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FE Trustnet

magazine

THE "EASY" PART
Reviewing your options at retirement

PICK AND MIX
Experts' investment trust selections

FASTEN YOUR SEAT BELTS
Your guide to every sector in 2019

Fund, Pension, Trust / Sector Profile / Stockpicker / What I Bought Last

ISSUE 46

CREDITS

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BE BETTER INFORMED

Editor's letter

You may remember FE Trustnet Magazine's first issue of 2018 – if only for the cover feature titled "keep on running", which focused on how everyone was in agreement the bull run would gather momentum and markets would end the year higher than when they started.

You know what happened next. In any case, Holly Black looks back at 2018 in this month's cover feature to find out what went wrong, while Cherry Reynard takes a more specific look at the investment trust universe. Adam Lewis and I go the other way, as I ask the experts for their investment trust recommendations and he runs the rule over every major sector for the year ahead.

In our regular columns, John Blowers examines your options at the point of retirement, Downing's Judith MacKenzie names three stocks that should benefit from the value style's resurgence and Shore Financial Planning's Ben Yearsley reveals which fund he is using to protect his portfolio if the US bull run comes to an end.

Have a great Christmas and new year.

Anthony Luzio
Editor

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In FE Trustnet Magazine's traditional end-of-year review, **Holly Black** attempts to find out what happened to the extended bull run everyone was taking for granted 12 months ago

A damp squib

For many investors the double-digit gains they have enjoyed across the vast majority of asset classes in recent years are little more than a distant memory

Any investor who had been hoping for a quiet year in 2018 will have been sorely disappointed. The past 12 months have seen a trade war between the US and China, a currency crisis in Turkey, and an ever-expanding list of Cabinet resignations.

We have seen political and economic strife across emerging markets, the first company to reach a market capitalisation of $1trn – closely followed by the second company to reach the milestone – and a sell-off in the stock market, which seems to have marked the beginning of the end of the longest and most hated bull run of all time.

The past 12 months have been full of surprises and volatility; for many investors, the double-digit gains they have enjoyed across the vast majority of asset classes in recent years are little more than a distant memory, with capital preservation the new priority.

Quantitative tightening

Central bank monetary policy has remained a dominant talking point in markets over the past 10 years and 2018 was no different. But this year the focus was on the winding down of quantitative easing programmes as banks started to raise interest rates – very gradually in the case of the UK and not so gradually in the US. The European Central Bank is expected to follow suit in 2019.

Jason Hollands, managing director at Tilney Bestinvest, says: "This has been a significant development

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for markets after nearly a decade of abnormal policy and has had understandable ramifications for capital markets, which have been so distorted by many years of stimulus."

He adds that rising borrowing costs in the US have hit bond markets, pushing 10-year Treasury yields over 3 per cent, which has stoked volatility in equity markets.

Brian Dennehy, director at Fund Expert, says alarm bells started ringing around the bond market earlier this year: "Back in May, one investment veteran told me, 'it's easier to raise money than at any time since I have been in the business over the past 30 years', and another said new bonds were offering 'some of the worst covenants we have ever seen'. To you and me, that means they were no good."

Emerging issues

A more volatile credit market and more expensive borrowing costs added strife to what was already a tough year for emerging markets. Many of these economies have been affected by a stronger US dollar, which has increased the cost of servicing debt and put pressure on currencies. South Africa fell into recession in September while Turkey hiked interest rates up to 24 per cent.

The rout in emerging markets was not helped by an escalating trade

Rising borrowing costs in the US have hit bond markets, pushing 10-year Treasury yields over 3 per cent, which has stoked volatility in equity markets

war between the US and China. President Donald Trump announced in March that he would put tariffs of up to 25 per cent on $50bn of goods imported from China, including steel and aluminium. China responded by putting its own tariffs on US goods including soybeans and cars, and accused Trump of starting the biggest trade war in economic history.

The long-term impact of tariffs is not yet known but there are fears they could weigh heavily on growth in China, where there are already concerns about a slowdown.

Darius McDermott, managing director at FundCalibre, says: "Rising interest rates support the US dollar and keep it strong, which is bad news for emerging markets. Couple this with the impact they have yet to feel from the trade-war tariffs and emerging economies could start to slow and see inflation pick up. Long-term investors may like to take advantage of cheaper share prices, but they may have to be patient."

While there is talk of a truce between the two nations, Hollands says: "This has clearly unnerved sentiment and could continue to ratchet up next year. Tariff rates on existing goods targeted are set to be hiked in January and potentially broadened out to all Chinese goods if a rapprochement isn't reached."

Political unrest

China and the US are not the only economies that have been driven by political rhetoric in 2018. In Europe, a coalition government in Italy caused unrest, while in the UK Brexit has continued to dominate the headlines. Amid the uncertainty, investors

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number of years from launch it took **Amazon** to become a **$1trn** company

A more volatile credit market and more expensive borrowing costs added strife to what was already a tough year for emerging markets

have continued to flee from UK equity funds, with net outflows every month this year. The FTSE 100 has been insulated from this sentiment to an extent because it is dominated by dollar-earners, but a sell-off in October saw it fall below 7,000.

Hollands says we have "potentially reached an inflexion point in markets" and that investors are feeling wary about the outlook. However, he points out this could be

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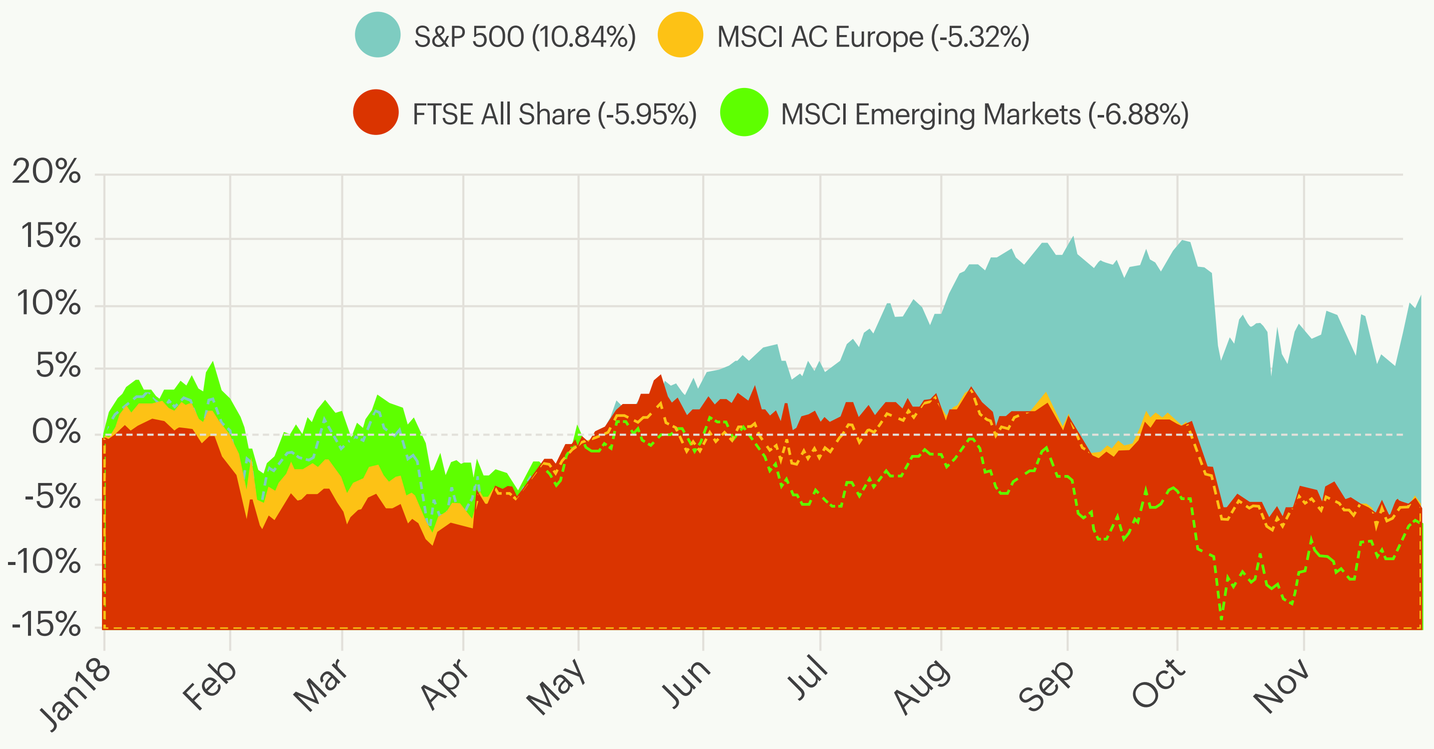
PERFORMANCE OF INDICES IN 2018



Source: FE Analytics

good news for value investors who tend to outperform once earnings have peaked. McDermott agrees: "As quantitative tightening gathers pace, value stocks could make a comeback."

Falling FAANGs

Most notable among the fallers in October were the FAANGs – Facebook, Apple, Amazon, Netflix and Alphabet (Google) – which have risen exponentially in recent years. Just weeks earlier, Apple became the first company ever to reach a market capitalisation of $1trn, 38 years after listing. Amazon was hot on its heels to reach that landmark, just 21 years after opening for business.

But Dennehy was not surprised to see the tech giants fall back after such a sustained period of success. The Nasdaq index reached 8,000 for the first time in the summer. Dennehy says: "This was the year when Apple suddenly didn't have all the stats to hand telling us how many iPhones it had sold. We think the tech rout could get ugly in 2019."

It was no surprise amid the tech turmoil that the Dow Jones – an index that is dominated by the sector – suffered heavy falls. The US has been firing on all cylinders and company earnings had increased by around 27 per cent in 2018 as the record bull run in the market continued. The US economy is enjoying its second-longest period of unbroken GDP expansion in history and that has been helped along by significant corporate tax cuts introduced by Trump. These have helped to drive a record year for share buybacks among US corporates, which has in turn contributed to the ongoing climb in US share prices. But Hollands warns that as the rate of buybacks starts to slow, share prices could also ease off.

