TRUSTNET magazine

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SAFE HOUSE?

Can you afford to gamble on the election?

HOLD TIGHT...
Sticking with the UK despite the uncertainty

ABSOLUTE BEGINNERS
A how-to guide for novice investors

YOU CAN'T JUDGE A BOOK...
The problem with IA Mixed Investment

ISSUE 29

CREDITS

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EDITOR'S LETTER

THE GENERAL ELECTION IS SOMETHING OF A DOUBLE-EDGED SWORD for financial journalists. It is an event we are obliged to cover, but after much analysis and research, the conclusions are almost always the same – don't take any big bets, remain calm and your diversified portfolio should see you through, whatever the result.

However, judging by the aftermath of the EU referendum – when some stocks opened by up to 40 per cent lower, before recovering the majority of losses by the time the market closed – keeping your head while all about you are losing theirs is easier said than done. In this month's cover feature, Pádraig Floyd reveals how to prepare for every election outcome to ensure you are ready for anything when you wake up on 9 June.

Staying on the theme of the election, Holly Black examines how markets have traditionally fared under each of the mainstream political parties, while I find out why fund managers recommend sticking with the UK despite the growing political uncertainty.

In our regular features, Adam Lewis shines a light on the IA Mixed Investment sectors, Rathbones' Jo Rands and Alexandra Jackson name three AIM stocks they are backing and Nexus IFA's Kerry Nelson reveals why she has bought the SVS Church House Tenax Absolute Return Strategies fund.

Finally, John Blowers goes back to basics with a beginner's guide to investing, which, while aimed at novices, could prove just as useful for experienced readers tempted to be "too clever" if the election throws up an unexpected result.

Enjoy reading,

Anthony Luzio
Editor
Trustnet Magazine

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SAFE HOUSE?

The election result looks like a foregone conclusion – but so last year did a Remain vote and a first female US president. **Pádraig Floyd** reveals how to position your portfolio for every outcome

THE COUNTRY WAS CAUGHT ON THE HOP when prime minister Theresa May announced she was calling a snap general election for 8 June.

Buoyed by the Labour Party's ongoing crisis and frustrated by Brexit hardliners within her own camp, she felt her position strong enough to seek a mandate for her own administration from the electorate.

The polls suggest her timing is right. At the end of April, most gave the Conservatives a 19 point lead over Labour, with just one or two outliers suggesting the Tory lead had been limited due to a resurgence of the Liberal Democrats. But just how much influence will the outcome have on your investments in the coming year?

MARKETS DEMONSTRATE PATIENCE

Dean Turner, an economist with UBS Wealth Management, says the markets are not overly concerned by the prospect of a snap election. He suggests the "muted response" in the FTSE as well as sterling and gilts indicates they are prepared to wait for greater clarity around the government's Brexit negotiations.

"We believe it is highly likely the Conservatives will increase their majority and firm up the future direction of government policy, particularly in regard to Brexit," says Turner. "The prime minister has been softening her rhetoric on Brexit in recent weeks and we expect her to use this election to secure a mandate for the future direction of the talks."

> **"Unless you think the whole capitalist system is at an end – as some people did in the financial crisis – people will do what they always do"**

Of course, relations may sour as EU members agreed at the end of April to stand united on negotiations with the UK and May promised in a BBC interview to be "bloody difficult" with Jean-Claude Juncker, president of the European Commission.

"Although disruption to the UK economy in the short-term is still likely, we believe that the longer-term outlook is brighter," says Turner.

Having an inkling about how the election will affect the markets means knowing what to look for and Turner is taking his lead from the pound.

Sterling has taken a pasting over the past year, proving to be a bellwether of market sentiment. In these uncertain times, the shock of the EU referendum result in June 2016 caused it to drop from about \$1.50 to \$1.31 the following week and by the end of the fortnight it was at \$1.29. It bottomed out at \$1.20 until the victory for Donald Trump in the US presidential campaign saw it rebound somewhat, but only as high as \$1.30.

STRONGER MANIFESTO, SOFTER BREXIT?

Turner says that if May gets a majority as expected, the pound is likely to strengthen. If it is a large majority, the hardline Brexiteers will be marginalised, which is likely to result in a softer Brexit.

This would suit the markets, as the existing plan is already priced in. However, what the markets are not ready for is the World Trade Organisation (WTO) scenario, where no deals are struck, customs barriers and tariffs are imposed and there is a loss of freedom of movement.

That would be much more disruptive and growth would •••

likely slow with the approach of the deadline. However, Turner points out the UK economy is flexible and open, meaning it should be able to adjust over the medium term.

GIMME SHELTER

Maike Currie, investment director at Fidelity International, describes the general election as "merely a blip on the radar", adding that the Conservatives are likely to have a good majority which will provide the prime minister with "a free hand for a softer/smoother exit from Europe".

She anticipates some stock market volatility around election time, but agrees the key trends to watch are those in the currency markets.

"A fall in the pound is good for FTSE 100 companies because

Theresa May promised in a BBC interview to be "bloody difficult" with Jean-Claude Juncker

many are global companies," she explains, but warns investors against relying on currency as an investment, which she describes as a "zero sum game".

"If you want to build in some protection, look at blue-chip equity income funds that invest in FTSE 100 companies that will do well if the pound drops, but whose performance is also influenced by global, not local, factors."

Currie recommends matching this with some small and mid cap exposure, such as FTSE 250 companies, or the blue-chip Woodford or JO Hambro equity income funds.

"If you are in a well-diversified portfolio, you will already be well protected," she adds.

NOT OVER UNTIL THE "BLOODY DIFFICULT" WOMAN SINGS

Despite a range of potential outcomes, Laith Khalaf, senior analyst at Hargreaves Lansdown, is convinced that no one will remember the 2017 election's impact on markets in 10 years' time.

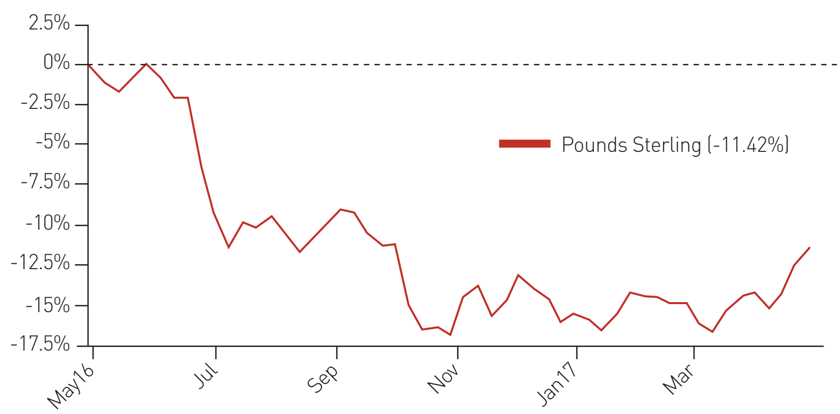
For that reason, he would avoid tinkering with portfolios, as it won't be easy to add any value.

However, he says things may become clearer on a sector basis once the manifestos are published, as a number of industries such as defence and energy suppliers could be vulnerable from policies such as spending cuts or price caps.

Housebuilders may also be affected, depending on the level of support for policies such as Help to Buy.

Khalaf warns that becoming overly pessimistic could cost investors "serious money" if they follow the old adage and "sell in May and go away".

