businesses has been more or less flat for both permanent and temporary staff. However chief executive Paul Venables points out that 'candidate confidence is improving' for professional roles.

Companies that have put a hold on hiring due to Brexit uncertainty are finding they don't have the human resources to replace staff who leave.

PageGroup's clerical and support staffing business Page Personnel has been a big driver for its earnings with fees up 12% in its latest quarter and 17% in the previous quarter.

By contrast its Michael Page business which is geared towards more senior candidates saw fees fall by 1% last quarter and 4% in the previous quarter.

Areas like the North West are attracting a growing number of professionals, helping to increase overall wage inflation.

Hays reported a 14% increase in fees from the North West in its most recent quarter compared with 3% growth in London and an 8% fall in the South East.

The other recruiters don't give specific details but they confirm that growth in the regions and the North West in particular is putting London in the shade.

According to the Office for National Statistics (ONS), average weekly earnings for full-time workers and some part-time workers have been rising at a faster rate since last summer than in the previous three years.

Earnings growth has now topped 3.5%, the fastest rate since 2008, with the highest earnings growth being recorded in the lowest-paid jobs. Earnings for those 'in continuous employment', or in other words those people who didn't change jobs, rose by over 5% last year according to the ONS.

Overall the reports from the recruitment firms and figures on wage growth suggest that despite the uncertainty over Brexit, UK firms are still hiring. London and the South East may no longer be the driving force but the North West and other regions seem more than able to pick up the slack.

By **Ian Conway** Senior Reporter

BooHoo, JD Sports, Flybe and other recent news

We look at some of the key announcements and share price movers over the past week

Festive updates from the retail sector continued to trickle in with **JD Sports Fashion (JD.)** and **BooHoo (BOO:AIM)** joining the list of Christmas winners in the sector.

The update from JD on 14 January didn't break out the Christmas period but said like-for-like growth remained 'consistently positive' over both Christmas and Black Friday in the context of a 5% increase in like-for-like sales in the 48-week period to 5 January as a whole.

The company also managed to maintain gross margins year-on-year, suggesting it was able to avoid heavy discounting to sustain this strong sales performance. Investors reacted very positively to the announcement.

Online 'fast' fashion specialist **BooHoo (BOO:AIM)** also managed a strong showing on sales growth and profitability on 15 January.

Its shares fell though as the market seemed to focus on a slight trim to the upper end of margin guidance and a worse than expected performance from some of its brands.

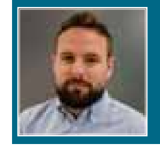
Faring badly was car parts-to-cycling retailer **Halfords (HFD)** which blamed the weather and a weak consumer backdrop while warning profit would fall short of expectations in both the current financial year to 30 March 2019 and the next year.

Revolution Bars (RBG:AIM) served up its own profit warning on 14 January thanks to a dreaded combination of falling sales and rising costs as well as a cautious outlook.

With the shares falling to an all-time low below 100p, the decision by shareholders to reject a recommended offer from Stonegate Pub Company at 203p per share in 2017 is cast in an unfavourable light.

Shareholders in regional airline **Flybe (FLYB)** received a nasty shock on 11 January as it agreed a £2.2m / 1p per share takeover bid from a consortium which includes Virgin Atlantic and Southend Airport-owner **Stobart (STOB)**. This deal was sweetened slightly on 15 January with a £2.8m revised offer.

The fact these offers came in so far below the company's market value pre-bid, when it had traded at more than 16p per share, and that £10m of a £20m bridge loan is having to be released immediately to support ongoing operations, shows the dire financial circumstances the business was in.


By **Tom Sieber** Deputy Editor

Buy BAE Systems for steady growth and tasty dividends at an attractive price

Shares in the defence firm look oversold, so buy now ahead of a potential big share price catalyst in February

Shares in defence firm **BAE Systems (BA.)** have fallen by 25% over the past six months, creating an attractive buying opportunity. We think some of the concerns which have weighed on the share price are overdone and would look to full year results on 21 February as an early catalyst for the stock to recover. Buy ahead of that event.

The weakness in the shares has left them trading on a 2019 price-to-earnings ratio of 11.2-times, below the 20-year average of 11.5-times. They also offer a prospective dividend yield of 4.6% backed by robust and improving cash generation.

Investment bank Berenberg says: 'BAE is entering a period of low but steady growth underpinned by long-term programmes. Favourable mix from higher-growth US activities should drive growth in earnings per share of around 6% a year.'

We think this 'steady growth' at an undemanding valuation is likely to prove attractive to investors, particularly given the company's relative insulation from Brexit.

It has very limited direct trade with countries in the European Union and as a low volume producer of expensive and high-tech kit for the defence industry, it is not as reliant on just-in-time supply chains as other industrial firms.

BAE SYSTEMS ↗ BUY
(BA.) 503p
Stop loss: 400p

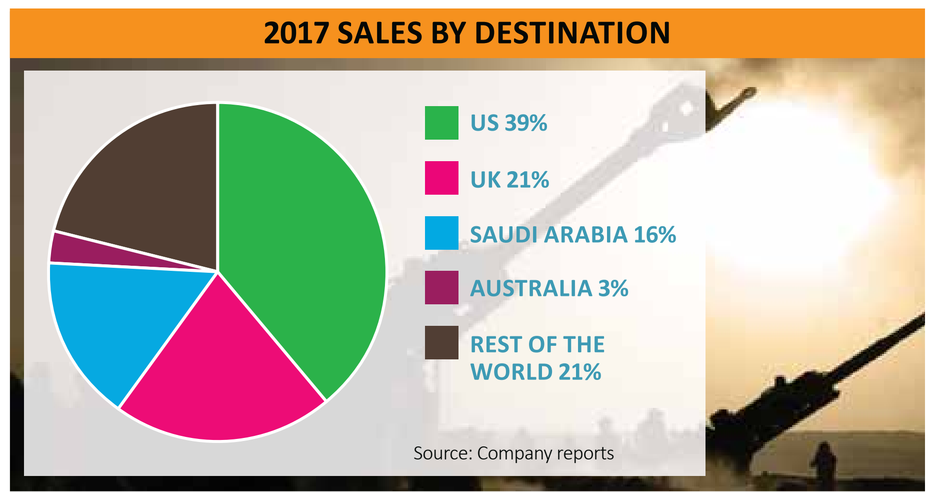
Market cap: £16.1bn

WHAT DOES IT DO?

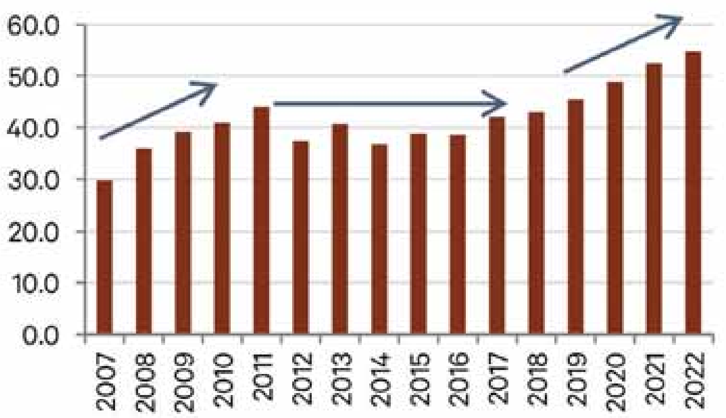
BAE Systems was formed in November 1999 by a combination of British Aerospace and Marconi Electronic Systems.

British Aerospace itself came into being through the nationalisation and merger of several UK aerospace and defence firms in 1977 while Marconi Electronic Systems was spun out of UK industrial conglomerate GEC.

Despite this strong British heritage and a still-dominant position in the UK, today the company has a truly global horizon. It is a top-six supplier to the US Department of Defense and has a big footprint in several



A RETURN TO EARNINGS PER SHARE GROWTH IS FORECAST



Source: Berenberg estimates, Datastream

international defence markets including Saudi Arabia, Australia and India.

The company's operations span the defence sector and include the design, manufacture, upgrade and support of combat aircraft, land vehicles and ships as well as offering engineering, commercial, financial and human resource services, electronics and, increasingly, cyber security.

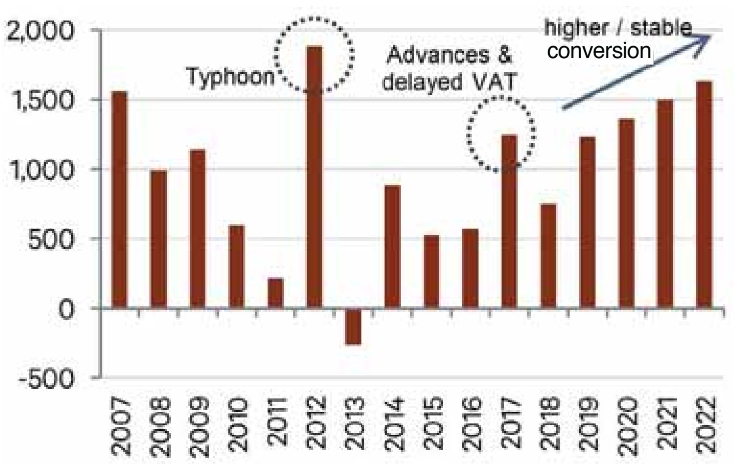
The company secured several significant new orders in 2018 which should support sales over the long-term. These included a £5bn order from Qatar for 24 Typhoon fighter jets and nine Hawk advanced jet trainers.

BAE was selected to deliver Australia's nine-ship SEA 5000 programme based on its anti-submarine Type 26 frigate, which was also chosen for the Canadian Surface Combatant programme.

It was picked by the US Marine Corps to deliver its amphibious combat vehicle, in a contract initially worth a relatively modest $198m but with options which could increase the size of the opportunity materially over time.

In the UK, in addition to ongoing funding for the Astute submarine programmes, BAE received around £600m for continuing design and development work on the nuclear successor submarine programme.

FREE CASH FLOW (£M) IS EXPECTED TO GROW STEADILY



Source: Company reports, Berenberg estimates

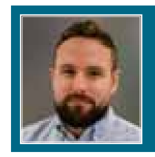
With several of these awards linked to major programmes, which are less likely to be cut, delayed or cancelled, and around 45% of the company's sales derived from services and support work, we think there is decent visibility on future revenue growth.

WHAT ARE THE MAIN RISKS FACING THE COMPANY?

A key area of uncertainty lies around the £10bn follow-on order of 48 new Typhoon jets from Saudi Arabia. The deal was green-lit in March but has not been finalised. The spotlight is currently on Saudi Arabia over the killing of journalist Jamal Khashoggi in October 2018, and this may delay progress here.