In October, investors finally seemed to become wary about whether the stock market success could continue. The Dow Jones reached a new peak of 26,951 on 3 October before it plunged almost 10 per cent to 24,285 by the end of November.

While the index has since recovered some of these losses, Dennehy thinks there could be further to fall: "We expect a correction of 20 to 30 per cent and possibly something much nastier," he says.

"Crucially, whatever the scale of the US fall, it will be more or less replicated in the UK."

> **"Crucially, whatever the scale of the US fall, it will be more or less replicated in the UK"**

There may be trouble ahead

December is when many investors expect to enjoy a Santa Rally, but with so much still to play out in the final weeks of the year, a seasonal surge may not materialise in 2018.

The new year will see Qatar depart the Opec cartel, leaving the outlook for oil prices uncertain; momentum could slow in the US after Trump lost the House of Representatives; and in the UK and Europe, fears about the implications of a no-deal Brexit continue to fester.

Dennehy says: "While it has been a year of peaks – peak Trump, peak Dow Jones, peak Apple – I don't think we have reached peak Brexit hysteria or peak voter discontent throughout the western world." •

Praveen Kumar, manager of Baillie Gifford Shin Nippon and deputy manager of the Baillie Gifford Japan Trust, tells journalist Joji Sakurai that Japan's staff shortages have sparked creativity and investment opportunities

The bright side of Japan's labour crunch

As Japan's population declines, it has been left with a glut of about 8 million abandoned homes, known as 'akiya', across the country. Katitas, held in Baillie Gifford Shin Nippon, buys up such houses, renovates them and sells them at an affordable price – rejuvenating communities and giving young families a start.

Katitas is a compelling example of the opportunities to be reaped in what looks like an alarming demographic picture – often cast as condemning Japan to long-term decline. One of Japan's most pressing issues is an acute labour crunch as its working age population, which peaked in 1997, continues to shrink. There are currently about 160 job openings for 100 applicants, the tightest labour market since 1974. One-third of Japan's construction workers are over the age of 55. Many all-night restaurants in Japan are closing because they cannot find enough staff. And Yamato Transport – Japan's largest parcel delivery company – is mulling an exit from Amazon same-day deliveries because of a lack of drivers.

Yet there is another way to look at labour shortages that points to a brighter future for Japan's economy.

Outsourcing and labour-saving technologies are the stellar growth drivers in the labour crunch

Outsourcing and labour-saving technologies are the stellar growth drivers in the labour crunch. One company that is benefiting from this structural tailwind is the specialist staffing company Outsourcing Inc, which both Baillie Gifford Shin Nippon and the Baillie Gifford Japan Trust hold shares in. During Japan's long period of stagnation, companies began to rely heavily on contract workers over permanent staff to

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rein in costs. The government subsequently introduced legislation that requires companies hiring staff working on temporary contracts for more than five years to employ them as permanent employees. Outsourcing's business model effectively hires such workers from major corporations as regular employees – providing them with the benefits of permanent staff – and leases them back to the company from which they originally came. The client pays an annual fee to Outsourcing and also pays the workers' wages.

Not only are they providing this large pool of experienced workers to companies that need them, they are also hiring these contract workers from their clients and employing them as their own full-

Contrary to the downbeat commentary you see in the financial press and elsewhere, there is a brighter side to Japan's labour crunch both for investors and for society at large

time employees, giving them all the associated benefits such as pensions, insurance and wages commensurate with their experience and expertise. This arrangement removes a potentially expensive staff overhead for clients. Meanwhile, Japan's world-leading expertise in robotics gives it natural advantages in laboursaving strategies. Cyberdyne is a company in the Baillie Gifford Japan Trust's portfolio that makes a robotic exoskeleton, enabling the physically disabled to walk. Now its technology is being used on construction sites to help workers perform heavy lifting.

Other labour-saving technologies exploit inefficiencies in Japan's economy – a system of middle-men and legacy relationships that push up costs for consumers. Infomart, for example, allows restaurants to place orders online from suppliers, in an industry greased by personal contact. Broadleaf runs a platform for garages to shop around for auto parts online. Both companies, which are in Baillie Gifford Shin Nippon's portfolio, challenge cherished practices that serve as social binders but hold back an urgent need to boost productivity.

And Katitas – the company that renovates abandoned homes – is a pioneer in promoting Japan's most important neglected labour resource of all: its women. About 40 per cent of Katitas's workforce is female and the company is proactive about bringing them into management. Last year, all five top salespeople on Katitas's staff were women. And unusually for Japan, the company extends generous maternity leave – without any career setbacks to be expected upon return.

Kumar believes that, contrary to the downbeat commentary you see in the financial press and elsewhere, there is a brighter side to Japan's labour crunch both for investors and for society at large. ●

The value of a stock market investment and any income from it can fall as well as rise and investors may not get back the amount invested. Investments with exposure to overseas securities can be affected by changing stock market conditions and currency exchange rates. Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions. The trusts' exposure to a single market and currency may increase risk. For a Key Information Document please visit our website at **www.bailliegifford.com**

Anthony Luzio finds alternative assets from a vast array of sectors are proving popular with investment trust analysts for the year ahead

Pick & mix

The recent spike in volatility has brought home to investors the importance of capital preservation, particularly through assets with a low correlation to equities. However, the fall in markets has also begun to attract more adventurous bargain hunters to out of favour areas. Both of these themes have a strong bearing on the experts' investment trust picks for 2019.

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Markuz Jaffe, Cantor

Cantor investment companies analyst Markuz Jaffe currently favours a blend of defensive strategies alongside higher risk ones, particularly those that have de-rated in the recent volatility.

In terms of defensive strategies, Jaffe is still keen on his trust-picks from last year – NextEnergy Solar Fund and Greencoat UK Wind – which he selected for their ability to provide long-term inflation-linked income.

"A particularly interesting angle here is the lack of acquisitions from the solar funds, where market pricing for subsidy-backed UK assets is too expensive to meet their return targets," he says.

"This could imply that the carrying value of the listed funds' assets is too conservative and therefore contains upside potential, even when adjusting for the relatively small premium rating on the shares."

For the higher-risk section of his portfolio, Jaffe says a UK equity strategy such as Henderson Opportunities Trust is appealing. The analyst notes that not only have UK equities been beaten down in the ongoing Brexit saga, but smaller companies have been hit particularly hard as sentiment has soured on UK-sourced revenues.

"A double-discount opportunity exists via Henderson Opportunities Trust, which trades around a low-teen discount and has a significant exposure to smaller, higher growth companies which themselves trade at depressed levels versus history," he says.

"Also, an allocation to sterling-denominated assets should mitigate against losses on non-sterling investments should sterling strengthen from its weak position."

Monica Tepes, finnCap

Monica Tepes, head of investment companies research at finnCap, believes most asset classes will struggle to deliver even high single-digit returns in the near to medium term. However, one investment company she believes has a good chance of making 10 per cent or more over the coming year is Grit Real Estate Income.

"Grit, founded in 2014 and listed on the London Stock Exchange in July 2018, is a $450m market cap pan-African real estate company which invests in politically stable and investor-friendly countries outside South Africa," says Tepes.

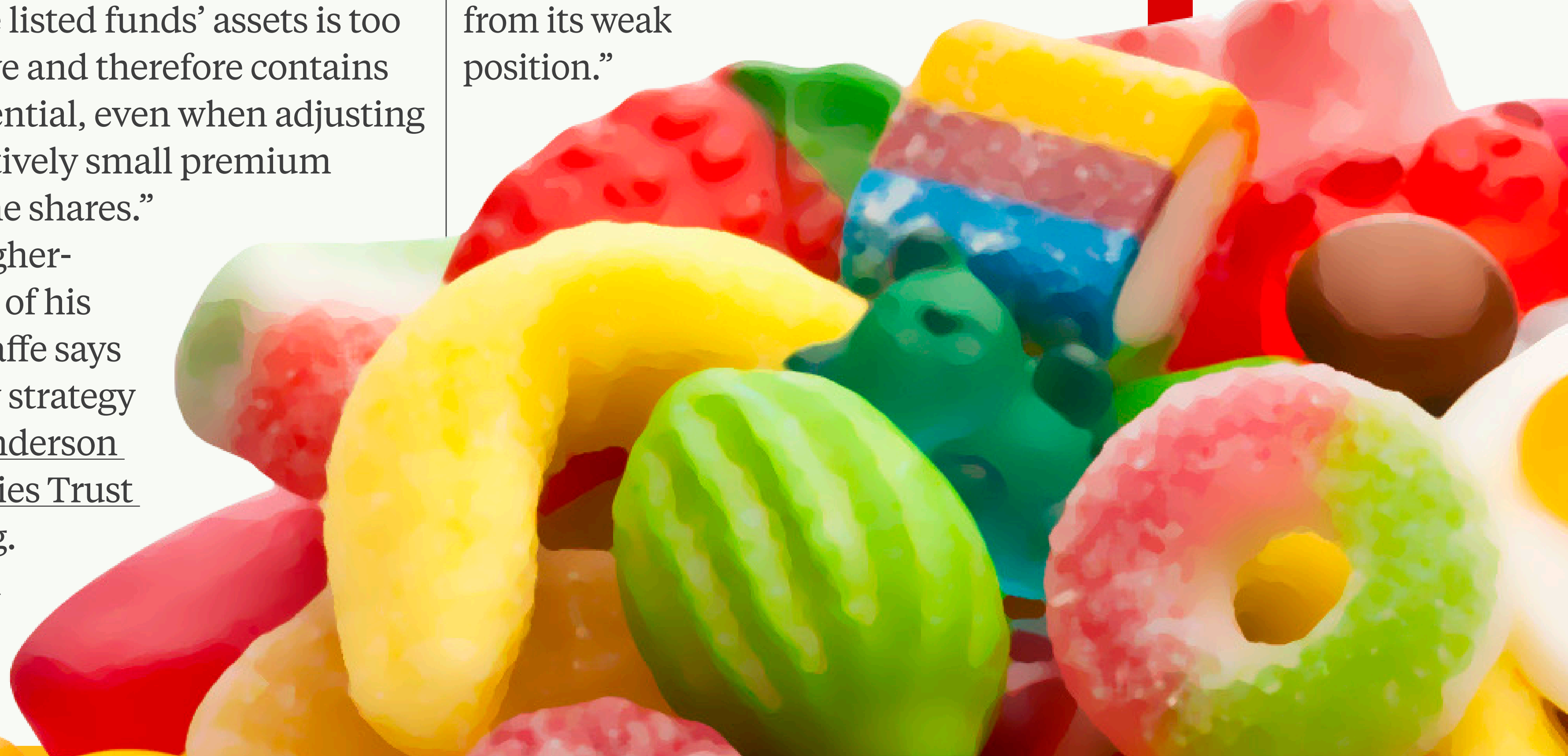
"Its tenants are blue-chip multi-nationals such as BP, Barclays and Vodacom, who pay rents in dollars and euros."