PERFORMANCE OF POUND VS DOLLAR OVER 1YR



Source: The AIC/FE Analytics

"Chances are, this strategy will cost you valuable returns and that's even before factoring in the charges associated with selling and repurchasing an entire portfolio," says Khalaf. "Trying to time the market is never advisable, even less so based on groundless superstitions."

NEW BOSS, SAME AS THE OLD BOSS

Although there was an exodus from UK equity funds before the 2015 general election, it is more likely the status quo will be confirmed this time around, rather than deposed.

The pound has been the driving force for the past nine months, says Khalaf, and many foreign companies in the FTSE 100 such as Royal Dutch Shell and HSBC have benefited from the inverse correlation between the currency and the stock market.

If the Conservatives win, a rise in the pound may take the shine off some of these companies.

Of course, nothing is set in stone and there is always the possibility of an upset. Labour has improved somewhat at the time of writing and the Liberal Democrats – punished by their supporters for their capitulation on a manifesto promise – are showing signs of revival.

Should the Conservatives not receive the support they need, a weak majority or even a coalition would not be welcomed by the market, says Khalaf.

"That's not a judgement on the politics, but a Conservative win will strengthen the status quo, whereas a coalition would require a rethink," he explains. "I wouldn't be surprised to see something of a sell-off as the market is wrong-footed."

COALITION COLLYWOBBLES?

Although it is a long shot, the notion of a weaker government should not be written off, says UBS's Turner.

> "There is no sense in betting on the general election as it is essentially a roll of the dice"

The extent of the Lazarus act by the Lib Dems is an "unknown unknown". Meanwhile UKIP, seemingly in disarray after losing its only Westminster seat and being wiped out in local elections, could see its support swing back to the Conservatives.

"Experience tells us Labour support can be very sticky," says Turner, who adds that recent success in by-elections doesn't suggest the marginal targets for the Tories will be easily won.

However, he says Labour won't win back Scotland – the SNP may have to hold out to 2022 for another referendum – but believes concerns about the Northern Ireland situation are over-egged.

Everyone agrees that any deviation from a larger majority may see a small reaction in the pound, although the market is unlikely to react to the general election as a Tory government will be considered "business as usual".

FUTURE IMPERFECT

Post-election, Turner says the pound should strengthen over the next 12 months as it is currently "deeply undervalued".

He adds the potential direction of gilt markets and interest rates is less clear-cut and although the chancellor has been seeking greater scope, it is too early to draw more concrete conclusions.

Cash remains unfavourable, despite the vast amount of money currently being stuffed away.

Currie argues there is value to be had in defensive stocks, particularly healthcare (US) and telecoms, while even tobacco shows promise.

Khalaf says the most important thing for investors to avoid is panic. A diversified portfolio will produce a market return that is unlikely to be affected by the elections in the UK or even in Europe.

"Unless you think the whole capitalist system is at an end – as some people undoubtedly did during the financial crisis – people will do what they always do. Even in a diversified portfolio you will have winners and losers."

The message from Khalaf is to get back to basics and do the things that increase your wealth, such as diversifying your portfolio and saving an appropriate amount tax-efficiently. And maybe choosing the right managers to look after your money.

'There is no sense in betting on the outcome of the general election," adds Khalaf, "as it is essentially a roll of the dice". ●

UNDIVIDED DIVIDENDS

Henderson's **Ben Lofthouse** explains why investors who rely on the UK for income are playing a dangerous game

THE UK REMAINS ONE OF THE STRONGEST equity income paying markets in the world. It hosts a suite of multi-national corporations with long records of paying steady and rising dividends. More and more these strategies are being rewarded by investors, in part because of the thirst for yield amid record low bond yields and interest rates, but also because of its tendency to signal quality to investors: strong cash-flow, robust balance sheets and good corporate governance. If management is not spending money on important projects they are returning cash to shareholders, signalling to the market their continuing confidence in the business' success that will in-turn bring fresh revenues for further projects. It can be true that companies awash with cash will eventually start to waste it.

But there's a slight structural issue in the UK stock market: the top 20 companies pay 70% of all UK dividends; the top 10 pay 50%; the top five pay 35%.

Research by Henderson has taken a closer look – analysing all of the UK equity income funds and investment trusts above £200m to see who holds what and in what concentration.

It was found that 26% of the money managed by the entire sector is invested in the following top 10 stocks: GlaxoSmithKline, AstraZeneca, Imperial Brands, Royal Dutch Shell, BP, British American Tobacco, HSBC, Legal & General, Vodafone and Aviva.

The graph over the page shows how many of the 52 funds and investment trusts we looked at held the top 10 stocks.

It demonstrated that all of the top 10 stocks are held, on average, by 70% of the funds in the sector. This is actually unsurprising:

The top 20 companies pay 70% of all UK dividends; the top 10 50%; and the top five 35%

As equity income portfolios get larger, fund managers are forced to hold these same largest companies in order to receive enough dividends to pay all of their shareholders. It is further evidenced by the fact that, of the largest equity portfolios in the UK, the average percentage of the total portfolio held in these top 10 stocks was 39%. When the liquidity pool is small, fund managers simply have little choice.

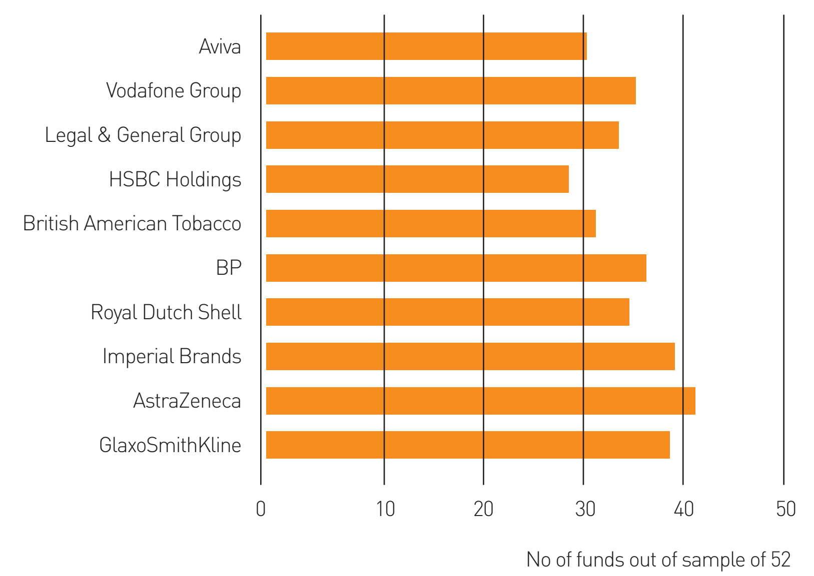
The percentages shift around over time but it does raise the idea of concentration risk. UK based investors are likely have the majority of their interests focused here, be it their job, houses, cars, investments, and so forth. Investors also often hold multiple funds to try to protect against a singular manager's poor performance, but they are likely duplicating across many of the same stocks.

What happens when something goes unexpectedly and spectacularly wrong - oft referred to as a black swan event? The Macondo oil spill in 2010 is a good example, when BP was forced to cut its dividend amid the rising and uncertain cost of the disaster. As one of the top five dividend payers in the UK this led to substantial shortfalls for equity income fund managers.

Henderson International Income Trust (HINT), managed by Ben Lofthouse, was launched exactly for these reasons in 2011. It is mandated to invest globally in income yielding equities but importantly it excludes the UK entirely, offering investors the chance to diversify away from their UK based investments and sources of income. What is more, the types of businesses that deliver strong levels of dividends tend to differ between markets, meaning sector-level diversification is also possible in addition to the geographic diversification.