The company's other support and maintenance work in the country, though it is fairly entrenched, could be threatened if there is a change of government in the UK given Labour leader Jeremy Corbyn's call for a suspension of Saudi Arabian arms sales.

These are some of the risks prospective investors in the company need to weigh. Another one is pressure on defence spending in the US and UK. However, the company looks relatively well positioned thanks to a focus on major equipment orders in the UK where the Ministry of Defence has limited scope to bin contracts, and areas of potentially significant growth in the US, including in weapons systems and electronic warfare.



By **Tom Sieber**
Deputy Editor

Fidelity European Values is just the ticket for current market conditions

Value is back in fashion and this investment trust is a great way to access quality stocks

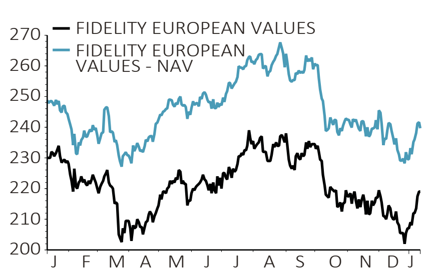
Investors wanting exposure to decent companies at a relatively cheap price and via a liquid fund whose portfolio is a bit different to what you might expect should snap up **Fidelity European Values (FEV)**.

Its objective is to achieve long-term growth in both capital and income by investing in European-listed companies. Fund manager Sam Morse has considerable expertise in picking stocks and has helped the fund's net asset value (NAV) to beat the FTSE World Europe ex-UK total return benchmark consistently over the last five years.

Fidelity European Values is the largest fund in its peer group with nearly £1bn of assets but it runs a relatively concentrated portfolio of just 50 to 60 stocks.

While none of the big blue-chip names such as L'Oreal, Nestle, Roche or Total are companies undergoing rapid expansion, they meet the quality and growth criteria needed for the fund to mitigate downside risk in the event of market sell-offs.

FIDELITY EUROPEAN VALUES BUY
(FEV) 214.5p
Stop loss: 170p



The fact European Values invests in large-cap, liquid blue-chip stocks doesn't mean it is slow-moving or an 'index hugger'. Quite the opposite, Morse not only manages the fund actively but is able to use derivatives to nimbly hedge the market risk or to improve returns by shorting stocks, namely profiting if certain companies fall in value.

As the table shows, the fund can have very different individual stock weightings compared with the index.

A disciplined focus on owning high-quality stocks which are trading below intrinsic value and which have the potential to pay out a steadily rising stream of dividends is the key to generating above-average returns.

That and a long-term view which enables the fund to hold onto stocks for three to five years, compounding returns for investors while keeping trading costs low in the process.

At the time of writing the NAV was 242p against a share price of 214.5p meaning the discount to NAV had widened to 11.4% against a one year average of 9.8% and a three year average of 9.2%.

It means investors can buy the investment trust even cheaper than normal and also obtain exposure to a portfolio trading well below the value of its underlying holdings.

FIDELITY EURO VALUES HOLDINGS

	% of Fund	Index	Difference
Nestle	6.9%	4.2%	2.7%
Sanofi	4.2%	1.6%	2.6%
Royal Dutch Shell	2.5%	0.0%	2.5%
L'Oreal	3.3%	0.9%	2.3%
BASF	0.0%	1.1%	-1.1%
Unilever	0.0%	1.4%	-1.4%
Allianz	0.0%	1.5%	-1.5%
Novartis	0.0%	3.2%	-3.2%

By **Ian Conway**
Senior Reporter

29 January 2019 – Business Design Centre, London

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Steven Frazer*, News Editor – Shares*
Richard Penny*, Fund Manager – CRUX Asset Management*
Gervais Williams*, Senior Executive Director – Miton Group*

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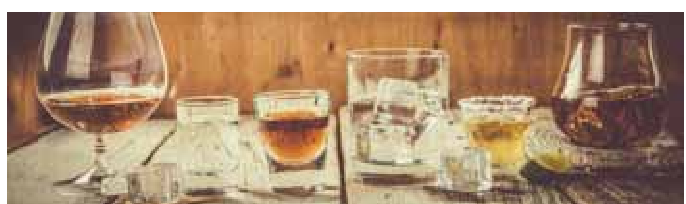
EI GROUP
(EIG) 202.5p

Gain to date: 18.4%

Original entry point:

Buy at 171p, 8 November 2018



UK PUB OPERATOR **EI Group (EIG)** has announced the long-awaited sale of its commercial properties portfolio for £348m.

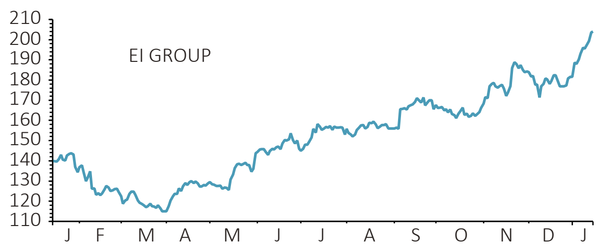
The portfolio of 370 sites is being sold to US hedge fund Davidson Kempner Capital.

The sale price is in line with book value and is the equivalent of 13 times earnings. The money will be used to reduce debt and analysts think it could also potentially fund a special dividend.

EI currently trades at a 40% discount to its net asset value (NAV) of £1.5bn. Canaccord Genuity analyst Nigel Parson says: 'We would expect the discount to narrow as the market becomes more comfortable with the robustness of the NAV.'

Liberum analyst Anna Barnfather says the property disposal is a significant event. She comments: 'Ei Group's successful disposal of a large portfolio of commercial properties is a game changer, allowing more rapid deleverage and leaving scope for cash returns to shareholders while underscoring the underlying net asset valuation of the group.

'This is not a one-off, but should now be an ongoing strategy transferring value from debt holders to shareholders.'



SHARES SAYS: ↗
Keep buying.

MARLOWE
(MRL:AIM) 389p

Loss to date: 8.7%

Original entry point:

Buy at 426p, 28 June 2018

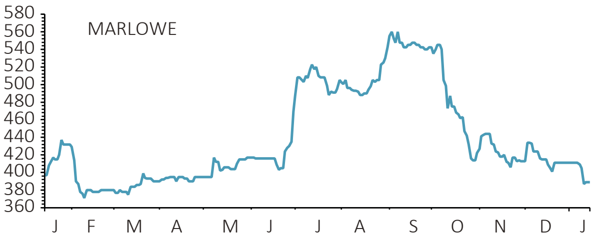
DON'T BE DISMAYED by **Marlowe's (MRL:AIM)** share price failing to keep up with the broader market this year. While equities in general have started to move forward in 2019, Marlowe has drifted down slightly and we see no reason for the price weakness.

The fire and water safety expert raised £7m just before Christmas at 410p per share, which was a 2.2% premium to the market price at the time and the fundraising was oversubscribed, showing that institutional investors remain eager to support the company's growth plans.

It used that money, plus existing cash and debt facilities, to buy William Martin, a property-related health and safety audit and consultancy service group, for £30m. A large amount of William Martin's earnings are recurring and it made £2.4m pre-tax profit in the most recent financial year.

Marlowe says the acquisition will be at least 10% earnings enhancing in the first full year of ownership, which one would have thought would be positive for the share price.

In fact, broker Cenkos upgraded its adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) forecasts for the year to March 2020 by 20% to £14m. This comes off the back of similar upgrades to earnings in December for the current financial year and 2020 following its half year results.



SHARES SAYS: ↗
Positive earnings momentum is normally a good share price catalyst so remain patient. We remain big fans of the stock. Keep buying.

ELAND OIL & GAS

(ELA:AIM) 124p

Gain to date: 17.5%

Original entry point:

Buy at 105.5p, 10 January 2019

OUR POSITIVE CALL on **Eland Oil & Gas (ELA:AIM)** in last week's issue is already off to a strong start with an operational update (15 Jan) reinforcing our confidence in the company.

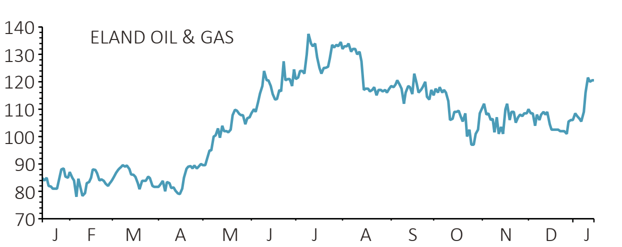
Production guidance for 2019 is between 14,000 and 17,000 barrels of oil equivalent per day, so likely to be at least double the average output achieved in 2018.

The majority of this output will come from its flagship OML 40 licence but the company also expects a modest contribution from its Ubima field, thereby providing some diversification in its production.

The company reported a year-end net debt position of $4.7m but adds that post year-end it has received $20m from Nigerian state oil firm NPDC for its share of costs on two recent development wells.

Capital expenditure in 2019 is expected to be $80m to $90m and the company has committed to drilling its first exploration well on the Amobe prospect at the end of the second quarter, quoting potential resources of 78m barrels with a 42% probability of success.

Broker Cantor Fitzgerald comments: '(2018 was) a transformational year for Eland, which saw a step-change in production from Opuama and the diversification of its producing asset base. 2019 is shaping up to provide more of the same, with the first exploration well in the company's history and commercial production from Ubima in the near-term.'



SHARES SAYS: ↗

Keep buying.

C&C

(CCR) €3.19

Loss to date: 4.5%

Original entry point:

Buy at €3.34, 8 November 2018

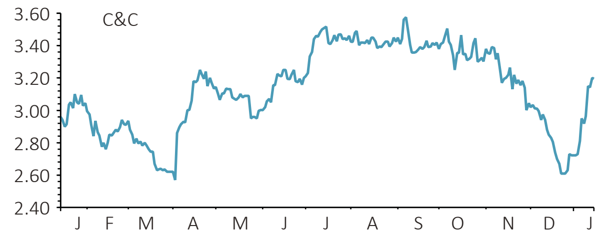
OUR BULLISH CALL on Irish brewer **C&C (CCR)** may be 4.5% underwater, but we're optimistic a recent share price rebound has further to go.

The premium drinks company behind *Bulmers*, *Tennent's* and *Magners* issued a positive update (10 Jan) covering the four months to 31 December, with C&C trading in line with expectations.

We originally argued Dublin-headquartered C&C was at a turning point following the acquisition of Matthew Clark and Bibendum out of the ashes of Conviviality. So it was pleasing to learn that operational delivery and customer service at both Matthew Clark and Bibendum were 'very strong and ahead of plan' in the four month period and the two businesses delivered 'an exceptional operating performance over the key Christmas period'.