Grit pays a covered dividend of 8.5 per cent, which is expected to grow by more than 3 per cent or more per annum, and targets annual NAV total returns of 12 per cent.

Tepes notes that both the dividend growth and NAV total return target are underpinned by the contracted index-linked annual rent increases of 3 to 5 per cent a year.

"So as long as these blue-chip tenants keep paying their rents (I would say the risk of default is relatively low), the income should grow and so should the property valuations, assuming no widening of yields," she continues.

"Additionally, further NAV growth can come from redevelopment of existing assets, lowering the cost of debt, yield compression on improving macroeconomics and achieving savings as new tax rules come into force."



Ewan Lovett-Turner, Numis

With markets focused on the geopolitical uncertainty going into 2019, Ewan Lovett-Turner, director of investment companies research at Numis, believes it is an attractive time to invest in HgCapital Trust. This is a private equity vehicle which he says is differentiated through "its clearly defined investment approach focused on technology and technology-enabled services".

"The portfolio has little sensitivity to economic growth, due to a focus on fast-growing, cash-generative businesses, with a high proportion of recurring earnings," Lovett-Turner adds.

"Software as a service (SaaS) companies represent a significant portion of the portfolio."

HgCapital's 20 largest investments have average sales growth of 23 per cent and earnings growth of 19 per cent. These sorts of figures have helped it achieve NAV total return growth of 13.3 per cent per annum over the past 20 years, significantly above the 5.7 per cent from the FTSE All Share.

Lovett-Turner adds the trust has a strong record of timing the cycle well and has been a net seller of investments over recent years, "consistently exiting at significant uplifts to carrying value".

"Even though the portfolio is now less mature, we believe HgCapital is well positioned to continue delivering double-digit NAV growth over the long term," he says.

The trust currently trades on a 9 per cent discount.

Disclaimer:
Hg is the owner of FE

James de Bunsen and **Peter Webster** reveal how they are positioning Henderson Alternative Strategies Trust for the latter stages of the business cycle

Alternative times call for alternative solutions

At Henderson Alternative Strategies Trust (HAST), we have been gradually reducing the portfolio's riskier positions in anticipation of a downturn and October's sell-off was a comforting nod to the team's efforts.

October may have been a sign of things to come with increased volatility typical of the latter stages of the business cycle. The FTSE World Index, which HAST aims to outperform over the long-term, returned -5.5% during the month. The Trust returned -2.2%, which means it outperformed the benchmark by 3.3% (source: Bloomberg) during a tough month for global investment markets. The Trust's NAV was also less sensitive to the late January/early February sell-off in global equity markets.

This is encouraging in the sense that we have built the portfolio to be less correlated with mainstream equity and bond markets over recent years. It gives us some confidence that we are moving in the right direction and we can weather the storm and keep our shareholders happy.

Reorienting the portfolio to a 'risk-off' (less risky) position has been a gradual process, but now we are close to where we want to be. We have divided the portfolio into six distinct categories: hedge funds (23.7% as at 21st November), private equity (29.6%), listed equity (15.4%), property (12.2%), commodities (4.0%) and credit (11.1%). Using these categories we can demonstrate the diversity of the portfolio and why we believe it will be resilient to volatility.

Hedge funds

We took the opportunity during October's sell-off to top up a few of our hedge fund positions with the sector taking a heavy beating during the month. Our largest hedge fund holding is the Blackrock European Hedge Fund. The fund takes both long and short positions to invest in the public equity markets of Europe. It invests in stocks of companies operating across diversified sectors and invests across all market capitalisations, with the primary aim of maximising total returns.

Private equity

One pick from the private equity sleeve of the portfolio is Mantra Investment Partners' Mantra Special Opportunities Fund, also one of the Trust's largest holdings. The fund invests in a broad range of private equity businesses and we like it because it buys these businesses at significant discounts to net asset value.

We have built the portfolio to be less correlated with mainstream equity and bond markets over recent years. It gives us some confidence that we are moving in the right direction

Listed equity

Litigation finance firm Burford Capital was one of two new positions added during October and it is one we are very keen on. The market sell-off in early October provided a good entry point for us to open a position in Burford, which suffered as did many small and medium-

sized high growth businesses during the month. However, we see litigation finance as an uncorrelated asset class generating high returns, a very underpenetrated market with significant barriers to entry. Burford is undoubtedly the leading litigation financier and we were able to open a position at an attractive level as the stock fell 23.5%, peak to trough in October.

Credit

HAST's mandate to source alternative investment opportunities often takes us well off the beaten track and can lead us towards good performers like Asmore Sicav Emerging Markets Short Duration Fund, which invests in short duration emerging market bonds, typically issued by governments or companies, which are denominated in USD. Since its inception in 2014, the fund has delivered a three-year annualised return of 16.86%.

Property

In the property sleeve, we are excited about Urban Logistics REIT (Real Estate Investment Trust). Urban logistics is a fast-growing segment within the real estate sector and includes warehouses and facilities used for the storage and delivery of consumer goods. The growth of online shopping and increasing demand for home delivery has led to more demand for urban logistic centers and it's a trend we think will continue in the long term.

Commodities

Commodities are another great diversifier to some of the mainstream equity markets and a natural protection against inflation. We hold the Bank of America Merrill Lynch Global Commodities fund because we believe that a truly diversified multi-asset fund should have an allocation to commodities. We do not have a strong belief that commodity markets will rise over the coming years and we like the Bank of America Merrill Lynch strategy because it is market neutral in nature.

Spread your bets

These examples should provide a sense of the diversity within the Trust's portfolio and how the team is working towards a resilient portfolio that can outperform during times of market stress.

We believe that investors will have to adjust to greater volatility going forward. At this stage of the market cycle, missteps by policy makers are likely to be more keenly felt. Global growth seems to be gently rolling over, mainly led by China, although the US remains solid for now and this should support risk assets. However, we are becoming increasingly cautious and so remain vigilant and will look to react accordingly. ●

Glossary

Volatility: The rate and extent at which the price of a portfolio, security or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

Quantitative tightening: A contractionary monetary policy applied by a central bank to decrease the amount of liquidity within the economy. The policy is the reverse of quantitative easing aimed to increase money supply in order to stimulate the economy.

Bull market: A financial market in which the prices of securities are rising, especially over a long time. The opposite of a bear market.

Liquidity: The ability to buy or sell a particular security or asset in the market. Assets that can be easily traded in the market (without causing a major price move) are referred to as 'liquid'.

Despite a disappointing year for the sector, a growing number of people are coming around to the long-term advantages of investment trusts, writes **Cherry Reynard**

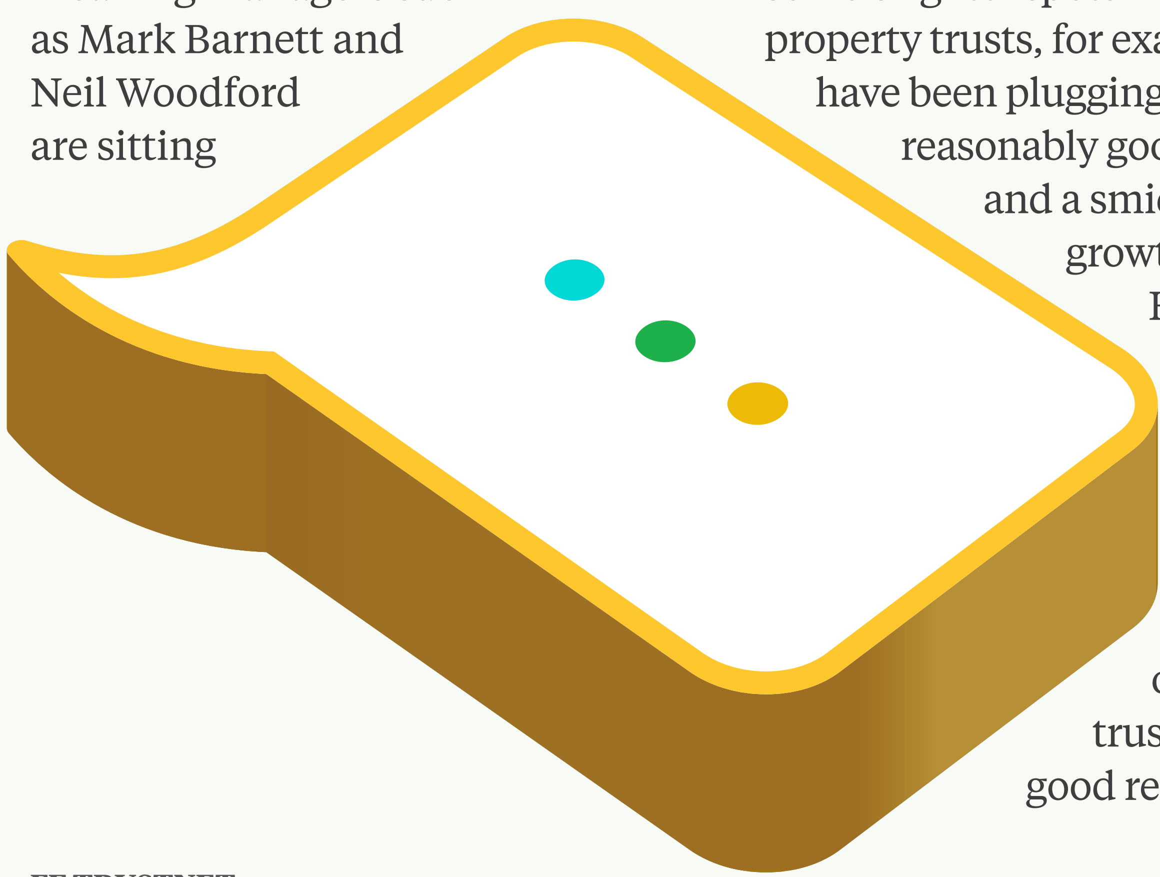
Getting the message through

With F&C celebrating its 150th anniversary and Smithson breaking the record for the largest ever investment trust launch, 2018 was a fruitful year for the closed-ended sector. It continues to evolve, away from its heritage as a structure for conventional equity funds and towards alternative assets classes. It is also broadening its customer base as self-directed private investors become more convinced of the performance argument for closed-ended funds.