HINT is also an investment trust and we strongly believe this structure benefits investors seeking income - in any given year the fund manager is able to retain up to 15% of dividends in a reserve pot, so that during difficult times when stock markets are down and perhaps dividends are being cut, the fund manager can use the reserve to top up the income paid out to investors. The effect is to smooth the dividend stream paid-out over time, which may be useful to those who heavily rely on the income.●

HOW MANY OF THE PORTFOLIOS HOLD THE INDIVIDUAL STOCKS



Source: Source: Henderson Global Investors, Morningstar; as at Oct 2016

ELECTORAL DYSFUNCTION

Holly Black warns against trying to draw any conclusions about how a victory for one of the two main parties in the election will affect markets

THE ANNOUNCEMENT OF A SNAP ELECTION sent the stock market tumbling, but bullish investors soon helped the FTSE 100 to recover from the shock.

However, with only a matter of weeks to go, many investors are wondering how this latest political event could influence their portfolios. On the face of it, there is good news for those predicting a landslide victory for the Conservatives. Looking at figures from AJ Bell that show how the FTSE All Share has performed under each prime minister since Harold Wilson took office in 1964, four of the top five spots are taken by Tory leaders.

Margaret Thatcher's 11-year tenure coincided with the most successful stock market run, at 270.6 per cent – more than double the next best growth rate of 107.1 per cent, delivered between 1990 and 1997 when John Major was resident in Downing Street. She did have an additional four years in office, however.

Just one prime minister – Gordon Brown – left with the FTSE All Share lower than when he took office, although these figures do cover the height of the financial crisis. The stock market fell 19.2 per cent in his three years in Number 10.

However, Tom Stevenson, investment director at Fidelity, says: "Any correlation between the political party in power and stock market performance is extremely loose. The background economic and market environment is much more important than who currently lives in Number 10."

> **"Any correlation between the political party in power and stock market performance is extremely loose"**

In addition, these figures only tell part of the story. The FTSE All Share is made up of hundreds of different companies, the fortunes of which have varied dramatically over the years. Analysis by Fidelity reveals which sectors have done the best under each prime minister over the past two decades.

Under Tony Blair's 10 years in office, for example, the MSCI UK Materials index rocketed 342 per cent and MSCI UK Utilities by 312 per cent. MSCI UK Industrials was among the worst performing indices, up by just 24.7 per cent in total.

But experts stress that there are far more important drivers of the stock market. Russ Mould, investment director at AJ Bell, says: "Share prices are influenced by many factors including politics, but in the long-term they are driven by company profits and cash flow."

Under Blair, the MSCI UK IT index plunged 74.2 per cent, for example. But that isn't because his policies were particularly damaging to that industry – this dramatic fall had more to do with the bursting of the dotcom bubble.

It is not surprising, then, to see MSCI UK Financials fell 42.19 per cent under Gordon Brown's tenure – he presided over the financial crisis. In office for just shy of three years, the MSCI UK IT index sector fell 16.4 per cent on his watch, MSCI UK Telecomms by 12.7 per cent and MSCI UK Consumer Discretionary by 15.1 per cent. The best performing indices were MSCI UK Consumer Staples and Energy, up 21.9 and 16.8 per cent respectively.

The MSCI UK IT sector soared some 253.5 per cent under David Cameron, while MSCI UK Telecomms surged 144.7 per cent. Over his six-year tenure, the MSCI UK Materials index was the only one to finish in negative territory – down 31.1 per cent over the period.

Theresa May has been in Number 10 just nine months but already there have been some major sector changes, including reversals of the best and worst performers under her predecessor. MSCI UK Materials has climbed 34 per cent since she took the leadership in July 2016 and MSCI UK Financials by 28.6 per cent. Four indices are in negative territory, MSCI UK Telecomms the worst performer among them, down 11.2 per cent.

There doesn't appear, then, to be a distinct pattern as to which sectors •••

... do better under a Conservative or Labour leadership. However, one thing the market does appear to appreciate is certainty – in the six weeks before the vote of the last seven elections, the FTSE 100 has risen on the three occasions the result was considered fairly certain, such as the Labour wins of 1997 and 2001. Its biggest pre-election gains were in the run-up to the Conservative win of 1987, when the market climbed 9.7 per cent. When the competition is more closely run, the stock market tends to dip, falling more than 8 per cent in the run-up to the 2010 election, which resulted in a hung parliament and coalition government.

With the Tories around 20 points ahead in the polls, this could indicate the market is set to rise over the coming weeks. But complacency has cost investors dearly before and the surprise announcement of an election has led to jitters – it sent the FTSE 100 to its biggest one-day loss since the EU referendum last June.

Tom Becket, chief investment officer at Psigma, thinks a Tory victory will strengthen the economy, which should mean banking and financial firms do well. With a larger majority, May should be able to negotiate better trade deals, which should boost the industrial sector, while a stronger pound is good for engineering companies and domestic firms.

> **"With the Tories around 20 points ahead in the opinion polls, this could indicate the market is set to rise over the coming weeks"**

Meanwhile, if the pound continues to strengthen, that could hit the profits of those FTSE firms with overseas earnings, while proposed energy cap plans from the Conservatives could be negative for utilities.

Becket says: "A Labour win would be generally bad for most sectors. In that instance I would focus on businesses with international earnings and avoid domestic consumer companies because the pound would likely fall further."●

PERFORMANCE OF MARKETS UNDER PAST 10 UK PRIME MINISTERS

Prime minister & term	Party	Change in FTSE All-Share
Margaret Thatcher, 1979-90	Conservative	270.6%
John Major, 1990-97	Conservative	107.1%
James Callaghan, 1976-79	Labour	66.7%
David Cameron, 2010-16	Conservative	36.9%
Edward Heath, 1970-74	Conservative	21.9%
Tony Blair, 1997-2007	Labour	19.9%
Theresa May, 2016-	Conservative	10.0%
Harold Wilson, 1964-70	Labour	9.0%
Harold Wilson, 1974-76	Labour	8.6%
Gordon Brown, 2007-10	Labour	-19.2%

Source: Thomson Reuters Datastream (price only)

AMERICA STILL GREAT AGAIN

Tom Slater, head of Baillie Gifford's US Equities team and fund manager for Baillie Gifford's American Fund, talks about investment opportunities in the US

AS DONALD TRUMP APPLIES HIS CONSIDERABLE, but unpredictable energy to governing the USA, it would be fair to ask whether his plans to 'make America great again' will have the same effect for investors. Will the onward march of corporate America be thwarted by immigration curbs? Or by plans to bring manufacturing onshore? Tom Slater, head of the US Equities team at Baillie Gifford, believes America will not be so easily derailed.

Part of this confidence stems from US innovation and corporate culture, unmatched elsewhere in the world. He says: "There are companies in the USA for which there is no equivalent: Facebook, Tesla." As to why the US is able to grow such innovative businesses, Slater says there is no single formula, but from the deep pool of risk-seeking capital to an inherent entrepreneurialism, the US has long been good at turning great ideas into great businesses.

He gives the example of Illumina, a genetic sequencing company, which was built from UK technology, but there was no commercial impetus in the UK to develop it. It is now a $25 billion company and is part of the S&P 500. Google's deep learning technology was built from UK technology, but commercialised in the US. While these businesses are not immune to political issues, their concerns tend to be international and most will remain relatively immune to President Trump's activity.