Across the rest of C&C, positive trading momentum has continued into the second half and CEO Stephen Glancey seems confident about the outlook for the beer, cider, wine and spirits seller.

'In Scotland and Ireland our combination of leading brands and distribution assets is highly resilient, cash generative and delivering growth. With a strong balance sheet and normalised cash flow conversion of 60-70% of EBITDA we are poised to provide enhanced shareholder returns,' says Glancey.



SHARES SAYS: ↗

Cash-generative C&C is looking a much healthier business and we're heartened by the Christmas performance and positive group-wide momentum.

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The City watchdog reveals its key concerns for retail investors

They include advice on pension transfers and automated investment decisions

A new report from the Financial Conduct Authority (FCA), a regulator, reveals its current concerns about the financial markets and therefore areas which it might look to clamp down on in the future.

In particular, the FCA notes the steady growth in retail investor activity and the challenges that come with a greater number of people managing their own money or turning to third parties for help.

It is keeping tabs on the changes driven by the low interest rate environment, policy and regulatory changes and technological developments, and says a disparity in inter-generational wealth will play a part in how the sector develops over the long-term.

As the report explains: 'Younger consumers will not be able to look forward to the same pension benefits as older consumers. It will put them under pressure to build up meaningful levels of long-term savings to see them through retirement.'

Its main concerns relate to the suitability and quality of products and services, the level of charges levied on investors and the risk of financial or data loss from financial and cyber crime.

It also highlights the fact that, when you take pensions out of the equation, only a third of the UK population holds any form of investment product.

WHAT CHANGES DOES IT IDENTIFY?

One of the big changes highlighted by the FCA is the growth of investment platforms, both direct-to-consumer and adviser platforms. It also notes the use of model portfolios to make investing simpler by offering portfolios with a broad risk label like 'cautious' or 'adventurous'.

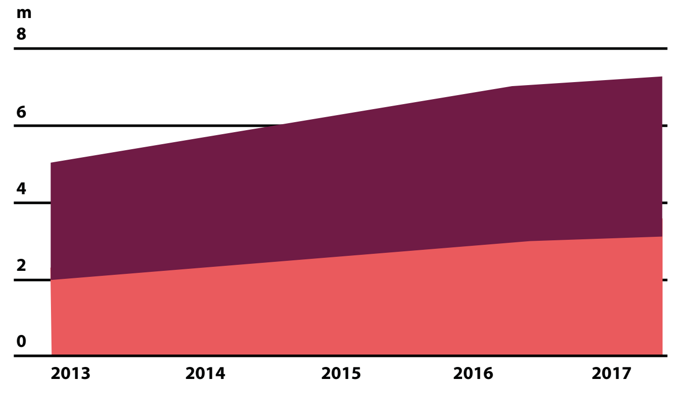
It says consumers have been investing in more complex products like contracts for difference, crowdfunding and structured products but adds the total amount invested in such areas is 'relatively small'.

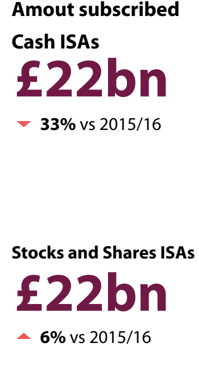
In addition, it anticipates growth in automated advice with some of the big retail banks planning to launch services in 2019. While this could increase access and affordability of financial advice it also notes automated advice is still 'relatively untested' as a concept.

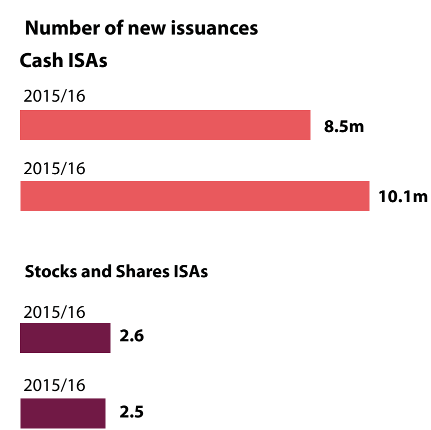
WHAT KEY RISKS DOES IT FLAG?

One of the biggest concerns in the report is unsuitable advice on making transfers from defined benefit to defined contribution pension schemes. It also notes 'the market is failing to provide consumers with the tools to understand their retirement needs when it comes to product selection'.

In general the availability of







advice for people with small investment pots remains limited, creating a risk that investors pay for advice they don't need or invest in unsuitable products.

The regulator also fears confidence and participation in financial markets could be threatened by a combination of financial crime, cyber crime and technological disruption.

With a growing proportion of assets being invested using artificial intelligence it adds: 'The speed of machine reactions could have serious consequences. If artificial intelligence using an algorithm were to make an inappropriate asset management decision, any resulting losses could be quickly compounded.'

HOW DOES THE FCA VIEW INVESTMENT PLATFORMS?

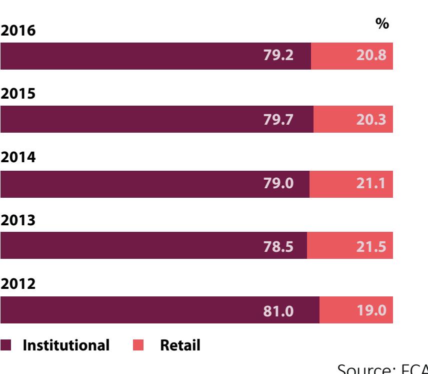
The FCA is expected to imminently update the market on its review of investment platforms. Its findings so far suggest the market is working well in some areas with levels of satisfaction high but it does flag the difficulty of switching between platforms and the way fund charges are presented among other concerns.

WHAT COULD IT MEAN FOR FUTURE REGULATION OF THE INDUSTRY?

To the likely relief of many industry figures, the FCA acknowledges the sheer volume of new rules which have been introduced in recent years. It says: 'The complexity and volume of regulation does raise some concerns over execution risk, potential operational risks and potential fee increases.'

One area which could be targeted by the FCA is model portfolios and the lack of consistency in how risk categories are defined.

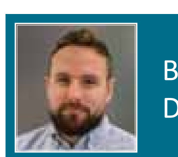
Findings from its review of investment platforms which relate to model portfolios will be applicable to other distribution channels and any remedies proposed may also be applied more widely.



Source: FCA

The focus in the report on exchange-traded funds (ETFs) suggests they too might be in for tighter regulation, with the FCA clearly worried that investors do not always understand the price of an ETF and the net asset value of the underlying fund can diverge significantly.

The FCA has launched a consultation paper on investment-based crowdfunding and this is clearly another area being looked at closely, particularly in an environment where people are looking further afield for high-yielding products.



By **Tom Sieber**
Deputy Editor

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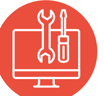

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TIME TO BUY HOUSEBUILDERS

Valuations are cheap and dividends are generous

We are turning positive on the housebuilding sector on the basis that shares in the biggest companies are currently too cheap to ignore. Some are offering dividend yields in double-digits which are supported by strong balance sheets.

In our view the robust financial positions enjoyed by the sector heavyweights means they can afford to keep paying generous dividends even if house price ease back. Many of the housebuilders are sitting on significant amounts of cash which puts them in a very strong position.

We believe share prices will rise to reflect increasing market confidence the promised dividends will be paid.

We are most positive on the high-yielding trio of **Barratt Developments (BDEV)**, **Bovis Homes (BVS)** and **Taylor Wimpey (TW.)** which are also trading on relatively attractive price-to-net asset value (NAV) ratios.

Sentiment towards the sector is beginning to improve but on valuation grounds it is still trading at a level comparable to that seen immediately after the savage sell-off it endured in the wake of the 2016 EU referendum result.

That means investors have a chance to buy stocks that are cheap and also offer considerable income appeal.

HOW ARE HOUSEBUILDERS VALUED COMPARED TO THE IMMEDIATE AFTERMATH OF THE BREXIT VOTE?

Housebuilders tend to be valued against their assets using the price-to-book metric – also known as price-to-net asset value (NAV). However, the price-to-earnings (PE) ratio still provides a useful yardstick of how the sector is being priced now compared with history.

The FTSE 100 housebuilders' average PE, according to Refinitiv data, is 7.7-times against

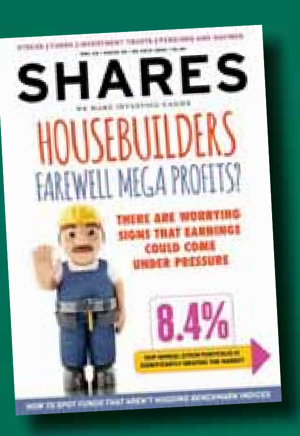
7.5-times in July 2016.

Even on a more traditional price-to-NAV basis housebuilders trade at a similar level as they did in July 2016 based on data from Canaccord Genuity. Its universe of housebuilders are trading at 1.27-times NAV today against 1.24-times at the sector's low point on 8 July 2016. In general, housebuilders are deemed too expensive when they exceed 2.0-times.

It is important to stress that the outlook isn't entirely rosy for the housebuilding space. The pressure on earnings that we highlighted in our 5 July 2018 feature *Housebuilders: farewell mega profits?* remain but the difference now is that the sector has sold off heavily from the highs seen in summer 2018.

WHAT WE SAID LAST SUMMER:

'Get out, wait until the market has had time to price in lower earnings and there has been a natural rotation for investors out of the sector; and only then potentially consider buying back if valuations have dropped to really attractive levels'



WHY ARE WE SAYING TO BUY AGAIN?

We believe the challenges facing the housebuilders – the main one being their ability to achieve the required growth in average selling prices to compensate for rising build costs – are now factored in to their market valuations.

That said, investors should not rule out further volatility until there is greater clarity on Brexit. Being a sector with an almost entirely domestic bias it would likely suffer if the EU separation outcome is worse than the market expects.

According to analysis from Canaccord Genuity at the end of 2018 the sector was 'broadly' pricing in a 5% fall in house prices and 10% fall in volumes. 'If the actual outcome for 2019 is at or close to current consensus expectations, we would expect a sharp value rally,' it says.

Consensus expectations are for modest (1% to 2%) increases in volume and pricing. Sentiment could also improve on a resolution to Brexit which we believe would be viewed favourably by the market.

Against this backdrop, the traditional spring selling season could be an important catalyst for share prices and next month a series of trading updates from the sector will offer some insight into the outlook.

WHO IS REPORTING WHEN?

6 February
Barratt Developments first half results

6 February
Redrow first half results

7 February
Bellway trading statement

27 February
Taylor Wimpey full year results

28 February
Bovis Homes full year results

Investors may have to react quickly and sell shares in housebuilders if either the Brexit outcome is very damaging to the economy, and/or if future trading updates suggest a material slowdown in the market.