Ratings for some domestically oriented companies have deteriorated to the extent that they are discounting a serious recession

Having said that, they may not have felt as satisfied with their investment trust holdings this year, with almost every sector under water. Peter Walls, manager of the Unicorn Mastertrust, says: "It hasn't been the easiest time to make money. If you look across equities, bonds and commodities, there aren't many bright spots."

Equities have struggled globally. Emerging markets suffered, with the sector down 10 per cent while European markets fared almost as badly. The UK has also been out of favour, with trusts exposed to the domestic economy, notably mid and small caps, hit particularly hard. Within the UK market, "value" focused funds have struggled, meaning managers such as Mark Barnett and Neil Woodford are sitting towards the bottom of their respective sectors. Barnett has argued ratings for some domestically oriented companies are now discounting a serious recession and Walls believes there may be some value in the year ahead. In the meantime, it has been an uncomfortable time for investors.

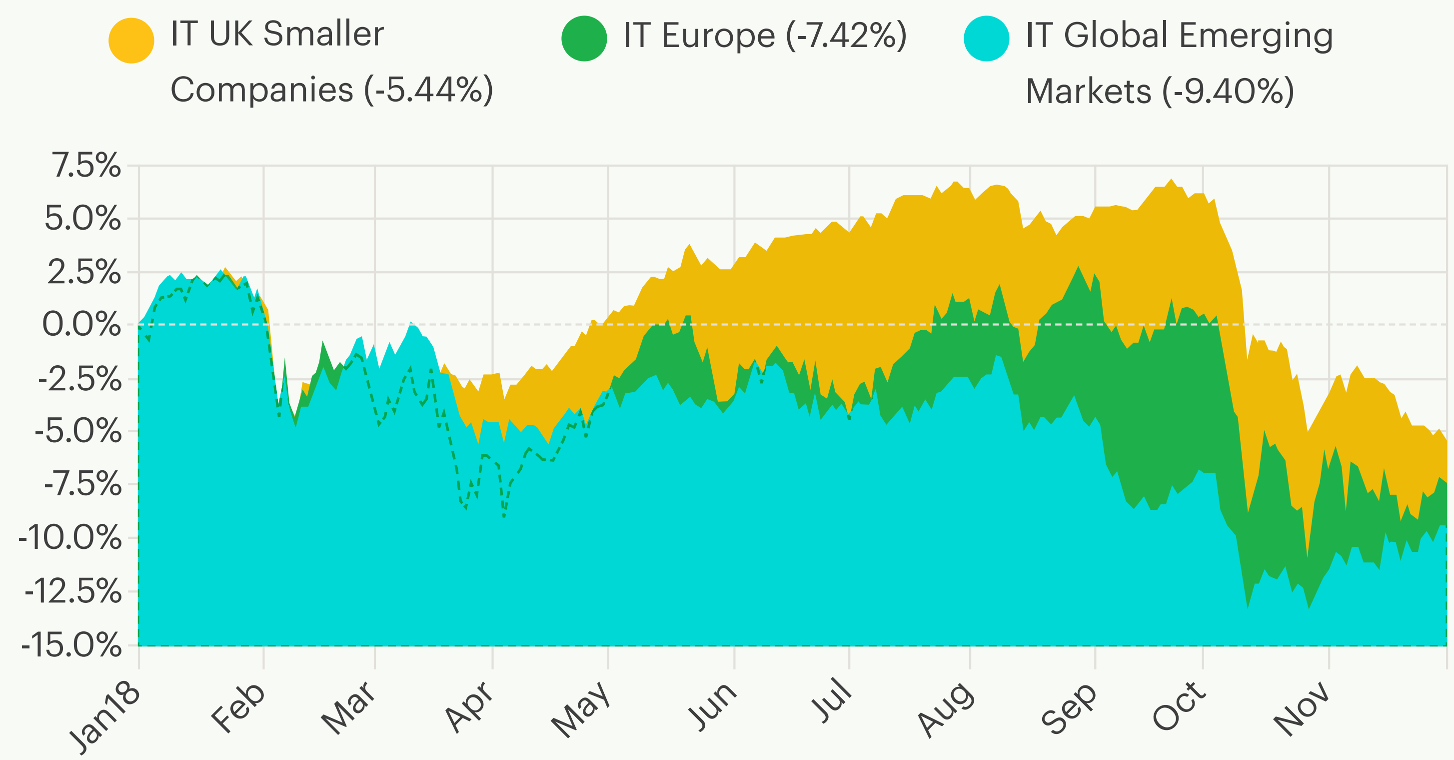


Brighter spots

Walls points out there have been some brighter spots – commercial property trusts, for example. "These have been plugging away, getting reasonably good rental growth and a smidgen of capital growth," he says.

He also says that despite the turmoil towards the end of the year, many technology or US-focused trusts have made good returns.

PERFORMANCE OF SECTORS IN 2018



Source: FE Analytics

At the same time, market weakness doesn't seem to have deterred new investors. Terry Smith's Smithson trust raised a record £822m, perhaps helped by its decision to take on all the costs of the launch. This was a significant precedent to set and may pressure other investment trusts to do the same.

Walls says it is notable on the equity side that new launches have moved away from the "steady income" approach that has characterised new investment trusts in recent times. This year has seen the introduction of Baillie Gifford US Growth, Augmentum Fintech, AVI Japan Opportunity, and the Mobius Investment Trust.

Tony Yousefian, investment trust research analyst at FundCalibre, says: "The Mobius Investment Trust is interesting in terms of timing – emerging market smaller companies have been hit in the market sell-offs, so it could be a good entry point for long-term investors. Mark Mobius has put together a strong team and, although it 'only' attracted £100m at IPO (half its target), it is a niche asset class, so perhaps this is not surprising."

Yousefian was also interested in Richard Buxton's Merian Chrysalis Investment Company, which will invest in unquoted stocks. "This is another trust that didn't hit the IPO target, but which we think offers something new and different."

It is notable that on the equity side, the new launches have moved away from the "steady income" approach that has characterised new investment trusts in recent years

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Playing a different tune

There was also plenty going on in non-equity investment trusts, a sign of how the sector has diversified. There was the launch of Hipgnosis Songs, which invests in music rights, as well as Gresham House Energy Storage. More established alternatives such as infrastructure have also raised additional capital.

This makes it difficult to generalise about discounts, but Miton Global Opportunities' Nick Greenwood says investors often move back to the benchmark in difficult times: "As a result, many small caps have struggled and are now on significant discounts."

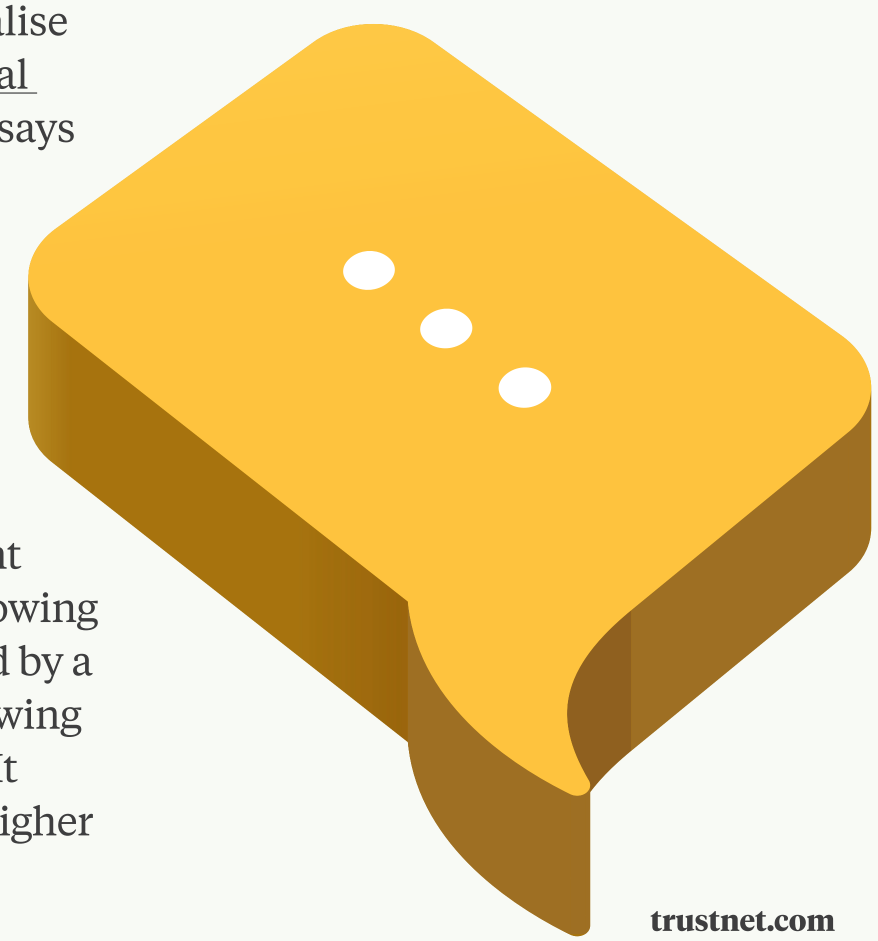
Greenwood has noticed a marked change in the shareholder register of investment trusts, with platforms taking a growing share. This momentum was aided by a CASS Business School report showing trusts tend to outperform funds. It found even when gearing and a higher weighting in smaller companies are factored out, trusts still do better. The message is getting through.