The top ten holdings of the Baillie Gifford American Fund reads like a list of technology icons, but Slater says they seek out businesses that they believe can grow sustainably over time. It often takes them to technology, but only in its broadest sense.

He says: "What is technology? It is difficult to get a neat answer. Google and Facebook could be seen as advertising businesses, while Amazon is a retailer. We have seen a revolution in retail and advertising – these companies are changing the model."

"We are seeing something similar

in the automotive market, which is developing in much the same way as the mobile phone market. My decade-old car looks like a smartphone from the mid-1990s. With electric cars there is a real competitive advantage, because they are moving out of engineering and into software. As electric vehicles move to full autonomy, it will open up vast swathes of the market. This creates a new business model and the scope to take huge market share."

Slater wants to understand how a holding could grow by at least 2.5x over five years. Typically, only around 20% of stocks do this. He believes this is a far more useful way to determine a company's worth than looking at metrics such as price to earnings ratios. Companies that look expensive on this basis may simply be reinvesting a lot in new ventures. If they are growing very fast, that ratio quickly falls.

He gives the example of electric car company Tesla, which has built a strong franchise in the luxury vehicle market, but is now in the process of building a mid-range car. This will take the company from sales of 50,000 per year to around 500,000 per year, but to do so, it needs to build up its manufacturing capability, which is expensive. However, in the long term, companies making this investment in innovation will have a real advantage.

Their focus is firmly on the long-term. Slater believes this is a key differentiation in a world that too often is simply trying to predict the next quarter's earnings

The new ideas in the portfolio have been in smaller companies, notably in healthcare

statement. This means they take a strong interest in the culture of a company. He says: "If you're only holding a stock for six months, you don't care about the culture. But if you're holding it for five years or more, cultural factors are very important.

"What is the purpose of a company and what is its ambition? The answers can be a real source of competitive advantage. If a company has strong and defined ambitions, they can inspire passion and zeal."

There are other sources of investment 'edge'. Is the company addressing an outsized opportunity, for example, and how rapidly? Stocks within the portfolio fall into three main growth objectives: The largest is 'transformational growth companies' – companies such as Amazon that are significantly disrupting the industry in which they operate. They also seek out 'dynamic growth companies', which are not bringing revolutionary change, but require capital to grow and are taking market share. He gives the example of Carmax in auto retail, which has a 'no haggle' model, and incentivises its staff on the volume of sales rather than the value, so they have motivation to help people get the right car.

The final area is 'enduring growth companies'. These are companies with broad and deep franchises. Slater says that the network effect is very powerful for companies such as Facebook – the more users they add, the more powerful their franchise becomes. Investors are only just waking up to the value of this.

More recently, the new ideas in the portfolio have been in smaller companies, notably in healthcare. Slater says: "We are sceptical on big pharma, with its incremental drugs and its unaffordable cost base, but we like companies such as Abiomed, which makes heart pumps that are improving the clinical outcomes for patients. On the drugs side, we also like Juno Therapeutics, which makes modified stem cells for leukaemia patients."

Another recent purchase has been online furniture group Wayfair: Slater believes certain categories have been resistant to online and it's time for this category to shift decisively.

In the meantime, they try to stay focused through the news flow emerging from the US. Slater says: "We try to be owners of shares in a business, rather than reacting to news flow. We are prepared to accept holding things for too long." They aim to own companies 'through the wobbles', Trump-related or otherwise.●

HOLD TIGHT...

Despite the uncertainty surrounding Brexit and the election, fund managers have dismissed the idea of cutting UK exposure. **Anthony Luzio** finds out why

IT IS GENERALLY NOT DIFFICULT TO FIND two fund managers with opposing views on the same subject. Every time one of them sticks their head above the parapet to say all the fundamentals suggest the only way is up for a particular sector or region, you tend not to have to wait too long before another one points out the easy money has been made and all the good news appears to be priced in.

This was what I thought, anyway, until I decided to write an article about whether investors should cut their exposure to UK stocks. With the choices for UK residents in the upcoming election either the most socialist government since the 1970s, or, more likely, a Conservative Party that appears to have its heart set on a hard Brexit, I thought this would provoke some debate at the very least.

ALMOST UNEQUIVOCAL

However, the answer that came back was almost unequivocal – "no".

"Almost" is the key word here. Chris Darbyshire, chief investment officer at 7IM, is one of the few managers who says investors should consider cutting their UK exposure. The 7IM Balanced fund has just 10 per cent in the UK, although it is overweight sterling to hedge currency risk.

"There are many risks that can be mitigated in life, but country risk is not one of them," Darbyshire explains. "Country risk typically occurs at times of deep recession or financial crises and is particularly pernicious, not just on your investment portfolio, but also your short-term earnings, long term career prospects (what we call 'human capital') and house value. These all decline at the same time."

"Such events are expected to occur no more than once every 50 years or so but, with Brexit, the risks have become elevated. Much depends on the government's actual plans, and the negotiations themselves, but there is, perhaps, a one-in-10 chance that Brexit leads to a deep recession in the UK in the next few years. While we hope that this will not be the case, 'hope' is not an acceptable investment strategy."

The vast majority of fund managers didn't even entertain the idea of following Darbyshire's lead – no matter how much their outlook on the UK economy differed from one another's. David Jane, manager of Miton's multi-asset range, says that with the election unlikely to lead to anything other than a stronger Conservative majority, the UK may even be considered a safe haven "with clear political leadership, an economy benefiting from a weak currency, continued low interest rates and a robust consumer sector".

SHREWD

Mark Martin, head of UK equities at Neptune, was more pessimistic, saying there are signs that the UK economy is slowing – which may have even influenced Theresa May's decision to call an election.

"The timing was shrewd, not only from a political perspective – Labour has never been weaker relative to the Tories – but also from an economic perspective," he explains.

"Real wage growth has been positive for some time, but the most recent data point showed a slight decline. With inflation expectations increasing, negative real wage growth could have a ...

knock-on effect on GDP growth and consumer confidence. Recent data showed that UK retail sales recorded their largest decline in seven years in Q1 2017, while house price rises, particularly in central London, have also started to slow."

Of course, the domestic market is not directly correlated to the performance of the economy and the relationship can even be an inverse one if, like the FTSE 100, its constituents derive the majority of their earnings from overseas. Nowhere was this more apparent than in the aftermath of the UK's vote to leave the EU, when the index spiked on the fall in sterling.

IN OPPOSITION

This helps to explain why many managers remain positive on UK assets even if they have the opposite view on the economy – and it is not just large caps that can benefit from overseas exposure.

"We retain our preference for internationally facing UK mid cap companies, many of which have yet to benefit from sterling weakness since the Brexit vote," adds Martin.

"We have taken the opportunity to top up positions in some of these companies since Theresa May's announcement, and remain optimistic about their potential to generate attractive returns on a medium- to long-term view."

"Conversely, we are cautious about domestic cyclicals, not only because of the potential slowdown in the UK economy, but because many of these companies are expensive relative to history. This includes the housebuilders, which we continue to avoid."

James Sullivan, director at Coram, adds that the "dismissive" behaviour of small caps can be appealing during periods of uncertainty, "where one can focus on company fundamentals, rather than the fear of being the wrong side of sterling".

This is a view echoed by Alex Wright of Fidelity Special Values.