In the rest of this article we take a look at the sector's largest constituents, ranking them by their price-to-net asset value, dividends and balance sheets.

We also summarise the latest commentary from housebuilding stocks to give a picture of how they are seeing the outlook for their respective businesses.

THE FIVE FACTORS UNDERPINNING THE SECTOR'S GROWTH – AND HOW THEY COULD BE AFFECTED BY BREXIT

The impressive returns achieved by the housebuilding sector in recent years have had five main foundations. Investors need to consider if these supportive factors will persist and how they might be impacted by the UK's exit from the European Union.

1. SUPPLY/DEMAND DYNAMICS

A possible population decline if immigration falls in the wake of Brexit could tip the scales somewhat but is unlikely to alter the fact that the country is still not building enough houses to keep up with demand.

A Government report published in December 2018 noted: 'Estimates have put the number of new homes needed in England at between 240,000 and 340,000 per year, accounting for new household formation and a backlog of existing need for suitable housing.

'In 2017/18, the total housing stock in England increased by around 222,000 homes. This was 2% higher than the year before – and the amount of new homes supplied annually has been growing for several years – but is still lower than estimated need.'

2. GOVERNMENT SUPPORT

The launch of the Help to Buy scheme in 2013, providing a 20% government loan on top of a buyer's 5% deposit on a new-build property, has been very supportive to the sector.

Industry body the Home Builders Federation noted that in the first five years of the scheme's operation 136,657 first-time buyer households had purchased a new-build home with support from a Help to Buy equity loan, representing more than four in five of all completions up to that point.

Help to Buy has been extended out to 2023, albeit on tighter terms, and the need to build more homes to meet the anticipated demand should mean, though does not guarantee, a supportive approach from across the political spectrum regardless of what happens with Brexit.

3. PRICE RISES

The supply/demand situation has helped house prices recover rapidly from the financial crisis, however the market has stalled recently, and this has been linked to the uncertainty around Brexit causing potential purchasers to sit tight.

Rising prices had made it easier for housebuilders to absorb increases in build costs.

Although warnings of a 30% house price crash in the event of a no-deal Brexit from the Bank of England were dismissed as too extreme in some quarters, they were at least an indication of how significant disruption to the economy might affect the market.

Such a situation could also force housebuilders to write down the value of their land holdings, which in the financial crisis put a big dent in profits and affected housebuilders' ability to pay dividends. One difference now is that housebuilders' balance sheets are much more robust than they were a decade ago.

4. A ROBUST JOBS MARKET

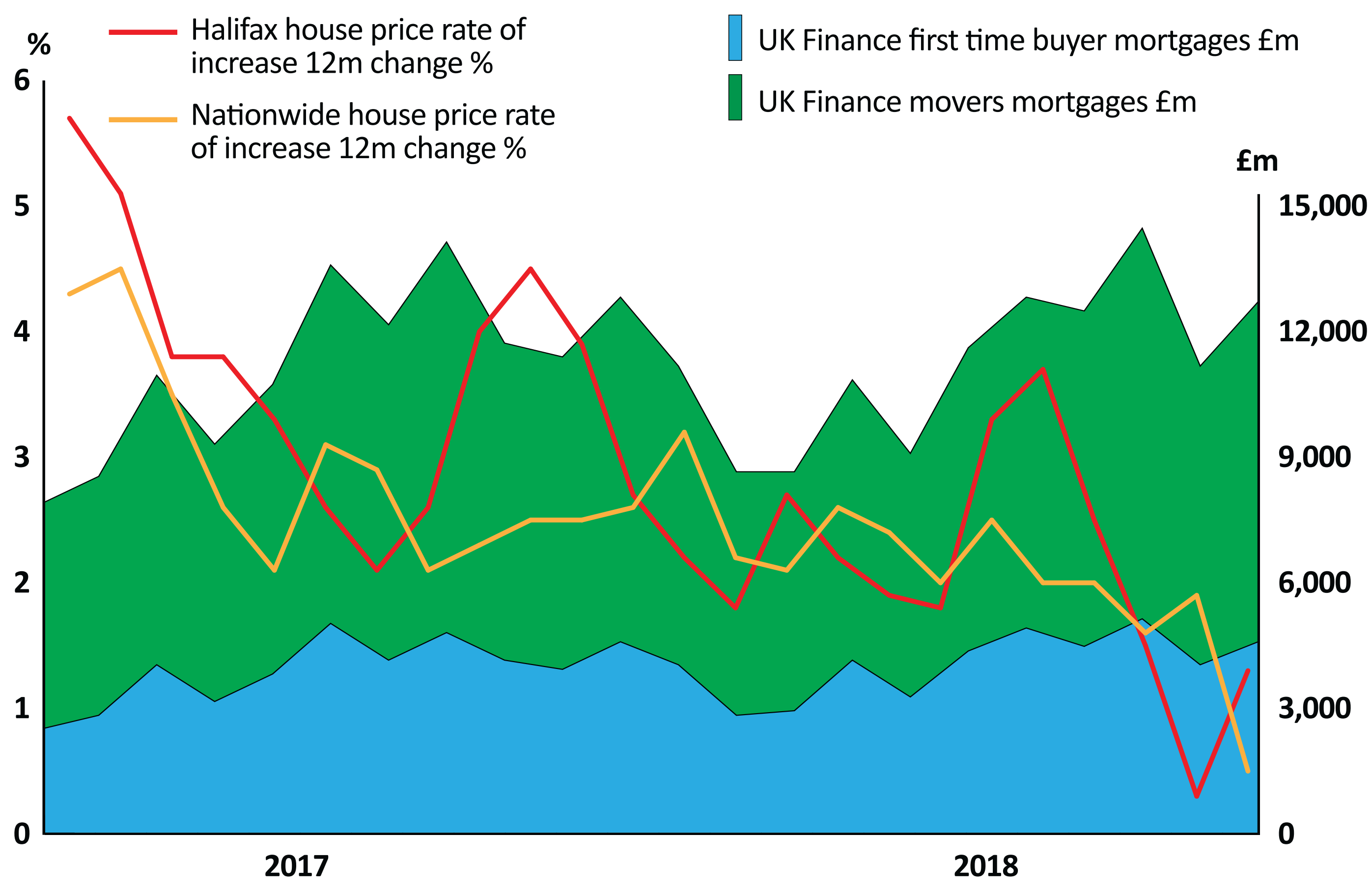
Unemployment levels are at multi-decade lows, even if wages have stagnated. While a disorderly Brexit could result in job losses in some areas, the potential reduced availability of workers from overseas could support employment and wages for those already in the UK.

5. AVAILABILITY OF CHEAP MORTGAGES

A combination of low Bank of England base rates and a highly competitive market has led to widespread availability of cheap mortgages for prospective buyers.

If a no-deal Brexit led to a significant deterioration in sterling, the Bank of England might be forced to push up rates to deal with the resulting inflation. Given the restrictions on banks in other areas, mortgages are likely to remain an attractive product for them to sell.

WHAT IS THE PICTURE IN THE WIDER HOUSING MARKET?



The good news for home buyers is that the seemingly relentless rise in house prices over the last 10 years seems to have petered out.

According to building society Nationwide the average house price in December 2018 was £212,281 or just 0.5% higher than a year earlier. This was the slowest pace of growth since the start of 2013.

A survey by Halifax reported an average house price of £229,729 in December 2018 which was just 1.3% higher than a year earlier, while the average selling price from Land Registry records has been flat at £231,000 for four months.

Mortgage borrowing was steady at around £12bn a month last year according to the Bank of England, and figures from UK Finance show first-time buyers taking an increasing share of mortgage lending through the course of the year.

On the minus side, the latest RICS survey shows a steep fall in new buyer enquiries even though more agents are reporting sellers lowering their price expectations.

As with all aspects of consumer spending, confidence has a large role to play. In December 2018 the widely-watched GfK confidence index hit -14, its lowest level since July 2013, generating a slew of negative commentary.

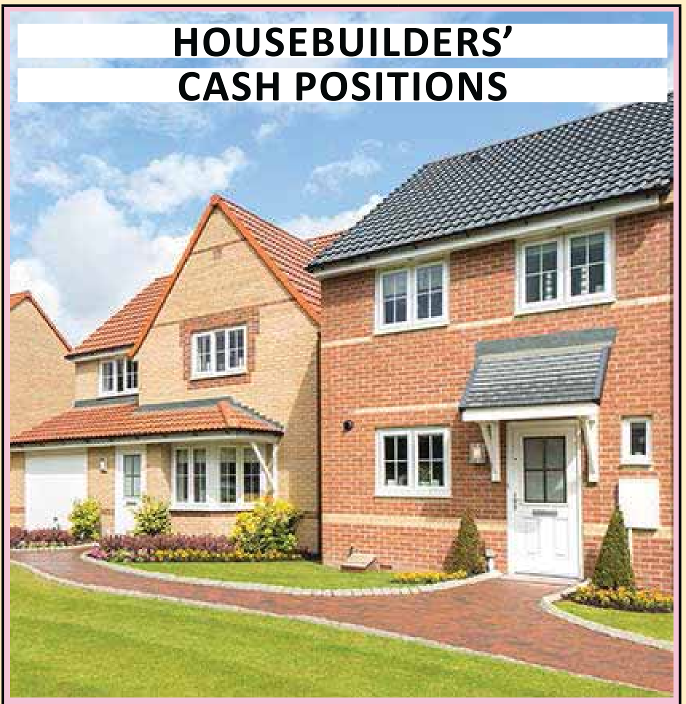
To put that in perspective, -14 is roughly half way between the survey's highest reading of +10 in June 1987 and its lowest reading of -39 in July 2008.

However, the 'major purchases' index, which asks consumers whether they think now is the right time to spend, ticked up to +2.

That is six points above the December 2017 level, suggesting that people's confidence in their personal finances is improving.

With house prices holding steady, interest rate rises on hold, a lack of new and existing homes for sale and a return of consumer confidence, maybe 2019 will see more buyers coming into the market.