Under pressure

Walls believes there is growing pressure on managers and boards if trusts don't perform, reflected in aggressive buyback and discount policies. There has even been a merger – between the Standard Life and Dunedin Smaller Companies trusts. Walls adds: "More should be done, but I'm not holding my breath."

Nevertheless, he believes the sector is coming of age: "More DIY investors are using them in their pension funds and parts of the IFA community, too."

These are small steps, but the sector is starting to look very different to how it did just a few years ago. ●



This fund has missed out on much of the bull run over the past five years, but its cautious positioning is beginning to pay off

Schroder MM Diversity

Schroder MM Diversity has endured several years of lacklustre returns but managers Marcus Brookes and Robin McDonald expect the changing market backdrop to herald a pick-up in performance.

FE Analytics data shows Schroder MM Diversity has made 10.30 per cent over the past five years, putting it 116th out of 117 funds in the IA Mixed Investment 20-60% Shares sector.

This underperformance is down to the portfolio's cautious positioning, resulting from the managers' distrust of the ultra-loose monetary policy that has pushed markets higher in the decade since the financial crisis.

A higher allocation to cash, positions in alternatives – typically long/short funds with a defensive bias – and an aversion to bonds has caused the fund to lag its peers for much of the bull run. It also prefers the value style of investing, which has underperformed growth for much of the past decade.

However, this defensive stance has paid off in recent months as markets corrected on the back of concerns over the trade dispute between the US and China, the Federal Reserve's rate-hiking programme, Brexit and signs of slowing economic growth.

Over the three months to the end of November 2018, Schroder MM Diversity generated a 0.99 per cent total return. While this may seem small, it was the highest return of any fund in its sector and compares favourably with losses of 4.01 per cent from the MSCI World index.

McDonald conceded the fund has been through a challenging period recently, but said investors appear to be coming around to his way of thinking.

"The market appears to be very lopsided in how people are positioned and I think there is a fantastic opportunity to lean against the consensus here and make good returns," he said.

"Not that I should, but I do worry about other people's portfolios because they are heavily concentrated in areas that, over the next 12 months, they probably won't want to be in. But that's what makes a market."

"If we are right and people start reallocating towards our positions, that will be hugely beneficial for us."

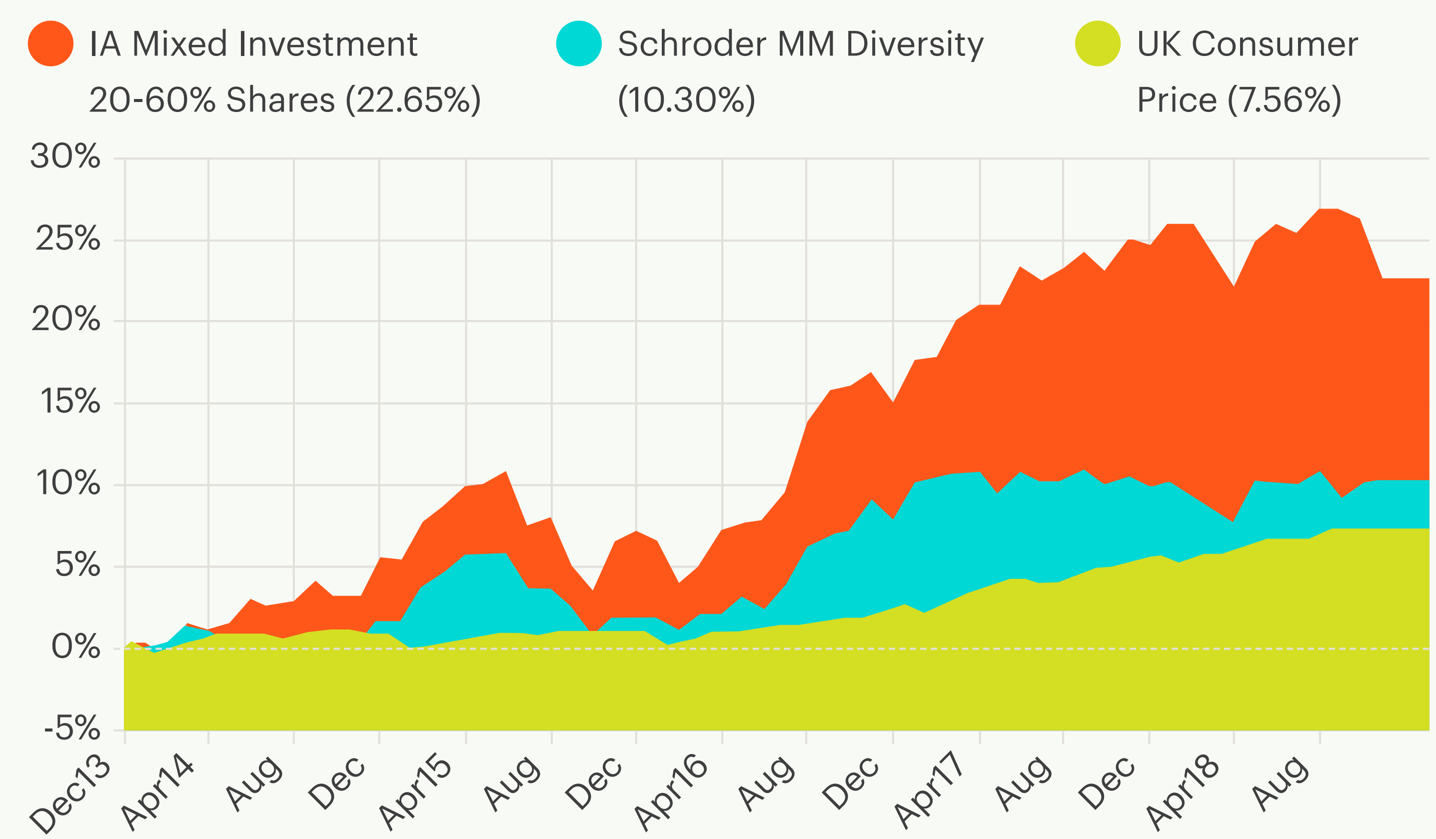
Schroder MM Diversity has 23.5 per cent in cash, 33.3 per cent in alternatives, 24.9 per cent in global equities, 10.1 per cent in bonds and 8.2 per cent in UK equities. Its biggest holdings are Invesco Tactical Bond, Majedie Tortoise, Sanditon European Select, GAM Global Eclectic Equity and GLG Japan Core Alpha.●

FACT BOX

MANAGERS: **Marcus Brookes & Robin McDonald** / LAUNCHED: **01/09/2005** / FUND SIZE: **£600m** / OCF: **1.25%**

FE CROWN RATING

PERFORMANCE OF FUND VS SECTOR AND INDEX OVER 5YRS



Source: FE Analytics

Manager Daniel Roberts says there is a contrarian opportunity in certain bond-proxy sectors that have suddenly fallen out of favour

Fidelity Global Dividend

While interest rates – in the US at least – are beginning to move higher, the need for yield remains as strong as ever.

High and sustainable yields from so-called "bond proxies" in sectors such as utilities and telecoms made such stocks the darlings of the low-rate environment. However, these have fallen out of favour as central banks have begun the process of normalisation.

As such, one manager has spied a contrarian opportunity among bond proxies that have sold off. Daniel Roberts, manager of the £883m Fidelity Global Dividend fund, has developed a reputation for his willingness to take unpopular sector bets – which have tended to pay off.

The manager has recently bought pharmaceuticals and consumer staples, which he believes are undervalued.

Aggressive assumptions in the market over the impact of biosimilars – copies of existing licensed drugs – and a more cautious outlook on pipeline success have seen pharmaceutical stocks devalue despite strong balance sheets. Meanwhile, Roberts is bullish on the prospects for the consumer staples sector because of the potential to tap into emerging markets and the growing consumption story.

He is not optimistic about all bond-proxy sectors, however, and noted the increased competition in telecommunications and interest rate-sensitive real estate stocks.

While the manager is willing to take strong sector bets, he also takes a high conviction, bottom-up approach to stockpicking, building a portfolio of just 46 names from a universe of 2,500 with a high yield that is capable of increasing over time.

The fund also has a capital preservation element, with Roberts focusing on risk from a potential loss perspective rather than tracking error or volatility. As he put it: "We ask ourselves: 'What is the potential for losing money on an investment?'"

"Albert Einstein called compounding 'the eighth wonder of the world', but when you're thinking about compounding, you've got to realise compounding returns and compounding losses are not equal."

The fund has made 134.53 per cent since launch in January 2012, compared with 120.2 per cent from its MSCI AC World index benchmark and 91.07 per cent from the IA Global Equity Income sector.