> "While we hope that this will not be the case, 'hope' is not an acceptable investment strategy"

"While some investors and commentators will keep a sharp focus on the day-to-day evolution of the political landscape, I prefer to focus on what is happening within the companies and industries I invest in, and avoiding skewing the portfolio too heavily towards one political outcome or another," he says.

"Last year should serve as a reminder to us all that proper diversification is the only defence against the unexpected."

IGNORE EVERYTHING

Schroders' Andrew Evans went even further, saying investors "may as well ignore anything any pundit has to say on the outcome of the June election" – which is exactly the same advice he gave out ahead of the 2015 election and last year's EU referendum.

"The only view we have on the upcoming general election is we have no view," he says.

"The confidence with which we express our view has twin foundations: our well-documented suspicion of forecasts and those who earn a living from making them, and our even more frequently expressed faith in value investing and its long-run ability, among other things, to turn bad headlines into good investments."

He adds that by focusing on the long term, his team avoids buying into any prevailing opinions or other "noise" that could influence portfolio decisions.

"We are mindful of their possible impact," he continues, "but can point to more than 100 years of history that shows an unemotional, valuation-based approach to investing should deliver over the long run – regardless of anything that economic, political or any other forecasters might have to say." ●

Fund

JPM UK EQUITY CORE

This was one of the few IA UK All Companies funds to keep pace with the FTSE All Share index last year

MANY ACTIVE MANAGERS WERE CAUGHT OUT by last year's rotation from quality growth companies into value. Expectations of stronger growth saw a significant proportion of UK equity strategies struggling to outperform the FTSE All Share index.

Despite failing to beat this benchmark, the £203.4m, three crown-rated JPM UK Equity Core fund put in a solid performance, returning 15.35 per cent in 2016 against a 16.75 per cent rise in the index. It outperformed its peers, with the average IA UK All Companies fund delivering a 10.83 per cent gain over the same period.

Portfolio manager James Illsley said the fund began adding to out-of-favour oil & gas stocks at the start of last year and the sector remains a significant part of the portfolio: Royal Dutch Shell is its largest holding, representing 7.7 per cent of assets under management, while rival BP is also in its top-10. This turned out to be a shrewd move as the FTSE All Share Oil & Gas index climbed 59.83 per cent in 2016.

Illsley said that this year, the fund has a bias to financial and cyclical stocks that have become more attractively priced. It has also been picking up cheap housebuilding stocks such as Redrow and Bellway since the EU referendum last year, noting low valuations and the ongoing need for housing stock.

"There have been supply problems in the housebuilding sector for 20 years and more. [The sector] should be building 250,000 homes per year, but it is only building 190,000," he said. "Some are investment properties that aren't being lived in."

Additionally, Illsley and co-managers John O'Brien and Christopher Llewelyn have found opportunities in sectors with greater exposure to consumers, which have been affected by increased uncertainty over the Brexit negotiations.

Illsley said bottom-up stockpicking is an approach that can also deliver growth over the long term. The fund takes much of its risk at a stock level, generating alpha from its overweight and underweight positions.

"Volatility is good for stockpickers," he said. "We will find opportunities, for us it's a very good market environment."

JPM UK Equity Core has made 25.28 per cent over the past three years, compared with 23.63 per cent from its IA UK All Companies sector average and 21.78 per cent from its FTSE All Share benchmark.

It has an ongoing charges figure (OCF) of 0.4 per cent and is yielding 2.82 per cent.●

FILE

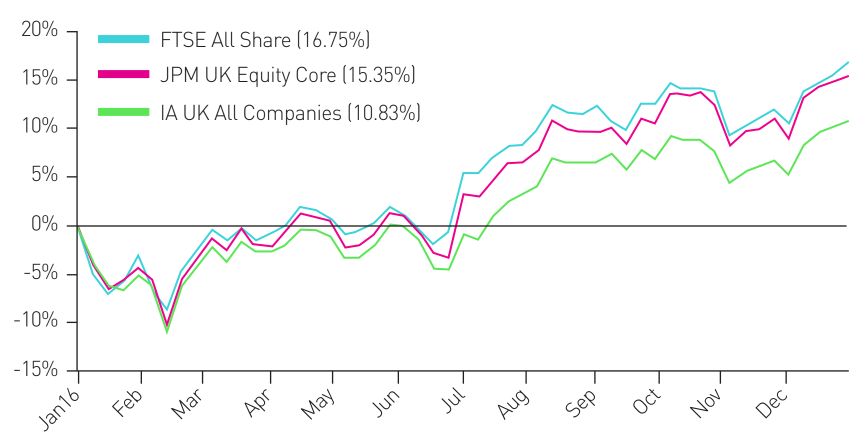
MANAGERS: **James Illsley, John O'Brien & Christopher Llewelyn**

LAUNCHED: **31/07/1997**

FUND SIZE: **£203.4m**

OCF: **0.4%**

PERFORMANCE OF FUND VS SECTOR AND INDEX IN 2016



Source: FE Analytics

Pension

CFIC CRUX UK

While investors may be more familiar with Crux's European offerings, it has just acquired a UK fund that has outperformed over the medium term

GIVEN THE ONGOING (AND FRAUGHT) Article 50 negotiations and next month's snap general election, investors could be forgiven for feeling nervous about the short-term prospects for UK equities.

For those looking to update their SIPP, however, it is vital to look past the short-term macro noise and find managers that are doing the same.

Patrick Barton and Jamie Ward are two good examples. They run the four crown-rated CFIC CRUX UK fund, which aims to preserve and enhance the real value of capital and outperform the FTSE All Share index over the long term.

While CRUX is well-known for Richard Pease and James Milne's European equity funds, investors may be unfamiliar with the firm's UK equity offering, given the fund was only acquired at the start of the year when CRUX bought Oriel.

Formerly named CFIC Oriel UK, it has a 24-year performance track record while its B share class was launched in 2011.

The £57.3m fund has beaten its IA UK All Companies sector and FTSE All Share benchmark by 18.01 and 24.13 percentage points respectively under Barton and Ward's six-year tenure, with a total return of 84.4 per cent.

Over this time it is in the top-quartile for its Sharpe ratio (which measures risk-adjusted returns) and for suppressing downside risk (which predicts a fund's susceptibility to lose money during falling markets), maximum drawdown (the amount lost if investors bought and sold at the worst possible moments), and annualised volatility.

The managers attribute this to their ability to select high-quality and attractively valued companies that also offer strong long-term growth prospects. To find these, they use a process that focuses on each stock's ability to compound cash and achieve high returns on capital. The portfolio currently contains just 24 stocks.

While Barton and Ward adopt a bottom-up stock-selection process and refrain from placing bets on market themes, they take long-term risk factors into consideration.

For example, they believe one of the biggest threats to quality growth investors is a faster-than-expected rise in bond yields and interest rates.