THE SECTOR IS SITTING ON A LOT OF CASH



HOUSEBUILDERS' CASH POSITIONS

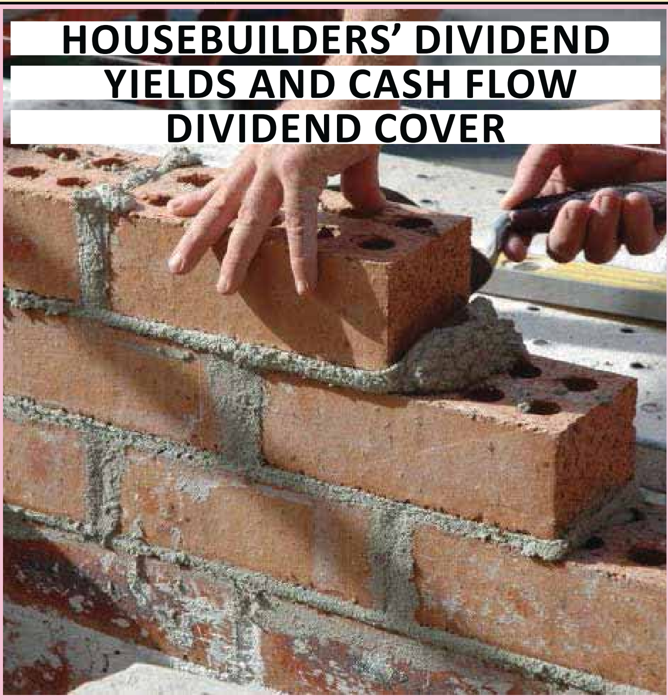
Company	Forecast average net cash*
Persimmon	£1161m
Berkeley	£886m
Barratt	£585m
Taylor Wimpey	£556m
Bovis	£198m
Redrow	£160m
Bellway	£102m

*2020 for firms with financial year ends before 1 July, otherwise 2019
Source: Canaccord Genuity

Having recently restrained investment in land – they previously bought a lot at cheaper prices in the wake of the financial crisis – many of the sector's largest constituents are sitting on very large cash piles.

While this drags on returns, it does provide a buffer against any downturn while also underpinning companies' plans to pay out generous dividends. Of the names included in the table, **Bellway (BWY)** is forecast to have the lowest net cash position.

COMPANIES HAVE PROMISED BUMPER DIVIDENDS



HOUSEBUILDERS' DIVIDEND YIELDS AND CASH FLOW DIVIDEND COVER

Company	Forecast yield*	Cash flow dividend cover*
Taylor Wimpey	12.4%	0.90
Bovis	11.6%	1.08
Persimmon	11.3%	1.01
Barratt	9.6%	1.01
Redrow	6.0%	1.83
Berkeley	5.8%	0.58
Bellway	5.4%	1.05

*2020 for firms with financial year ends before 1 July, otherwise 2019
Source: Google Finance, Canaccord Genuity

You need to take a step back and understand what high yields are really telling you, as many of the housebuilders offer dividend yields far in excess of most other FTSE 350 stocks.

A general rule of thumb with investing is to be cautious of dividends over 7% or 8%. Such high yields are often the result of a falling share price as the market doubts earnings forecasts.

In times of strife, dividend forecasts are sometimes downgraded much later than earnings as analysts want to be truly certain that any financial or trading problems are only short-term, so it makes yields look more attractive than they actually are.

To give you an example, let's say Company X is expected to pay 10p dividend and its shares are trading at 200p, so the yield is 5%.

The shares then fall as the market believes Company X is having financial and operational problems. If they drop to 100p and the dividend forecast is kept the same at 10p, the shares now yield 10%.

Some investors may look at the 10% yield and snap up the stock in hope of generous income. Sadly Company X then admits to various problems and suspends the dividend, meaning the yield is now 0%, much to the annoyance of anyone expecting 10%.

We believe housebuilders are in a different situation. Their high prospective yields are boosted by special dividends which are extra rewards on top of normal dividends. Companies tend to pay special dividends if they have excess cash to their business needs. They are rarely paid year in, year out, and should always be seen as nice bonuses rather than something to expect on a regular basis.

Housebuilders in general currently have lots of cash at their disposal. Forecasts suggest that in most cases dividends are easily covered by cash flow per share.

Many companies in the sector have also been explicit about their dividend plans:

- Taylor Wimpey recently (9 Jan) committed to paying £600m in dividends in 2019.

- Bovis is part way through a commitment to pay out £180m to shareholders in the three years to 2020, making a first £60m payment in November 2018. The company is also in a turnaround situation under industry veteran Greg Fitzgerald after getting itself in a mess at the end of 2016 with a major profit warning and strong criticism over build quality from purchasers.

- **Persimmon (PSN)**, which is forecast to be sitting on more than £1bn in net cash, has committed to return surplus capital of at least 235p per share to shareholders each year for the next two years ending 2020, and 110p per share in 2021. Its chief executive Jeff Fairburn was forced out in November 2018 amid backlash over his £75m bonus. The company had failed to put a cap on a long-term incentive plan agreed in 2012.

- In February 2018 Barratt committed itself to returning a further £350m in special dividends, with one payment being made in November 2018 and the other promised for November 2019.

- High end operator **Berkeley (BKG)**, despite not offering such a significant yield, is paying out plenty of cash in monetary terms too. It has committed to extend its annual return of £280m a year to 2025, beyond the previously stated end point of 2021. This commitment will be fulfilled barring a 'material deterioration in the operating environment'. These words are a reminder that dividends could still be affected by a pronounced housing market downturn despite the strong balance sheets in the sector.

"Dividends could still be affected by a pronounced housing market downturn despite the strong balance sheets in the sector"

VALUATIONS LOOK REASONABLE ON A PRICE-TO-NET ASSET VALUE BASIS

HOUSEBUILDERS' PRICE TO NAV

Company	Price to net asset value*
Persimmon	2.1
Berkeley	1.5
Taylor Wimpey	1.4
Barratt Developments	1.2
Bellway	1.2
Bovis	1.2
Redrow	1.0

*2020 for firms with financial year ends before 1 July, otherwise 2019
Source: Google Finance, Canaccord Genuity

Using price-to-net asset value as a guide, housebuilders are cheaper than they have been for some time, although not as cheap as they look based on price-to-earnings and dividend yield.

Persimmon is the notable outlier, trading at more than two times assets. This could reflect its existing large land bank, diversified exposure across the UK and a relatively low average selling price – meaning it is not as exposed to the more vulnerable premium end of the market. **Redrow (RDW)** is the only firm on this list trading at exactly net asset value.

WHAT ARE COMPANIES SAYING ABOUT TRADING?

Here is a summary of the most recent outlook statements from the sector:

- **Barratt Developments** (in October 2018) – *The company has made a strong start to the year, and is confident of good financial and operating performance*.
- **Bellway** (in October 2018) – *Strong order book, Brexit could hit consumer confidence during busy spring selling season, unchanged conditions should allow company to increase output in the year ahead*.
- **Berkeley** (in December 2018) – *A good start to the year resulting in increased full year guidance and reaffirmed for next two years, based on current market conditions, but short-term outlook clouded by Brexit and operational headwinds in London and South East*.
- **Bovis** (in November 2018) – *Good progress against medium-term targets, on course for record profit in 2018.*
- **Persimmon** (in January 2019) – *Profit for 2018 to be modestly ahead of market forecasts. Positive outlook statement.*
- **Redrow** (in November 2018) – *London market subdued thanks to Brexit and stamp duty changes but trading in line with expectations*.
- **Taylor Wimpey** (in January 2019) – *2018 results will be in line with expectations. Too early to give definitive view on 2019 but forward sales indicators are strong, with reference to wider political and economic uncertainty.*

By **Tom Sieber and Ian Conway**

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The podcast is presented by *Shares*' editor Daniel Coatsworth and AJ Bell's personal finance analyst Laura Suter. They are joined each week by special guests including various *Shares* journalists and other investment experts.

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How you can make hundreds of pounds for doing very little

Cashback websites are an easy way for you to earn extra money

Using cashback websites for your online purchases could potentially earn you several hundred pounds for a little extra hassle. If your new year's resolution is to boost your savings or sort your finances, using cashback sites could be one way of increasing your pay.

WHAT ARE CASHBACK WEBSITES?

Cashback websites pay you when you click through them, go to retailers or product providers and spend. Quidco, one of the most popular cashback sites, says its members earn £280 on average per year.

If you want to buy something online, you can use the link via these websites and you'll earn some money back on that purchase.

The amounts vary depending on what you're buying and how much it's worth, but for example you will typically get up to 6% off some department stores and up to around £50 for home insurance. The cashback also applies to some contracts such as for mobile phones.

WHAT THINGS SHOULD I LOOK OUT FOR?

Cashback websites are generally free although some offer a premium service such as faster payments in exchange for keeping some of your money each year. In general it is best to go for basic level accounts.

There can be problems with getting the cashback money; for example, some smaller cashback websites have folded, taking customer money with them, so you should never rely on or make a purchase based on the cashback – instead see it as a bonus.

You should also make sure you shop around first to get the best deal on an item, and then see if you could get cashback with that retailer via a cashback site.

And always withdraw any money you get straight away, as some of the sites are small and can go bust. Although most will require you to reach a certain level of earnings in your account before you can redeem any money.

WHAT ARE SOME OF THE SITES I COULD USE?

The biggest sites are TopCashback and Quidco, and because they are larger

Step-by-step guide to using cashback sites:

1. Research the item you want to buy and use comparison websites to ensure you're getting the cheapest deal.
2. Once you've decided on a retailer, check which cashback website has the biggest reward at the moment.
3. Log in to your account on that cashback website, and make sure you follow the link they provide to get to your retailer of choice, and then make your purchase as normal.
4. Once the cashback has been confirmed it will appear in your cashback account – it might take a while for the cashback to show, often weeks or months.
5. You can then get the money paid into your bank or PayPal account, or some cashback sites allow you to get it as an e-voucher for certain retailers.

they can usually negotiate the better deals.

TopCashback and OhMyDosh! are the top rated on TrustPilot, a consumer reviews website. Both TopCashback and Quidco allow you to sign up for free but also offer premium membership.

TopCashback says it has 8.2m members, and they can pick between free membership or Plus membership, which costs £5 a year (taken out of your cashback earnings). Plus membership can give you higher cashback rates and bigger bonuses.

For QuidCo the premium membership also costs £5 a year, and gives you bonus cashback promotions and entry into prize draws and giveaways.

It's worth shopping around between different sites, as they won't all offer the same cashback rates. For example, TopCashback is currently paying up to 10% on certain Marks & Spencer purchases, while QuidCo is paying up to 8%.

It's worth noting that TopCashback and QuidCo are in takeover talks at the moment, which has raised concerns that the cashback amounts they offer could fall.

CAN I GET MONEY FOR NOTHING?

In a weird quirk of the websites sometimes you can make money even if you don't buy anything.

You just need to complete some tasks such as filling in application forms, carrying out free trials or answering questionnaires.

For example, on TopCashback you can earn £1.89 for registering and completing one survey with MySurvey UK, while OhMyDosh! pays £2 if you sign up to a free trial of digital TV service NowTV.