The fund has a yield of 2.62 per cent and an ongoing charges figure of 0.93 per cent.●

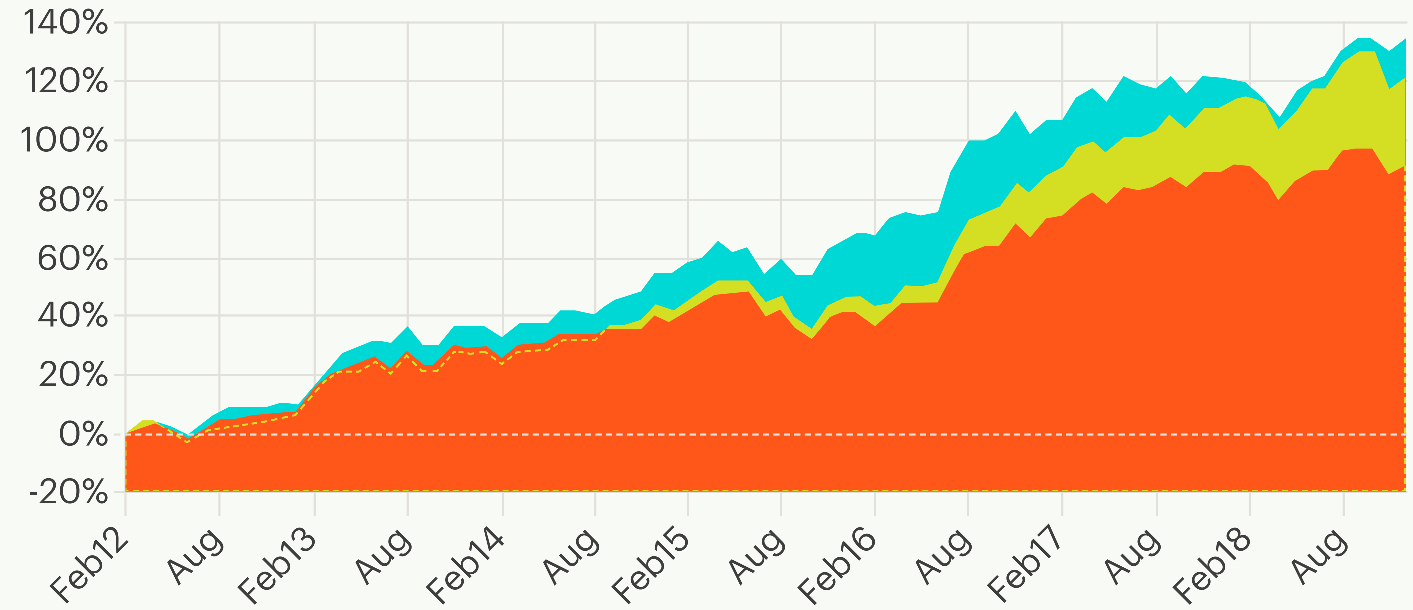
FACT BOX

MANAGER: **Daniel Roberts** / LAUNCHED: **30/01/2012** / FUND SIZE: **£883m** / OCF: **0.93%**

FE CROWN RATING

PERFORMANCE OF FUND VS SECTOR AND INDEX SINCE LAUNCH

Fidelity Global Dividend (134.72%) MSCI AC World (120.90%) IA Global Equity Income (91.40%)



Source: FE Analytics

This trust, headed up by Bruce Jenkyn-Jones and Jon Forster, allows investors to profit from "the war on plastics"

Impax Environmental Markets

There is a belief that an ethical investment strategy comes at the expense of higher returns and with the IT Environmental sector still down by more than 40 per cent since launch towards the end of 2000, it is not too difficult to see why.

However, this does not mean it is impossible to make a strong return from a strategy focusing on this area, with Impax Environmental Markets a case in point. The trust, overseen by Bruce Jenkyn-Jones and Jon Forster, is aimed at investors who want to benefit from the transition to a more sustainable global economy.

It has made 198.02 per cent since launch in February 2002 compared with 42.63 per cent from the IT Environmental sector and 228.91 per cent from the MSCI AC World index.

One of the best-performing themes in the trust this year has been "the war on plastics". Forster said a confluence of factors, including growing consumer awareness and policy changes aimed at stopping or reducing the pollution of the oceans, has seen this trend gather momentum over the last year.

"We have programmes like Blue Planet II causing a substantial public outcry and desire for change," Forster explained. "At the same time, we've had China introducing some import bans on contaminated recyclables."

"Europe and North America used to export millions of tons of contaminated recyclables over to China. It used to pick through it and then feed it back into its economy."

"China has environmental problems of its own now and is not going to sort out our problem anymore."

The combination of these two factors is having an enormous impact on governments and corporates, with a growing take-up of policies aimed at reducing the use of plastics and finding more environmentally friendly alternatives.

As such, Forster said the team is finding many opportunities in areas aimed at disrupting the disposable plastics industry.

These include infrastructure, where there is a growing need for more recycling facilities to process plastic bottles and containers; new materials, which offer a biodegradable alternative to plastics; and software and technology that allow companies to capture and analyse data from industrial environments.

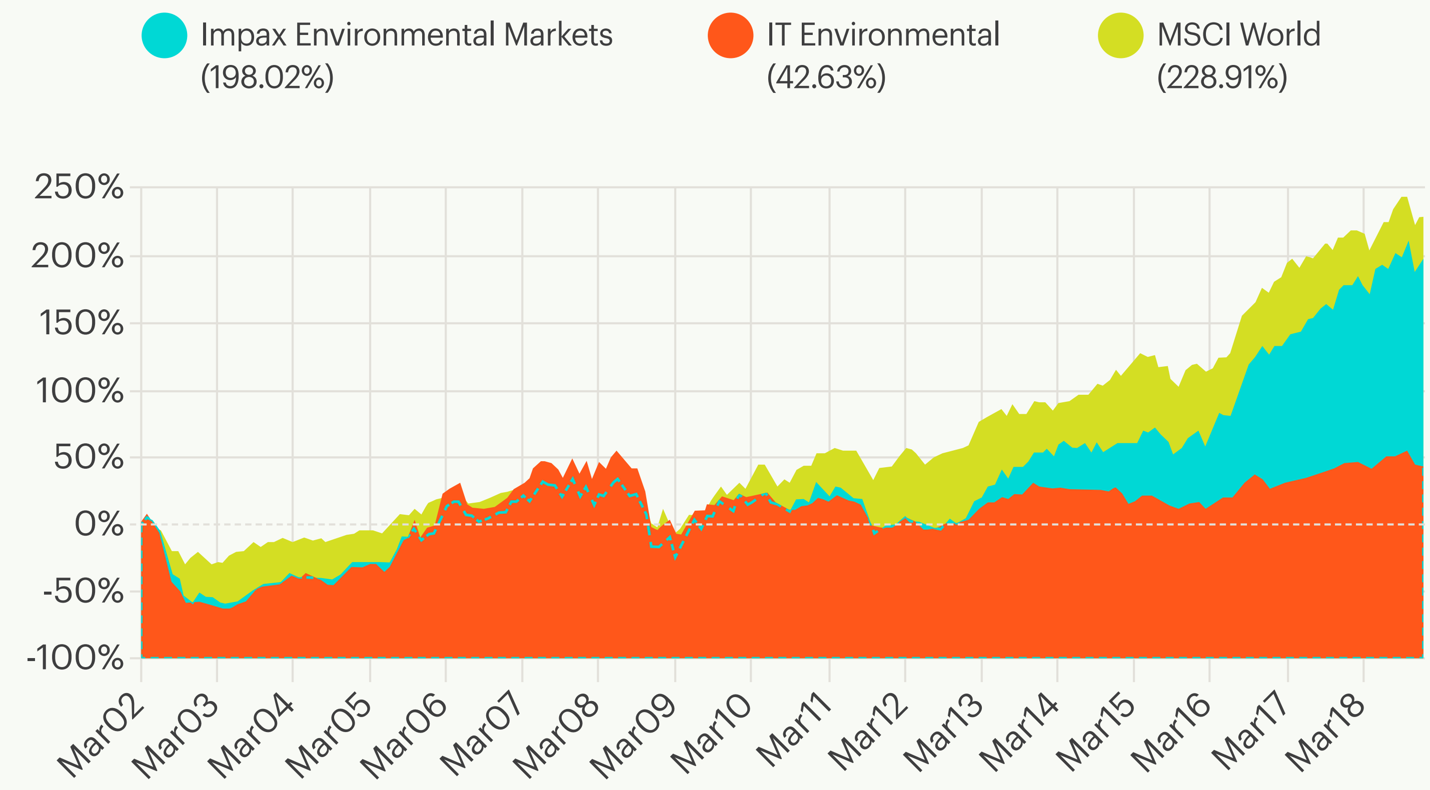
Impax Environmental Markets is trading at a 2.8 per cent premium. It has ongoing charges of 1.05 per cent. ●

FACT BOX

MANAGERS: **Bruce Jenkyn-Jones and Jon Forster** / LAUNCHED: **22/02/2002** / DISCOUNT/PREMIUM: **+2.8%** / OCF: **1.05%**

FE CROWN RATING

PERFORMANCE OF TRUST VS SECTOR AND INDEX SINCE LAUNCH



Source: FE Analytics

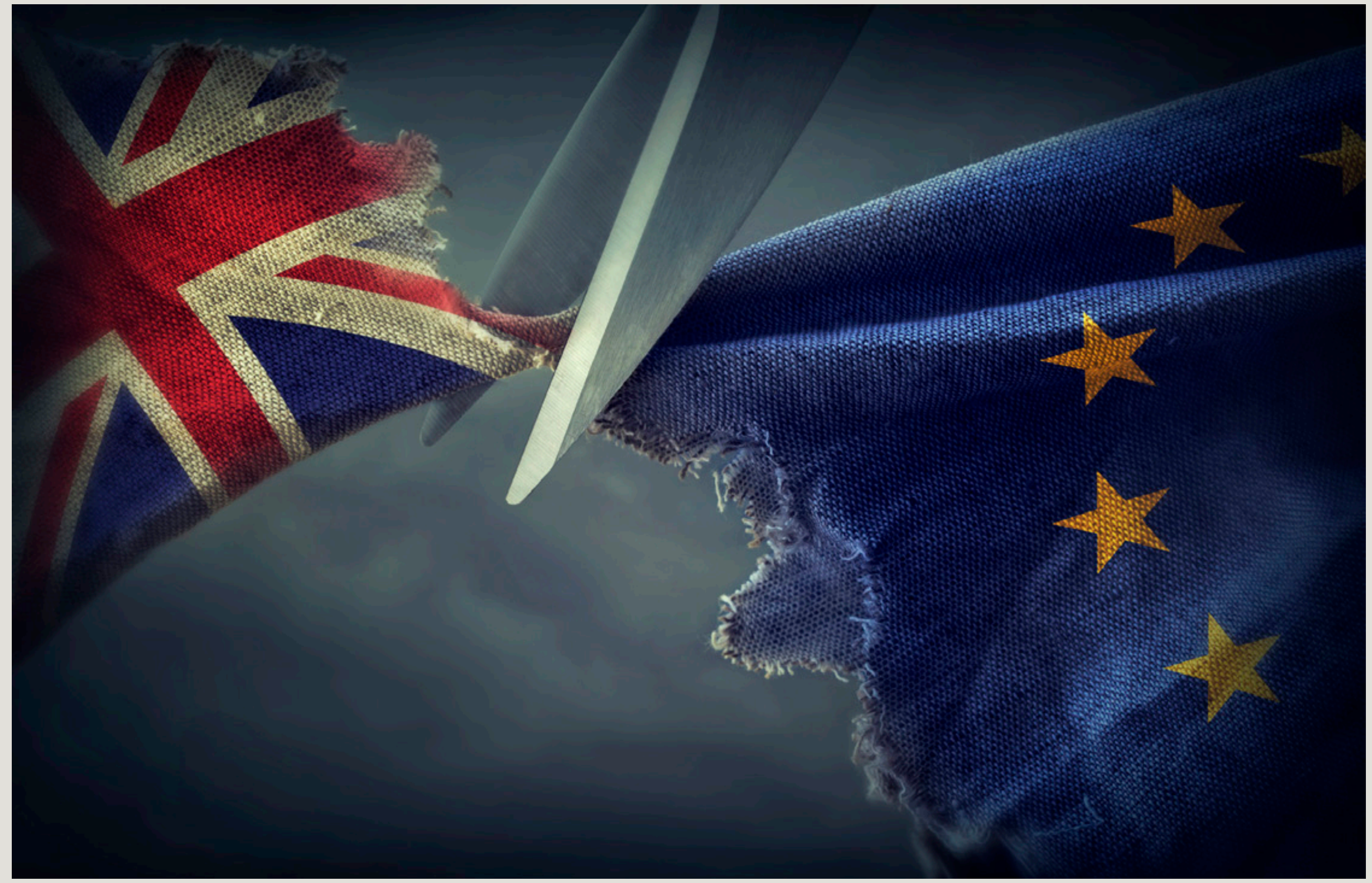
Adam Lewis finds fund managers bracing themselves for an uptick in volatility as he sums up the outlook for every regional investment trust sector in 2019