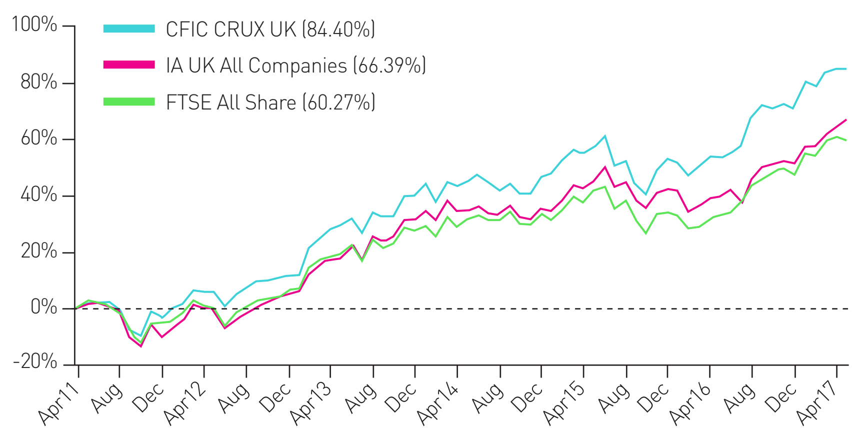
To hedge against this risk, they hold up to 15 per cent of the portfolio in overseas equities and have increased their exposure to US banks.

"Our view is US banks were cleaned up post the financial crisis in a way that did not happen in Europe and, to some degree, in the UK," the managers told FE Trustnet at the end of last month.

FILE

MANAGERS: **Patrick Barton & Jamie Ward**
LAUNCHED: **26/04/1993 (B share class 28/03/2011)**
FUND SIZE: **£57.3m**
OCF: **1.15% (B share class)**

PERFORMANCE OF FUND VS SECTOR AND BENCHMARK UNDER MANAGERS



Source: FE Analytics

Trust

GCP STUDENT LIVING

This trust's dividend is supported by the supply/demand imbalance of students in London and elsewhere in the UK

GCP STUDENT LIVING OFFERS A COMPELLING INCOME OPPORTUNITY to parents who are looking for positive aspects of sending their children to university aside from getting them out of their house.

The trust owns a number of private accommodation buildings, predominantly in London, renting directly to students.

It has performed well since inception in May 2013, returning 69.23 per cent, and providing £1,769.99 in income to an investor who put in £10,000 at launch.

Rents are paid in advance before the beginning of the year or term, with tenants largely drawn from international students as they have a lower default rate compared with domestic students. As a result, the trust has default rates of less than 1 per cent, compared with a sector average of around 2 to 3 per cent.

The trust's dividend currently stands at 3.8 per cent and is 94 per cent covered. Its managers say there are many reasons why they believe they can increase this figure while keeping volatility to a bare minimum.

These include barriers to entry – particularly in London, which is suffering from a residential housing shortage – planning hurdles and rental rates, which are significantly below the market average, giving the firm scope to increase rents by 10 per cent should it wish.

"London has the greatest number of students, but has the most pronounced undersupply of student accommodation of all markets in the UK," said director Nick Barker.

"If you look at the students we believe would be potential users of our accommodation, you've got 275,000 or so in London and there are only 70,000-odd beds."

"This cannot be reversed easily, if ever. You would have to see some quite dramatic changes in the property market for this to flip as the supply-side in London has become so hard to develop."

Despite the low rents, the trust has a net operating income margin of 79 per cent, which means for every £1 that it collects from a tenant, 21p goes towards operating the building.

It also sets aside maintenance and life-cycle provisions to ensure it doesn't need to go to the market to raise cash.

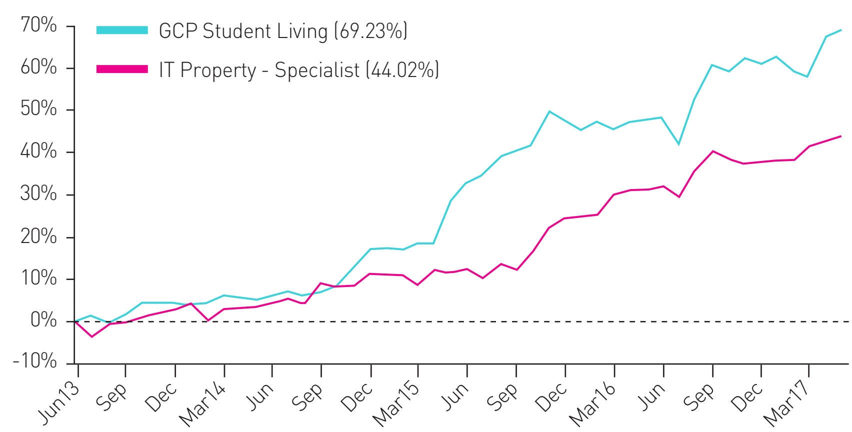
Fellow director Tom Ward added: "Smoothing it out is key. We don't want to go back to shareholders with surprises and have to raise £50m to sort the buildings out and make them rentable."

The trust is 6 per cent geared. It is on a 7.3 per cent premium, yields 3.87 per cent and has a total expense ratio of 1.6 per cent.●