You can also make money by referring people, and they don't even need to be friends. For example, QuidCo gives you £5 cashback for each person you refer, although you only get the cash once they have earned their first £5 of cashback. You can use Facebook and Twitter to share your referral link and get even more money.

WHAT ABOUT SAVING FOR MY CHILDREN?

KidStart has a different slant on cashback. It works the same as other cashback websites but you register your child's savings account with it and each month it funnels the cashback into that account.

It has around 1,500 retailers from whom you can get cashback, including Amazon, which is often not featured on other cashback sites.

KIDSTART IS A RARE PLACE TO GET CASHBACK FROM AMAZON AND THE MONEY GOES TOWARDS CHILDREN'S SAVINGS

The website could be a clever move to add to your children's savings pot for doing very little. You can also use it to save for nieces, nephews, grandchildren or friends' children too, if you don't have any of your own. The money can also be donated to a school or children's charities.

KidStart can be linked to any bank or building society account that accepts electronic payments, plus child trust funds and many Junior ISAs.

By **Laura Suter**
AJ Bell Personal Finance Analyst

'Help: I'm still getting calls despite the pensions cold-calling ban'

AJ Bell expert Tom Selby explains how the ban works and ways to avoid scams

Barbara from Surrey
'I read a story saying cold-calling for pensions is now banned, but on the same day I was contacted by someone out of the blue asking about my pension. Does this mean it's likely to be a legitimate investment?'

By **Tom Selby**
AJ Bell Senior Analyst

Absolutely not. As you rightly say, a long-awaited ban on pensions cold-calling came into force on 9 January. This intervention will help in deterring scammers – who could face a fine of up to £500,000 if they breach the ban – while also raising awareness of the tactics commonly used by fraudsters.

If someone you don't know calls you out of the blue about your retirement fund, hang up the phone immediately.

Unfortunately the cold-calling ban will only put a dent in scammers' activities rather than stopping them altogether. Some will simply flout the ban (unsurprisingly fraudsters often don't care much for what the law says) while others will set up call centres overseas where the legislation doesn't apply.

You shouldn't consider the introduction of the ban as a guarantee any call you receive is from a legitimate company.

Furthermore, text messages, emails and internet posts are not explicitly covered by the ban, although there are separate regulations restricting unsolicited direct marketing.

The best way to ensure you don't get caught out is to familiarise yourself with some of the common warning signs of a possible scam.

You should be extremely wary of any investment 'opportunities' that promise eye-watering guaranteed returns or people claiming to be 'advisers' offering a 'free pension review'.

Professional advice is never free and so following the old maxim 'if it sounds too good to be true, it probably is' is a sensible approach.

It's also a good idea to make sure you know with whom you are dealing. After all, your pension could be the most valuable asset you own, so don't hand it over to someone unless you know their credentials check out.

Slick fraudsters will sometimes pretend to be a bona fide company when in fact they are nothing of the sort, so have a look at the FCA register to see if the firm you are dealing with actually exists.

And whatever happens, don't be rushed or pressured into making a decision – such tactics should set off a big red warning light in your mind and are often indicative of a scam.

Finally, if you're at all unsure speak to a qualified, regulated financial adviser. You will need to pay for this but usually the benefit far outweighs the cost.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

The importance of investment style when picking funds

Make sure you understand how a fund manager will look for assets to put in their portfolio

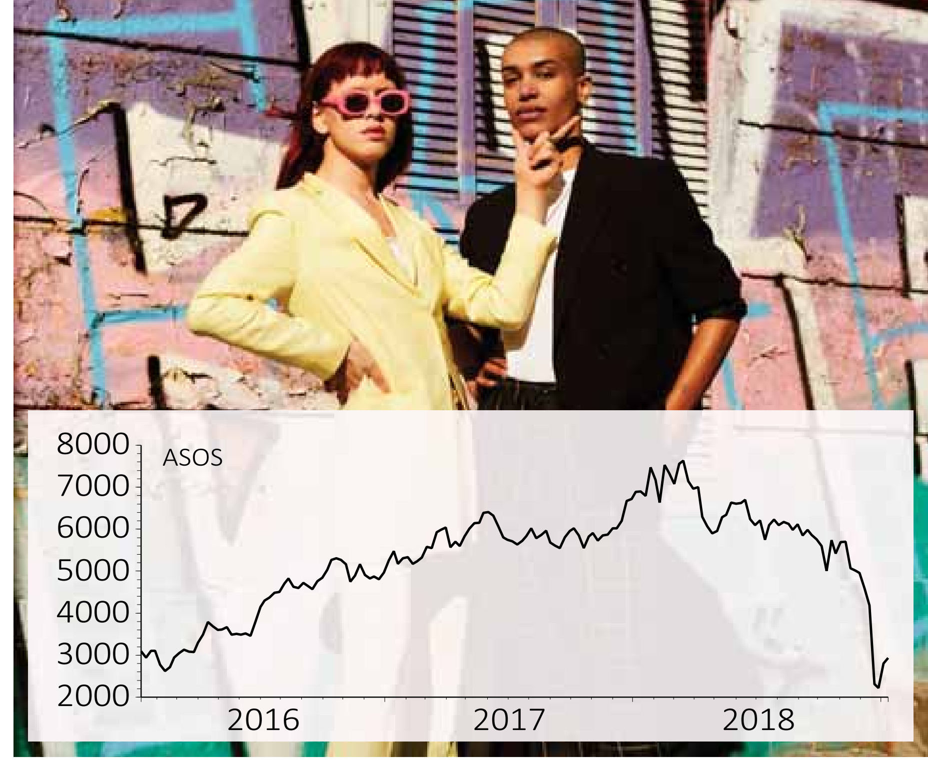
When it comes to choosing an investment fund there are a number of things to take into account: fees, track record and the assets and regions it invests in, to name just a few. But also worth bearing in mind is the investment style that a manager uses.

Investment style determines which assets are most likely to make it into a fund's portfolio and influences when it is likely to outperform and to underperform.

GROWTH AND VALUE

Investors tend to follow two main camps: growth and value. Growth stocks are those which are those which are growing. Value stocks are those which look to be good value, often because they are out of favour with other investors, sometimes for good reason.

Some funds do not have a distinct style but often a manager will favour one of these approaches. In some cases, entire investment houses have a bias towards a particular strategy.



WHEN DOES GROWTH DO WELL?

Growth investors tend to thrive in a bull run, when markets are rising and share prices are going up.

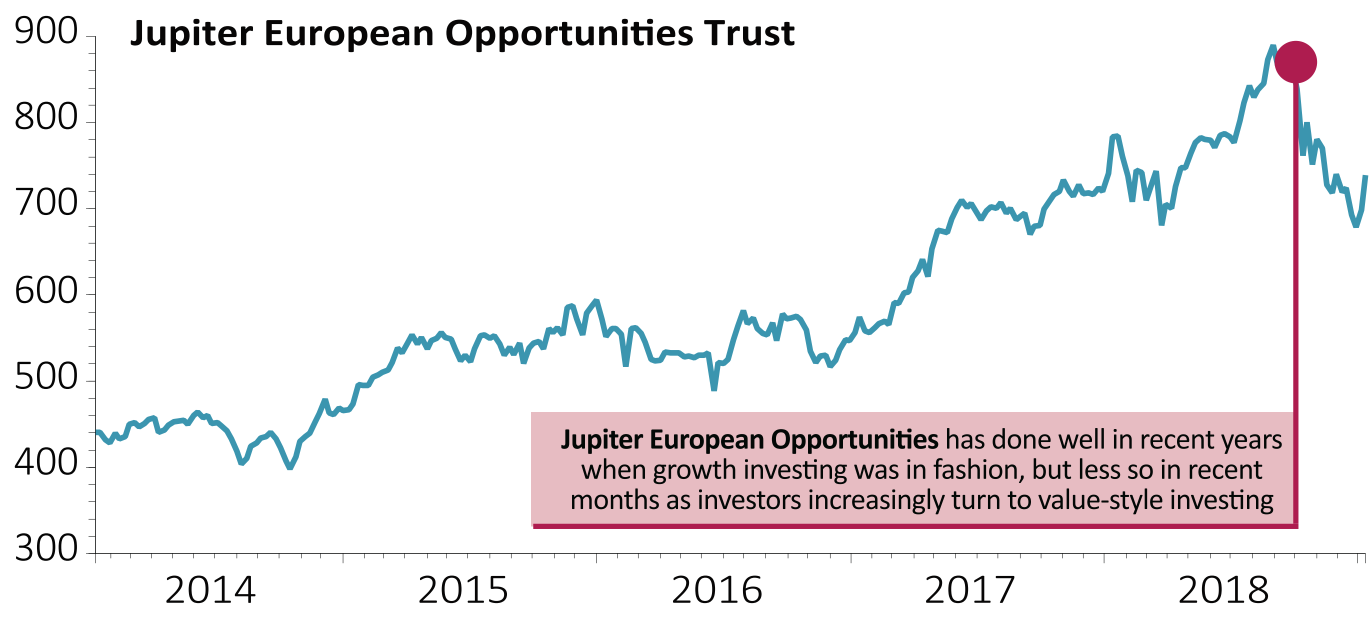
The danger here is that an investor may overpay for a stock in the belief it will continue on its upward trajectory, only for there to be a market correction or for the share to plunge.

One recent example is online fashion retailer **ASOS (ASC:AIM)**, whose shares had soared for years until a slip in growth forecasts in December saw the stock plunge by 40%.

Thomas MacMahon, senior analyst at Kepler Partners, says: 'Ultimately, growth investing makes sense if you believe you can identify which companies can generate the highest growth rates on their earnings.

'If this is the case, a fund should outperform as the value of stocks it invests in should rise at a faster rate than the value of the stock market as a whole.'

He says **Jupiter European Opportunities Trust (JEO)** is an example of growth investing. The fund invests in names such as sportswear brand Adidas and German stock exchange Deutsche



Boerse, and has returned 27% over three years.

OTHER INVESTMENT STYLES

Under the heading of growth, there are some more specific styles as well. For example, 'growth at a reasonable price' is a more price-sensitive version of growth investing. MacMahon explains: 'Managers aim to pick the stocks with the best growth prospects, but are stricter about the valuations at which they will buy and sell.'

Fund Expert managing director Brian Dennehy likes momentum investing. This follows the idea that investments which have done well for a while should continue to do well in the future.

He says: 'Applying this process to pick funds in the UK All Companies sector since 1994 has generated an extra return of 6% a year. You didn't do anything clever to achieve that, you just had to have a clear process for selecting funds and do it consistently.'