Fasten your seat belts

Interest-rate rises and the return of volatility were the dominant themes in 2018. After a period of calm, markets plummeted in February, prompting asset allocators to adopt defensive positions. Closer to home, Brexit uncertainty continued to abound, leading to outflows from domestic UK equity portfolios.

With these questions unresolved, 2019 looks set to be another eventful year. So what are managers doing with their portfolios and what are the best investment trusts to help you navigate the coming 12 months?

The UK



Heading into 2019, Toby Ross, co-manager of the Baillie Gifford-managed Scottish American Investment Company (SAINTS), says his focus remains exactly where it was in 2018 and the year before: namely the most resilient sources of income and growth. As a result, he is concentrating less on what is happening with global monetary policy and politics and more on bottom-up stock selection. SAINTS' global mandate means it can invest anywhere in the world; it currently has little domestic UK exposure, focusing instead on large caps that derive the majority of profits from overseas.

"We own Admiral, which has some domestic exposure and some international earnings, but this is not a stock which will be driven by Brexit concerns, because Brexit will not make a difference to your decision about insuring your car," says Ross.

"However, more generally we have more money in more global, high-quality UK growth businesses, which aren't likely to get dragged down by Brexit uncertainties."

Paul Niven, manager of the F&C Investment Trust, says that even though the UK looks cheap at present, it is likely to remain so even if there is a "good" Brexit outcome.

"Brexit uncertainty is set to persist and we think that the UK is in a lose-lose situation right now," he explains.

"Even if there is perceived to be a good Brexit outcome, this would lead to a rise in the strength of sterling which would be bad for large caps given their overseas earnings exposure. Nonetheless, we only have around 5 per cent of the portfolio in UK assets so we do benefit from falls in the domestic currency. We also have sterling borrowings and, to mitigate the potential risk of a rise in sterling (which would hit the value of our overseas holdings) we have started to add some sterling currency exposure rather than UK equities."

The fund-buyer view

Ben Yearsley, director at Shore Financial Planning, plumps for Alastair Mundy's Temple Bar investment trust, describing it as a value and special situations play on the UK. "Mundy likes buying unloved stocks when those selling are at their most irrational," he says. "UK domestic stocks are a current big position as many have been shunning these in the run-up to Brexit."

The US

The US represented a healthy portion of the F&C Investment Trust in 2018, totaling 53 per cent of the portfolio. However, while manager Paul Niven does not expect to reduce this weighting going into 2019, he has begun balancing his exposure to growth and value companies.

"The strong performance of the FAANGs and growth stocks has led to a large gap in the valuations compared with value stocks," he says. "As a result, we have levelled out our exposure to growth and value as we believe that as we become later-cycle, rising interest rates should start to become supportive to areas beyond the FAANGs."

This more balanced approach in the US, Niven says, is reflected in his weighting to financials, healthcare and energy stocks.

The fund-buyer view

"Finding a US fund or trust that consistently outperforms is difficult so I usually look elsewhere for US exposure," says Yearsley. "Technology is often where I end up, as these funds have a large US weighting. While the sector has had a poor couple or months, prior to that it had been on a charge for many years. I'm still a believer in tech for the long term as it's integral to everyday life. Polar Capital Technology Trust is the way I would play it: it currently has 70 per cent invested in the US in names such as Microsoft, Apple and Alphabet."

Europe

From a top-down perspective the European economy did well in 2018, but Niven says the disappointment is that this did not translate into the earnings outcome he hoped for.

"We had been reasonably optimistic on Europe but the earnings outlook has not come through," he says. "At the same time, the periphery continues to cause problems, such as renewed concerns in Italy and the effect it has had on financials."

As such, while Niven does not expect a blow-up in Europe in 2019, with the ECB pulling back on liquidity, he feels the window of stock market performance on the continent is "beginning to close". As a result, and even though the market looks attractive on valuation grounds, he is wary on European equities for now and his reduced his exposure to the region.

The fund-buyer view

Pascal Dowling, director at investment trust specialist Kepler Partners, picks out the Henderson Euro Trust. "The trust has an exceptional track record but the discount has come under pressure recently – partly on negative sentiment towards Europe but also because veteran manager Tim Stevenson is leaving," he says. "We think his successor James Ross is well drilled and the approach is unlikely to change, so it remains a solid choice."

Emerging markets

Ross says that despite a difficult year for emerging markets from a performance perspective, the discussions he has had with companies in the sector paint a more bullish picture. "Given the trade tensions, people this year have taken fright from many businesses that export a lot to the US," he says.

"While we own a couple of exporters, the managers of these companies are being much more proactive than the market is giving them credit for. They are thinking several steps ahead and see the trade concerns as an opportunity to take market-share away from their competitors, putting them in a much better position over the next five years. We don't share the fatalism that you often see in the press."

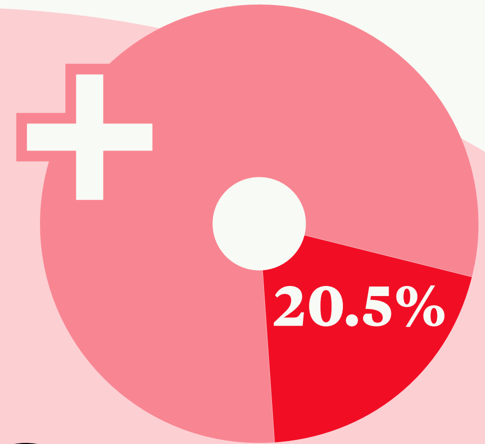
"Emerging markets are a conundrum," adds Niven. "Valuations look their cheapest since 2015, but they are under pressure from rising US rates, a strong dollar and a reduced growth premium over developed markets. In addition, the trade issues between the US and China could escalate into full-blown disruption to global supply chains. As such, while we are defensively positioned now, it is an area we want to engage with more in 2019."

The fund-buyer view

For long-term core exposure to emerging markets, Ryan Hughes, head of active portfolios at AJ Bell, says it is hard to look beyond the JP Morgan Emerging Markets IT. "They have an excellent long-term pedigree in the region with manager Austin Forey in place for almost 25 years, giving a consistency to the process," he says. "The trust is core in its positioning, but there is still room to be different from the benchmark at a regional and sector level. It sits on a 12 per cent discount, which may be appealing."

Crunching the biggest trends down into figures

From bull to bear:
2018's underwhelming numbers



of IA funds made a positive return in 2018

3

number of IA sectors where all funds made a positive return in 2018

5

number of IA sectors where not a single fund made a positive return in 2018

29 January

– date the MSCI Emerging Markets index peaked in **2018**

-3.84%

average total return of IA funds in 2018

2008

was the last calendar year in which such a small proportion of funds made a positive return

December 1999

– the FTSE 100 first hit its current level of **6,900** 19 years ago

7.96%

– 2018 return of IA Technology & Telecommunications, the best-performing IA sector this year

24.18%

– 2018 return of Baillie Gifford American, the best-performing IA fund this year

Source: FE Analytics, to 12/12/2018

You are spoilt for choice on information about saving for retirement, but the asset management industry is a lot less vocal when it comes to taking your money out. **John Blowers** weighs up your options

The "easy" part

Here's the thing. You, me and almost everybody else is fixated upon building up a pot of money for retirement, but when we get there, the tarmac superhighway we're on appears to peter out into a series of rough tracks leading in different directions.

In the UK, the savings industry has worked hard at creating ever more sophisticated ways of getting you to put money away, but almost leaves you to your own devices when it comes to taking it back out to fund your retirement.

Of course, all these financial institutions don't want you to take your money out at all. They earn good

In the UK, the savings industry has worked hard at creating ever more sophisticated ways of getting you to put money away, but almost leaves you to your own devices when it comes to taking it back out to fund your retirement

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money from your investments, year-in, year-out, in good markets and bad.

I'm now around 13 years from retirement age and I have little idea whether I've saved enough or whether it's too late to alter the course I'm on.

What's the right amount of money to see you through retirement? Who knows? How much will my pension pot grow over the next 12 years? Not a clue. What other assets can I deploy and what might they be worth? That depends. How long do I need to budget for in retirement? I don't want to know!

So, we start our "serious" retirement planning with a bunch of unknowns. Let's face it, most people in the UK pay scant attention to retirement until it is staring them in the face.

Below, I'm going to look at how to make final adjustments to your retirement plan and explore different strategies of how to use the pot when you stop earning.

Step 1

What kind of retirement do I want?