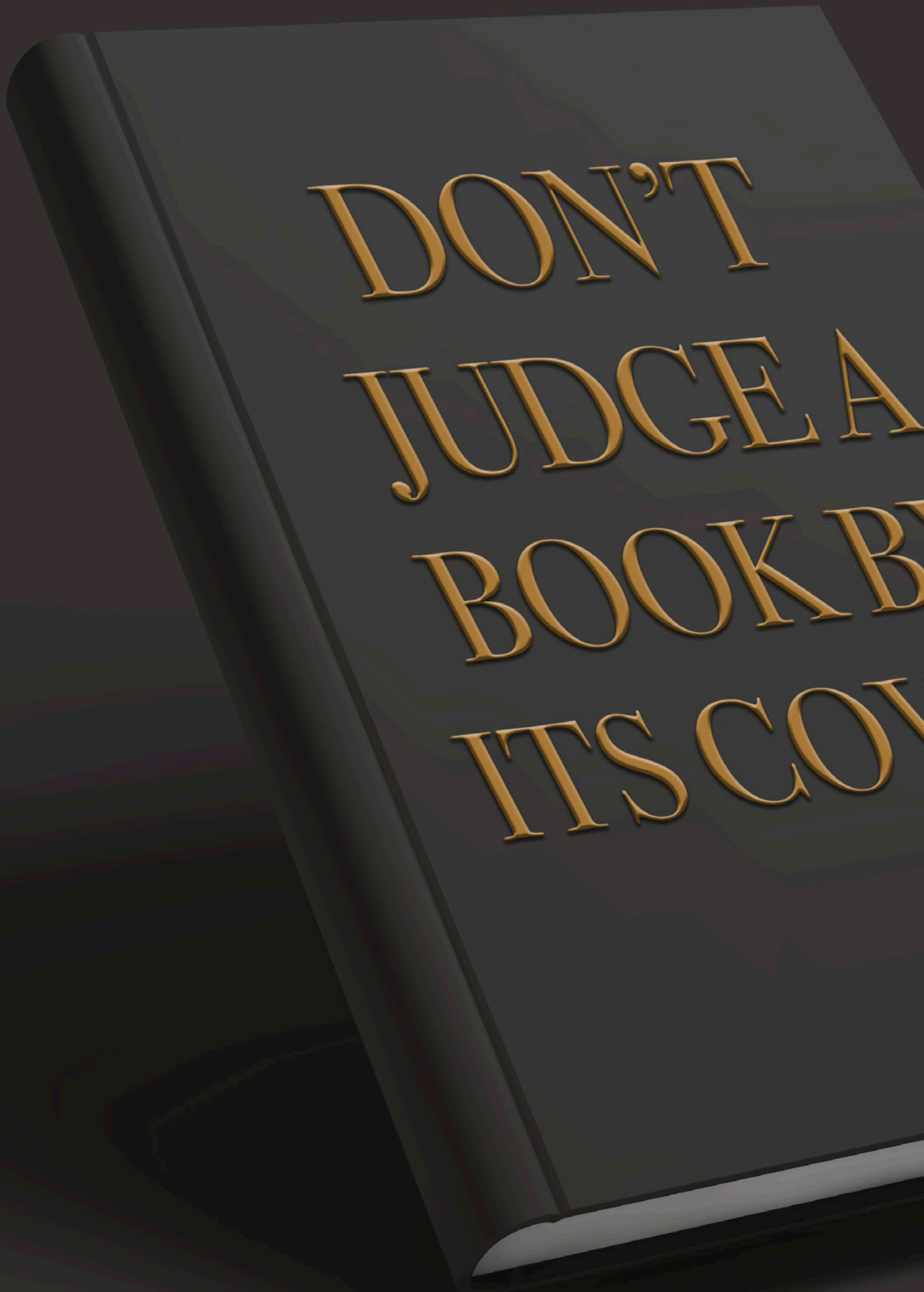
FILE

MANAGERS: **Tom Ward, Nick Barker & Dion Di Miceli**
LAUNCHED: **20/05/2013**
DISCOUNT/PREMIUM: **+7.3%**
TER: **1.6%**
FE CROWN RATING: **N/A**

PERFORMANCE OF TRUST VS SECTOR SINCE LAUNCH



Source: FE Analytics


DON'T
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ITS CO

Adam Lewis says investors should use the risk profiles of each IA Mixed Investment sector as a guide rather than a guarantee it will contain the right fund for them

THE IA'S MIXED INVESTMENT SECTORS have hit the headlines in recent weeks, with both the trade body and fund supermarkets reporting a surge in sales.

IA Mixed Investment 40-85% Shares was the most popular sector among investors in February with £303m of net retail sales, followed by the 20-60% Shares sector in third place with net sales of £164m.

Many industry professionals believe the multi asset funds in these sectors are perfect for the more cautious investor, but are there any other reasons to explain their surge in popularity?

First, a bit of history. Once simply known as the Managed Funds sector, it was split by the IA (or the IMA as it was back then) into Active Managed, Balanced Managed and Cautious Managed in April 1999 to give advisers more information about the underlying funds.

In January 2012, the IA acted on research that showed investors wanted jargon-free names for their fund sectors to give them simple information about the minimum and maximum exposure to shares. Collaborating with the ABI, it rebranded Cautious Managed to Mixed Investment 20-60% Shares, Balanced Managed to 40-85% Shares, while the old Active Managed sector become what is

now IA Flexible Investment. At the same time it launched the IA Mixed Investment 0-35% Shares sector, which has the lowest risk of all the peer groups.

Today 40-85% Shares is the largest of the mixed asset sectors, with £48.5bn under management. This is followed by the 20-60% Shares sector with £44.1bn, Flexible Investment with £25bn and 0-35% Shares with £6.2bn. In total, the four mixed asset sectors housed a collective £123.8bn as at the end of February.

However, rather than a more cautious outlook among investors given the unpredictable recent events that have unfolded in markets, Liontrust's head of multi asset John Husselbee thinks the popularity of mixed asset funds can be attributed to structural forces.

"Post the Retail Distribution Review (RDR), the cycle of advisers outsourcing their fund selection to multi asset funds has grown significantly and this trend continues to grow, given a greater focus on suitability," he says. "The options IFAs have today are to self-construct portfolios for their clients, select a range of managed funds, or outsource to DFMs either through model or bespoke portfolios."

Husselbee adds that if you drill down into data on the most popular funds, those that target a particular level of risk or a specific outcome, such as income, are selling more than return-based counterparts.

"People want their assets to sweat a bit more and are turning to these managed products," he says. "Target-risk funds aim for a particular level of volatility and drawdown, while with cash offering next to nothing, the thirst for income is drawing investors to funds focused on this outcome, of which the Mixed Investment sectors house many."

"We do not think that selecting a fund from one of these sectors without looking at its objectives and risk profile is enough to make an informed decision"

In addition to the secular theme of outsourcing, Husselbee says pension freedoms have opened up these managed funds to a new client base. "Finding income beyond the norm means the majority of money is coming from income seekers, both pre-and post-retirement," he adds.

So, what type of funds are in these sectors and which type of investor do they suit the most?

Alex Farrow, head of risk-based solutions at Square Mile, says the aim of rebranding the sectors five years ago was to improve consumer understanding. However, he adds that while the labelling is now clearer, the composition

PERFORMANCE OF FUNDS VS SECTORS

Name	1yr (%)	3yr (%)	5yr (%)	10yr (%)
Vanguard LifeStrategy 20% Equity	8.86	21.47	34.75	N/A
IA Mixed Investment 0%-35% Shares	9.14	15.09	26.7	39.04
Premier Multi-Asset Distribution	12.2	26.45	66.7	58.49
IA Mixed Investment 20%-60% Shares	12.48	19.25	37.78	46.25
Royal London Sustainable World Trust	26.17	50.57	98.04	N/A
IA Mixed Investment 40%-85% Shares	16.66	25.75	51.29	58.81

Source: FE Analytics

of the sectors has not changed significantly and there remains a broad spread of funds with different objectives and risk and return profiles in each one.

"Therefore we do not think that simply selecting a fund from one of these sectors without looking at its objectives and risk profile is enough to make an informed decision for a client," he says. "The sectors succeed in providing a framework for investors to search for funds with roughly similar levels of equity exposure, but, we feel, are not a particularly useful basis for performance comparison."

Farrow uses the example of Premier Multi Asset Conservative Growth, which sits in the 20-60% sector. He notes that the fund has an equity beta that is significantly lower than the majority of its peers and as such it is likely to lag behind them over the longer term if equity markets outperform other asset classes.

"However, on a risk-adjusted basis, namely taking into account volatility, the fund has historically been one of the strongest in the sector," he says.

"This fund is also one of a number that follow a growing trend we have seen over the last few years where managers are becoming more outcome-orientated and less focused on what the average fund in the sector has done or is doing."

"We feel having clear and tangible objectives is to be commended and in our experience it is something that investors seek, and has been highlighted in the FCA's recent Asset Management Market Study."

Farrow says the four sectors contain such a variety of funds that they are suitable for more cautious investors at one end of the scale right up to those with a high tolerance for risk. While 40-85% Shares has been the most popular sector recently, he notes 20-60% Shares has been the best-selling of the IA sectors in five out of the past 10 years.

He admits that some of this may have been driven by a reduction in risk appetite since the global financial crisis, but agrees with Husselbee that the requirements following RDR, the rise of centralised investment propositions and investors seeking diversified sources of income have been equally important factors.

"This has proved a popular universe for investors, with asset growth of around 38 per cent over the last five years," Farrow says. "We see no reason why this will not continue over the next five."●

The passive option

VANGUARD LIFESTRATEGY 20% EQUITY

Not all funds in the IA's Mixed Investment sectors follow an active strategy. The £612m Vanguard LifeStrategy 20% Equity fund, which sits in the IA Mixed Investment 0-35% Shares sector, invests in a series of the group's own index funds. The fund has 80 per cent in bonds and 20 per cent in equities, of which the largest allocation is to the US at 8.94 per cent of assets. Not a fan of bonds? Well look no further than Vanguard's £1.2bn LifeStrategy 80% Equity fund, which is first quartile in the 40-85% Shares sector over one and three years, and currently has about 80 per cent of assets in equity trackers.