Nothing keeps going up forever and this style may suffer when the momentum stops. MacMahon adds: 'Growth investing involves forecasting future demand and developments, which is difficult to do well consistently.'

Fund managers who adopt momentum techniques in their investing include Austin Forey, manager of investment trust **JPMorgan Emerging Markets (JMG)**, and Harry Nimmo, manager of **Standard Life UK Smaller Companies Trust (SLS)**.

MacMahon says: 'Nimmo won't buy into his picks when they sell off; he waits for the dust to settle and for some upward momentum to begin before adding to a position. Both managers are essentially growth investors with momentum being a secondary element to their style.' The funds have returned 74% and 12.6% over three years respectively.

> **This isn't about simply buying what is cheap, but buying what is unjustifiably cheap. This requires a manager to have the skill to analyse financial accounts, the patience to wait until the market reflects your analysis, and the discipline to not get distracted by market woes along the way**
>
> **Brian Dennehy on value investing**

WHAT DO VALUE INVESTORS LOOK FOR?

Value investors look to take advantage of mispriced stocks. Within this camp, some managers take a recovery approach, picking out those

stocks which look to be on the brink of a turnaround, while special situation investors look for one-off events which have adversely affected sentiment towards a stock.

Value investing doesn't have to mean picking out future winners but can simply be a case of finding instances where the market is being too gloomy about a company's prospects, or perhaps an entire sector is suffering because of one firm's failings. You buy with the hope that the shares re-rate to a higher valuation.

Dennehy adds: 'This isn't about simply buying what is cheap, but buying what is unjustifiably cheap. This requires a manager to have the skill to analyse financial accounts, the patience to wait until the market reflects your analysis, and the discipline to not get distracted by market woes along the way.'

EXAMPLES OF VALUE INVESTING FUNDS

Value investing styles are central to such open-ended funds as **M&G Recovery (B4X1L37)** and **Schroder Recovery (B3VVG60)**, which have returned 16.9% and 35.6% respectively over the past three years, according to Morningstar data.

Barclays features in Keystone Investment Trust's top 10 holdings

In the investment trust universe, MacMahon likes **Keystone Investment Trust (KIT)**, run by James Goldstone, who is currently finding opportunities in unloved UK banks and insurers. He thinks investors are irrationally negative about the short-term risk of Brexit to the sector. The fund is down 2.3% over three years, highlighting how choosing out of favour stocks can result in periods of underperformance.

The value investing strategy has a number of risks; sectors or stocks can remain cheap for a long time, or they may turn out to be so-called value traps, whereby the stock was cheap for good reason but an investor has been lured in by its cheap price.

MacMahon says: 'Ultimately both growth and value investment styles include the same element – analysing the valuation of an investment and making a judgment about its growth prospects – but they weight those elements differently.'

EXAMPLES OF INVESTING STYLES FOUND IN FUNDS AND INVESTMENT TRUSTS

1. GROWTH
2. GROWTH AT A REASONABLE PRICE
3. VALUE
4. MOMENTUM

By **Holly Black**

Big deals mean gold may still have lustre

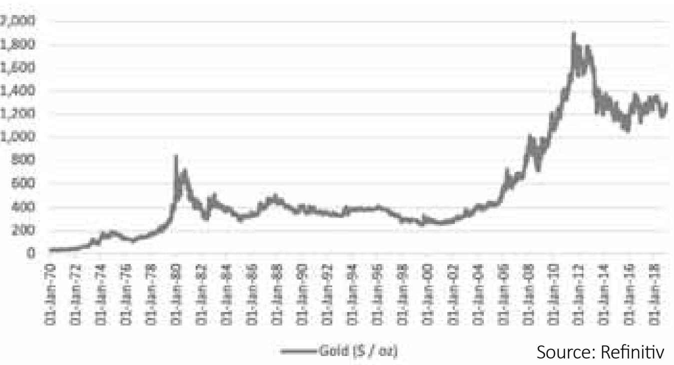
M&A involving gold miners has put the spotlight back on the precious metal

The investment decisions that generate the best returns are rarely the most comfortable or easy ones, and few asset classes generate such strong feelings as gold.

Some investors will be inclined to share the view of economist John Maynard Keynes that the precious metal is a barbarous relic. Others will warm to legendary investor Warren Buffett's view that gold has no intrinsic value, on the grounds it has no practical use and generates neither yield nor cash.

Some will warm to it as a potential port in a storm, remembering how well it performed during the economic downturns of the 1970s, early 2000s and 2007-09.

GOLD DID WELL DURING STOCK MARKET AND ECONOMIC DOWNTURNS IN THE 1970S AND EARLY 2000S



Source: Refinitiv

One thing that no-one can deny is that gold – along with German government bonds – was just one of two major asset classes that generated positive total returns in sterling terms in 2018. Since the FTSE All World index peaked in September, that stock index has lost 11% while gold has risen by $90 an ounce, or 7%.

This begs the questions of whether the positive run can continue and whether investors need to be pondering once more whether gold can be a useful provider of portfolio diversification.

THE CASE FOR GOLD

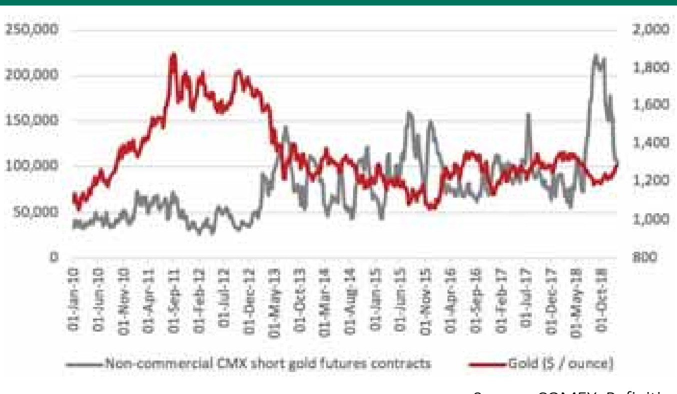
Two factors may speak in gold's favour. The first is that it seems unloved.

Anecdotally, this column never gets a question about it. (Compare that to say bitcoin a year ago).

More tangibly, figures from CME show that non-commercial futures positions on its derivatives marketplace in the US still mean traders have a net short position.

While the number of shorts has dropped from a high of 222,210 contracts in August to 106,028 in December (the last number released before the US government shutdown) this suggests that sentiment is still washed out, something that makes gold's recent advances back toward $1,300 an ounce all the more intriguing.

TRADERS HAVE YET TO GET BACK INTO GOLD



Source: COMEX, Refinitiv

The second is that while stock market investors do not seem interested in gold or shares in gold miners, the miners themselves are becoming active.

No sooner had America's Barrick Gold merged with former FTSE 100 member Randgold Resources in a $6bn all-stock deal, this week (14 Jan) Newmont Mining has swooped for GoldCorp in a $10bn cash-and-stock deal.

The timing is interesting. A comparison of America's HUI Gold Bugs index relative to the gold price suggest that gold miners look cheap relative to the metal.

GOLD MINERS LOOK CHEAP RELATIVE TO GOLD

Source: COMEX, Refinitiv

THE CASE AGAINST GOLD

Two factors still speak against exposure to gold. The first is Buffett's argument about its lack of yield or cash-generative capabilities. It remains a play on market psychology and many investors will conclude that trying to second-guess that is a mug's game.

The second is the US Federal Reserve. Gold soared between 2009 and 2012 because the central bank had embarked upon quantitative easing (QE) and markets feared it had lost control. That does not seem to be the case right now.

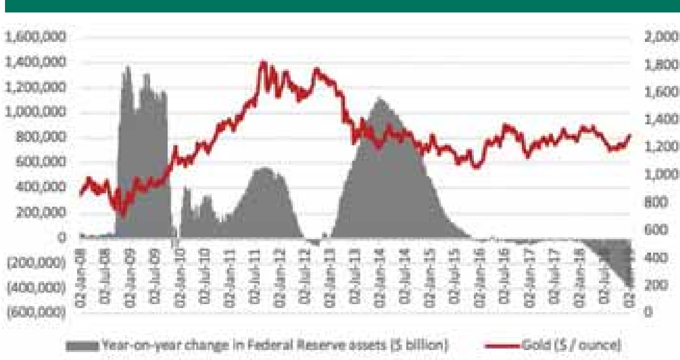
The Fed has raised interest rates nine times to 2.5%, which makes gold's lack of yield seem even more of an issue, and embarked upon quantitative tightening. Under such circumstances, it seems like the Fed is in control.

POTENTIAL CATALYSTS

Two swing factors may decide where gold (and thus gold mining stocks) go from here.

The first is central bank policy. There is no indication that the Fed is considering a cut to interest rates or a return to quantitative

A RETURN TO QE BY CENTRAL BANKS COULD BOOST GOLD



Source: FRED - St. Louis Federal Reserve database, Refinitiv

easing. If prevailing fears over economic weakness or policy becoming too tight then gold will doubtless be cast aside as a 'barbarous relic' once again.

But if the Fed does turn tail, cut rates or even sanction a return to QE then the precedent of 2009-2012, after the launches of the first two rounds of QE, would suggest that investors could look to gold as a haven and store of value in the face of yet another round of ultra-loose, unorthodox monetary policy.

The second is technical. A move above the $1,350 to $1,400 an ounce level, which the metal has failed to crack on five occasions since the start of 2017, would really encourage gold bugs. Equally, any failure to make a sustained breakthrough would challenge the bull case for the precious metal.

GOLD MAY NEED TO MOVE FIRMLY BEYOND $1,350 TO CONFIRM THE DOUBTERS

Source: Refintiv

By **Russ Mould**
AJ Bell Investment Director

Eight ways to invest in the thriving water sector

Pictet Water is among the funds and shares providing exposure

Water is an essential resource for life – no one can live without it. Beyond its basic functions of sustaining life, water is also a precious commodity. Its supply is limited and global challenges such as population growth, urbanisation and climate change are putting existing water resources under increased stress.

The global issue of water access is a two-fold problem: safe drinking water is hard to come by, while basic access to sanitation is less common than one might expect.

Put simply, the need to secure the current water supply, and increase its capacity through new technology and services, will be a major theme over the years to come and one that benefits from trillions of dollars of investment.

And as the role of private companies in the water value chain steadily increases, so does the size of the long-term investment opportunity, whose attractions are supported by the rising M&A momentum in all parts of the water industry.

Investors can get exposure via funds such as **Pictet Water (B516BZ3)** which invests in companies operating in the water and air sector. It has achieved 10.9% annualised returns over the past decade.

Other examples of water-themed funds include **RobecoSAM Sustainable Water (B8DPYR2)** which has achieved 10.7% annualised returns over the past three years, says Morningstar.