This is really important, as many people don't ask this question of themselves. Are you single or married? Do you have children and grandchildren? Are you going to stay in the same house or downsize? Are you thinking of retiring overseas? Are you going to carry on working past retirement age? Do you have mortgages or other debts that need settling?

It is worth grabbing a piece of paper and writing down how you imagine the days of your retirement will pan out. Spend time thinking about this, because it is likely to be quite different to how you spend your days during your working life.

It's also different from previous generations, so don't go looking at the examples of your parents and grandparents. They had two advantages over us: they had more generous company pensions than we typically have now, which paid out over the remainder of their life, but crucially we are likely to live for longer than our forebears.

This creates the dilemma of how to make a less generous pension go further.

But before we get to deal with that problem, we need to work out what kind of lifestyle we want and attach a "cash-burn rate" to it.

Here's my plan, as an example:

I don't need to live in the large house where I am now, so I plan to sell it soon, pay off the remainder of the mortgage and ideally buy two small places, one in the UK and (if we still can) one in France or Italy.

At first, we'll spend equal amounts of time in each one post-retirement, before deciding to settle in one and sell the other, probably in our 70s.

This will involve double property costs and lots of travel, a car or two, and so on. Then I need to overlay these costs with living expenses, such as bills, food and clothes. Do I want to eat out, or shop at Aldi? Do I want to fund holidays with the kids or the grandkids?

Where else will my money go? And, I must remember that I need to pay tax on my retirement income as if it were my salary.

To cut a long story short, I reckon that my monthly net cash-burn in retirement will be around £3,500 (or around £4,500 before tax).

Everybody's plan will be different, but it is really important you get to this number as early as you can.

Step 2

How much money do I need at the date I retire?

This question is a lot easier to answer once you have your average monthly (or annual) cash-burn number.

For example, if you know you plan to spend around £3,500 per month – or £42,000 a year – after tax, you can start to model your plan.

It's actuarily true that people in their 50s are likely to live until about 90, so I always use this age as my "drop-dead" date. If I retire at 67 and spend £42,000 a year until the age of 90, my trusty calculator tells me that I need £966,000 in my pension.

It's a large amount of money to build up, but the shocker is that I need to accrue enough money to last me 23 years, not the 10 to 15 years our parents budgeted for.

But other forces are at work, such as the growth of my pension pot during retirement as well as inflation, eating away at the value of my money.

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At the rate I'm currently contributing each month, I'll accrue a pension that amounts to somewhere in the region of £600,000.

If I just draw out my £3,500 (after tax) each month from my retirement pot and leave the rest invested and growing at 5 per cent per annum, then my £600,000 pot should last until I'm 88. Let's face it, unless you're shelling out for long-term care in your mid-80s, the chances are that you won't be spending at the furious rate you were in your late-60s.

Sorry kids, you'll have the house, but no cash!

Step 3

How can I make the best use of my pension pot?

There are a few alternatives as to what to do with your retirement pot when you hit 55, let alone 65 or 67 when you hang up your boots.

At 55, you have the chance to take 25 per cent from your pension tax-free. While it is very generous of the government to offer this tax-break, it can lead to some very bad behaviour.

If you reinvest this cash, for example in an ISA (or several), you can still use it as part of your pension fund and you won't pay tax on it at withdrawal (like you do with your pension).

You could also use the lump sum to acquire other appreciating assets, but you should avoid blowing it all on a holiday or new kitchen just because it feels like free money. It isn't free and ripping 25 per cent out of the engine room of your pension pot will likely leave you short in retirement.

When you actually retire, you will be faced with more choices, all poorly articulated in today's market, leading to a confusing array of options. The world of retirement has changed dramatically over the past four years, but the advice around it hasn't kept pace.

Many people bank their pension as cash, hoping to eke it out over their remaining quarter of a century. With interest rates still close to zero and heady inflation at work, your cash pile will be haemorrhaging value. Never a good idea.

Or you could buy an annuity. Sales of annuities are rising again, and you never know – there might be life in the old dog yet. However, every time I write about drawdown versus annuities, the maths suggests annuities provide around half the income of a well thought-out drawdown strategy. Of course, if you live to 120, then it will be the correct choice.

Which leaves us with drawdown. It frustrates me that the people who have helped you accrue your pension don't offer a better system to help you take your cash out again at a sustainable level.

With drawdown currently a DIY exercise, you need to plan your cashflow carefully. The most important point is that, at retirement, your pension should be at its largest and so teasing out extra growth should result in some significant monetary gains. It is also important to note that, in volatile markets, it can see some significant losses, too.

If you have a lot of money in your pot, then capital preservation is a good strategy and a lower-risk portfolio may be for you.

What concerns me is I don't think I will have a large pension at retirement. But what I will have is nigh on 25 years of investing to play with. I can leave my money to grow and carve off cash when I need it.

So, in conclusion

– and to answer the original question – you should almost carry on in the same way as you did when building your retirement pot.

Keep your money invested so it will grow. Sure, it will start diminishing as you start drawing it down, but the balance can keep growing. Avoid bad habits such as taking out a fixed amount each month, even when you don't use it, as you want the maximum amount of money exposed to growth potential.

Keeping your pension invested over the long-term acts like a parachute, slowing your money's rate of descent.

There will be testing markets where your portfolio falls and you will wonder whether you were right to do so, but that was also the case on the way up.

Hopefully, with more time in retirement to devote to your investments, you can pay more attention to them and ultimately extract more value.

Alternatively, you can go and play more golf. ●

Downing Strategic Micro-Cap Growth's **Judith MacKenzie** picks three stocks that should benefit from the value style's resurgence after years in the doldrums

Back in play

A multi-year bull market has benefited growth and momentum strategies, with value investing out of favour. However, share prices are often motivated by sentiment rather than the fundamentals or operating performance of individual companies. The resulting pricing inefficiencies can provide attractive entry points and opportunities to average down book-cost through the holding period.

We believe a strategy of buying businesses at a discount to intrinsic value will outperform over the longer term

We believe a strategy of buying businesses at a discount to intrinsic value will outperform over the longer term, unlike growth and momentum styles which can be transitory. Buying discounted businesses reduces the likelihood of permanent capital erosion. These opportunities can exist because of the inefficiencies in markets – particularly at the micro-cap end of the spectrum – yet many investors lack the long-term view and patience to profit from them. ●

AdEPT Technology

AdEPT Technology provides managed services for IT, unified communications, connectivity and voice solutions. The company functions as an aggregator of telecoms services, providing a smoother integrated service to corporates and governments. We were first attracted to AdEPT by the high operational gearing and recurring revenue streams at attractive margins. Additionally, it is cash generative and pays a dividend. Recent results show nine consecutive years of EPS growth – a feat matched or bettered by only three companies on the AIM market.

Volex

Volex, a manufacturer of power cords and cable assemblies, has faced challenges recently, with Chinese competition eroding margins. Management and strategic changes failed to capitalise on the business's competitive strengths and its market cap declined. However, its new management is focused on operational and supply-chain excellence and profitable growth. We think its turnaround isn't reflected in the share price, while opportunities for growth are mispriced, making Volex one of the most promising of the smaller AIM stocks.

Pennant

Pennant supplies products, services and training and support solutions to help operators in the defence and regulated civilian sectors. The company has invested well, leading to a 12.2 per cent return on equity and 13.8 per cent return on capital expenditure in 2017. It has also tripled production capacity since last year. It recently won a contract with the Canadian Department for National Defence with an initial two-year value of around C$11.9m and overall value over five years of approximately C$30m, which provides a firm foundation for future expansion.

Shore Financial Planning's **Ben Yearsley** says this fund's use of short positions should offer some protection if the US bull run comes to an abrupt end

Artemis US Extended Alpha

There are clearly times when changes need to be made; fund manager moves, fund closures or simply a different market environment

I try not to make too many changes to client portfolios as I think the best results are generated through a blend of different styles and approaches, allowed to play out over the longer term. That doesn't mean I don't make changes, it just means I don't make them every month.

My ideal investment is one I can buy and hold for the next decade or more. However, there are clearly times when changes need to be made; fund manager moves, fund closures or simply a different market environment. It's the latter that has caused some recent changes in our portfolios.

Going into mid-summer I started getting nervous about US equities. This market always commands a higher rating than its peers due to the higher growth profile, and I've always had an issue with these valuations as I'm a cheapskate when it comes to investment. During the course of the earlier part of 2018, valuations became far too stretched, primarily led by tech and high-growth companies. The problem is that the US is such a large part of global equity markets, it simply can't be ignored from a portfolio perspective.

So my solution for potentially capturing most of the upside but offering some downside protection was a 130/30 fund. "Rarer than hen's teeth" might be a phrase used to describe these funds, but essentially a 130/30 fund can have up to 130 per cent long equity exposure (meaning it buys companies expected to go up in price) and up to 30 per cent short equity exposure (meaning it benefits from falling share prices to the value of 30 per cent of the portfolio).

The fund I added was Artemis US Extended Alpha, managed by Stephen Moore. I actually switched out of Artemis US Select, managed by Moore's colleague Cormac Weldon, as this is a traditional "long only" equity fund.

Artemis US Extended Alpha is unashamedly bottom up – the team looks for both good and bad companies to profit from. Moore tends to spread the risk around a greater number of companies in the short book, as the risk of losing money is greater. As this is driven from the ground up, you will find both long and short positions in most sectors as there will be winners and losers. Microsoft and Alphabet (Google's owner) feature in the top-10, as does Warren Buffett's Berkshire Hathaway and various healthcare companies.

Is this the fund to hold at the start of a bull market? No, is the simple answer. However, after one of the longest bull runs in history, stretched valuations and a possible peak in economic growth, it seems like an opportune time to use this fund as opposed to a more traditional US equity product. ●

Ben Yearsley is director of Shore Financial Planning

FE Trustnet

magazine

January preview

The facts of life

The January 2019 issue of FE Trustnet Magazine will find out when and how you should teach your children about investing without turning them off the subject for life. We will also look at what the younger generation can teach you in terms of how their changing consumption habits will shape future investment themes – and to what extent these are already priced in.

Our sector focus will fall on IA Europe, one of the worst-performing regions in 2018. But does this make it a contrarian play or is there more pain to come?

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