2 EXAMPLES OF WATER-THEMED EXCHANGE-TRADED FUNDS

- LYXOR WORLD WATER ETF (WATL)
- ISHARES GLOBAL WATER ETF (DH20)

4 EXAMPLES OF LONDON-LISTED WATER-THEMED COMPANIES

- AMIAD WATER SYSTEMS (AFS:AIM)
- MODERN WATER (MWG:AIM)
- SEVERN TRENT (SVT)
- WATER INTELLIGENCE (WATR:AIM)

OPPORTUNITIES ON TAP

The private water supply sector, which consists of the supply and storage of drinking water, is one great example of the problem and the opportunity.

According to the OECD, by 2050, up to 4bn people across the world could be living under 'severe' water stress, up from 1.2bn today.

Economic growth is only exacerbating the water shortage. This is because it boosts personal wealth, thereby driving increased consumption of products requiring more water to produce.

Tight budgets and ageing infrastructure mean

governments around the world are increasingly unable to maintain supply, so there will be countless opportunities for companies involved in innovative water supply solutions, such as water recycling and desalination, to profit.

A THIRST FOR GROWTH

Pictet Water fund invests in companies providing water supply, water technology or environmental services. Pictet Asset Management's Cédric Lecamp and Louis Veilleux actively manage the portfolio using a combination of market and fundamental company analysis to select companies they believe offer 'secular growth prospects at a reasonable price'.

The fund invests globally, including in emerging markets and mainland China, and the portfolio had 54 positions as at 30 November 2018.

Pictet Water's managers score companies on the strength of the business franchise, their ESG (environmental, social and governance) focus and the quality of management as well as valuation prospects. 'We try to apply a barbell strategy of a defensive core of utilities and more economically sensitive companies,' adds Veilleux.

OBTAINING SUPPORT FROM TRUE EXPERTS

'The DNA of this fund is built upon an advisory board of scientists, academics and engineers that helps us define the strategic direction of the investment universe,' says Lecamp, keen to stress the long term nature of the investments in the portfolio. 'Our average turnover is less than 10% and the average duration of our holdings is 10 years,' he explains.

In terms of the investment threshold for the fund, Lecamp explains that at least 20% of a company's value has to be linked to the water theme, although he will look at a company's future prospects and would consider a company that is investing a lot more capital in water activities.

A good example is medical, industrial and commercial products conglomerate Danaher. He says: '35% of its value is linked to water and it is divesting some non-water related activities, which will increase its exposure to the water theme.

'Management has an exceptional track record on return on invested capital, as they are extremely good allocators of capital,' insists Lecamp.

Significantly, this capital allocation extends to corporate takeovers such as the recent acquisition of Pall which had been a holding in the Pictet Water portfolio for more than a decade.

Also in the fund's top 10 holdings is Xylem, the largest pureplay water equipment services company in the world; a pumps, pipes and valves provider that has entered into the metering and smart data space.

'Xylem is increasingly going down a data and software road to add value,' says Lecamp. It recently acquired Pure Technologies which was also held in the Pictet fund for more than a decade.

'We expect the performance to beat the global equity market over an investment cycle because of the barbell approach,' concludes Lecamp.

'The portfolio has performed best in choppy markets or where there is a correction because of the defensive core of utilities. We've done less well in the early stage of rebounds, such as 2009, because we are underrepresented in cyclical companies.'

COMPANIES IN PICTET WATER'S PORTFOLIO

Companies in the portfolio include the likes of water and wastewater services duo American Water Works and Aqua America; and Thermo Fisher Scientific, the scientific instruments leader with water quality testing and laboratory products.

The fund also invests in Suez, which operates municipal water distribution and treatment systems in France and Spain; and Ecolab which is a water, hygiene and energy technologies provider established in 1924.

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

What are convertible bonds and why could they shine in 2019?

Michel Perera looks at the chameleons of the fixed interest world

When convertible bonds are mentioned, the reaction of most people is to yawn. They have a reputation of being a bit geeky and in the realm of mathematicians. But in a time when interest rates are starting to creep up – albeit slowly – and equities are climbing a 'wall of worry', the chameleon properties of convertibles mean they could be worth a second look.

A convertible bond is a fixed-rate instrument that can convert into shares at a specific share price, which is preset by the issuing company at a premium over the share price at the time of issue. The bond also has a coupon, but the interest rate is lower than that of a normal bond, because the conversion feature gives it an equity upside.

So convertibles have an equity correlation and can move with the underlying share price. But they also have a 'bond floor' – i.e. a price below which they cannot fall (unless the company loses creditworthiness) due to the interest rate they are paying.

This hybrid bond-equity make-up can shape convertibles into a flexible and attractive vehicle to some investors. It optimally protects an investor's initial investment on the downside, but it also lets them make the most of the upside if the company's shares increase in value.

There are a few different types of convertible bonds:

1. Some operate way below the share price at which the bond converts and will behave like regular bonds, as the equity kicker is too far away to matter

2. Some have become pure equity, as the share price has risen substantially

3. Others are in between and trade with a mixture of both the bond and equity factors – this is known as the 'balanced' zone

The graph below shows how this works.

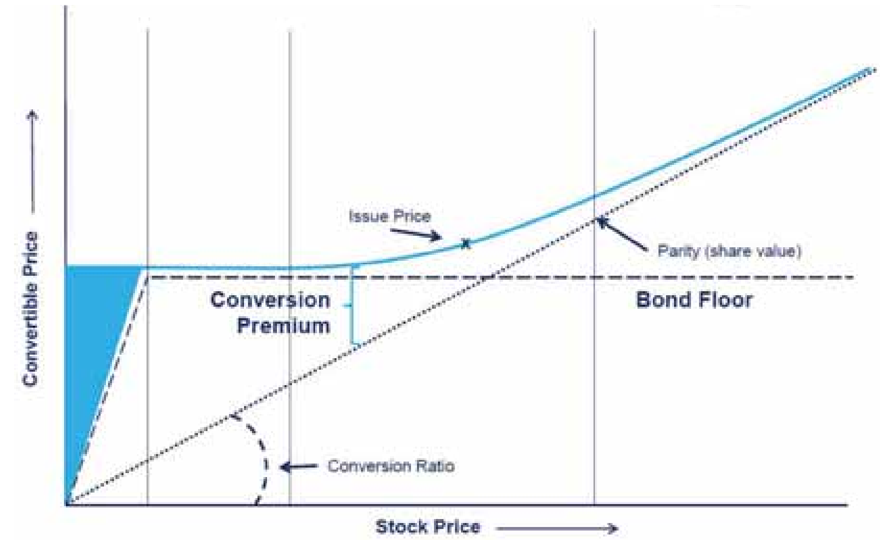
WHAT KIND OF RETURNS DO CONVERTIBLE BONDS OFFER?

Historically, convertible bonds have returned as much as equities, but with about half the volatility. If that sounds too good to be true, there are a couple of caveats.

Interest rates and bond yields have dropped for decades, which has helped bond floors to go up.

The convertible market is also much smaller than the equity markets, so you could never replace all the shares in your portfolios with convertibles.

However, when interest rates rise and equities feel nervous about how far rates will go, convertibles have often delivered a better risk/return ratio than a simple blend of equities and fixed income. This is one of the reasons we believe they will be



key in 2019.

Good convertible managers can move from one bond to another and will take advantage of market moves. The same managers can also move from one region of the world to another, or one credit rating to another, and hedge or not hedge the underlying currency of the bond. This creates a lot of variables for an active manager to play with.

AN IMPORTANT INVESTMENT THEME FOR 2019

Properly managed, convertibles can give a great risk/return ratio and improve that ratio in a diversified portfolio, making them a valuable addition while equity markets continue to climb an ever-growing wall of worry.

That leads us to ask whether convertibles are right for retail investors. Convertible bonds are a specialist asset class and are deemed to be fairly complex.

One disadvantage of convertible bonds is that the issuing company has the right to call the bonds, meaning the company can convert them from equities back into bonds. This might happen when the stock's price goes higher than the amount investors can redeem the bond.

> "A convertible bond is a fixed-rate instrument that can convert into shares at a specific share price, which is preset by the issuing company at a premium over the share price at the time of issue"

Another issue is that they are relatively illiquid, meaning investors can't realise their investment particularly quickly.

Using the services of a fund manager may therefore be a better way for retail investors to access these products.

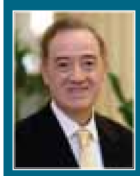
WHAT FUNDS CAN RETAIL INVESTORS USE TO ACCESS CONVERTIBLE BONDS?

Retail investment funds that play the convertible bond theme are relatively few and far between, but there are a few that have historically invested in convertible bonds.

For example, **Jupiter Dynamic Bond Fund (B7NFPD8)** is one of the biggest retail bond funds in the UK, investing in different parts of the bond market. It is managed by Ariel Bezalel, supported by Jupiter's team of fixed income specialists.

Another one is **Aviva Global Convertibles Fund (B86L3G9)** which is a balanced fund, with fairly equal exposure to the US, Europe and Asia including Japan, with a delta (correlation to equities) of slightly above 50% and a 25% exposure to the IT sector with an average investment grade rating and a focus on balanced convertible bonds.

These are examples rather than fund recommendations and DIY investors should always do their own research before making an investment decisions.



By **Michel Perera**
chief investment officer of Canaccord Genuity Wealth Management

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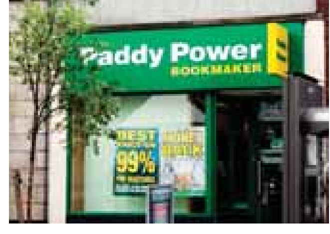

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22 Jan: BHP, Accrol, IG Group. **23 Jan:** Joules.

Trading Statements

21 Jan: William Hill. **22 Jan:** Dixons Carphone, EasyJet, Halfords, Pets at Home. **23 Jan:** AJ Bell, Burberry, Brewin Dolphin, Computacenter, JD Wetherspoon, Marston's, WH Smith, Antofagasta. **24 Jan:** CMC Markets, Daily Mail & General Trust, Fevertree Drinks, Kier, PayPoint, St James's Place, Restaurant Group.

Shares is published by AJ Bell which is referenced in this list. Journalists and other members of staff involved with *Shares* own shares in AJ Bell.

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All charts' data sourced by Refinitiv unless otherwise stated

PRODUCTION
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Designer Matt Ely

Shares magazine is published weekly every Thursday (50 times per year) by AJ Bell Media Limited, 49 Southwark Bridge Road, London, SE1 9HH. Company Registration No: 3733852.

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