The long-timer

PREMIER MULTI-ASSET DISTRIBUTION

Premier Multi-Asset Distribution was one of the first true multi asset funds when it launched in October 1995. Managed by the group's head of multi asset David Hambidge, it is run with an income mandate, investing in equities, bonds, commercial property and alternatives. The £1.2bn fund is ranked second out of 75 in the IA Mixed Investment 20-60% Shares sector over five years, returning 66.7 per cent over this period compared with 37.78 per cent from its peer group composite. It is currently yielding 4.21 per cent – investors who put £10,000 into this fund five years ago would have made £2,497.73 per cent in income alone over this time.

The ethical choice

ROYAL LONDON SUSTAINABLE WORLD TRUST

Blasting the myth that by investing ethically you are forgoing potential returns is the performance of the Royal London Sustainable World Trust. Mike Fox's £315m fund sits top of the IA Mixed Investment 40-85% Shares sector over five years, its returns of 98.04 per cent nearly double those of the 51.29 per cent made by its peer group composite. The fund's sustainable investing remit means the manager focuses on key themes such as healthcare and climate change, with almost 85 per cent of the fund currently invested in equities and 15 per cent held in bonds.

ABSOLUTE BEGINNERS

John Blowers goes back to basics, offering advice to people who are thinking about investing for the first time but don't know where to start

AS AN INDUSTRY, WE'RE PRETTY USER-UNFRIENDLY and it is no surprise that even in this world of ultra-low interest rates, most savers tend to leave their money in cash-based products such as current or savings accounts, cash ISAs or our national favourite, property.

In the UK, we are fearful of risk but love the idea of reward. Unfortunately, the two are bedfellows and there is a direct link between the amount of risk you take and expected growth levels.

On the surface, holding your money in cash appears to be the least risky option. If you put £100 in the bank, it will still be worth at least £100 when you take it out. With inflation rising and interest rates at rock-bottom levels, however, your cash will buy less the longer you leave it in your account.

The concept behind investing is you pay a professional who will allocate your money to companies that they expect to grow. My advice to beginners is that investing in individual stocks is not a great place to start. You are exposing yourself to additional risk by committing your money to a small number of companies and are effectively putting all your eggs in one basket. A fund manager can call on enormous analytical resources to unearth and invest in a variety of companies on an ongoing basis.

Although you pay for the privilege of this service, you'll avoid the headache of having to constantly watch your investments.

More than 4,000 funds are available to UK residents, meaning that there is an investment to suit every need. Finding the right fund is no easy job, however, as we will discuss later.

If you think investing may be right for you, read on, but please bear two points in mind. First is whether investing is suited to your needs – can you afford to lose money if markets have a particularly bad period? Second, and allied to the first point, is that you need to invest for the longer term (five years at the very least). This is because over time, the peaks and troughs in your investments tend to even out. If you need to get your cash out in the short term and your investments are worth less than the amount you put in, then you will lose money.

HOW DO I START – IFA, BUY DIRECT OR PLATFORM?

Here's where the choices start. If you're terrified of choosing your investments, there are many independent financial advisers (IFAs) equipped to help you. They charge a fee for their advice and you will also pay the fund management charges for the investments they make on your behalf.

You could also visit the website of any fund management groups that catch your eye and invest directly with them.

Several offer very swish services, but in the long-term you'll probably invest with several different firms, you won't be able to obtain a single overview of your investments and you may end up paying more than using the most common service – a platform.

Platforms offer private investors the ability to choose and manage their own investments in a single place. Most offer funds, shares, investment trusts and exchange traded funds and allow you to pick from a wide range of fund managers.

They usually also offer the ability to put these investments in an ISA or pension. Platforms tend to be the

cheapest option, although charges differ and sometimes it is difficult to compare the reasonably complex pricing structures on offer.

UNDERSTANDING TIME HORIZONS

Most people invest for a purpose, whether this is for retirement, defending cash against inflation, saving for a house, boat, car, wedding, children and so on.

Although it would be great to see your money grow quickly and steadily from the moment you invest it, this almost certainly won't happen. There will be plenty of ups and downs – there are times you will be thrilled and others where you may end up out of pocket – in the short term at least.

> In the UK, we are fearful of risk but love the idea of reward

On the whole, however, history has demonstrated that equity markets tend to grow over long periods of time.

There are three typical phases of investing: aiming for growth in the early stages, moving to capital preservation later on to defend your gains and finally an income phase so you can live off your investments.

Don't consider investing if you need to access your money in less than five years; a more realistic time horizon is between 10 and 30 or more years. Of course, you can cash in your investments at any time, but in the short term they may be worth less than the amount that you originally put in.

•••

CHARGES – A CRASH GUIDE

While fund growth is not forseeable, charges are and everybody seems to want a piece of the action.

First, fund management groups. They take a cut each year for running the fund, usually around 0.75 per cent. Some funds will charge more than this while others will charge a little less.

Because they are computer driven and not managed by (expensive) people, passive funds and ETFs charge considerably less – usually from 0.1 per cent per annum up to around 0.35 per cent.

One last note. Funds also have an ongoing charges figure, or OCF. This is the actual amount that is deducted from your investments and takes into account additional variable costs such as research and administration. This is the best figure to use when assessing costs.

If you use an IFA, they will charge an additional fee for their advice.

Platforms tend to charge two additional fees – a platform fee and potentially a dealing fee. Every time you buy or sell an investment, there may be a dealing fee, ranging from around £5 to £15. Then there's the platform fee, which takes a small percentage of the value of your investments each year. This ranges from around 0.2 per cent to 0.45 per cent, although some platforms have caps or tiered pricing (for example, Trustnet Direct's platform fee is 0.25 per cent but is capped at £200 per annum for larger portfolios).

Some platforms offer fixed pricing, which can be expensive for small portfolios, but is far more economical for larger ones.

WHICH FUNDS SHOULD I PICK AT THE START?

With so many funds, investment trusts, ETFs and shares to choose from, where on earth do you start?

Some platforms have shortlists of what they consider the best – or ideally, most consistent – funds. For example, the Trustnet Direct 100 fund list, which is compiled from FE's extensive fund research business. This is a shortlist of individual funds that we consider best of breed in a number of sectors – but it is worth pointing out that buying a single fund doesn't offer much diversification.

> **Never panic when markets fall. Historically, the stockmarket has always risen over the long term**

You could also look at model portfolios, which are carefully constructed baskets of funds that spread risk and tend to have a specific investment objective. Again, Trustnet Direct offers a range of these fund selections.

Finally, there are risk-rated funds which allow you to choose the level of risk you are comfortable with. The fund manager keeps tuning the investments in these products to get the best balance of risk versus return. The best known of these include the BlackRock Consensus, Vanguard LifeStrategy and Standard Life Investments MyFolio fund ranges.

WRAPPERS – WHAT ARE THEY?

This is another hopeless piece of jargon, but effectively a wrapper is either an ISA or a pension that allows you to protect the investments you pick from the tax man. Almost all funds can be added to a pension (such as a Self-Invested Personal Pension – SIPP) or an ISA, which means all your gains from your investments are tax-free. The ISA limit was increased to £20,000 a year in April 2017, allowing you to build a serious tax-free investment portfolio over time.

Another wrapper is the Junior ISA (JISA), which allows you to build a tax-free sum for your children.

MONITORING AND MANAGING INVESTMENTS

So, you are now invested and that's where the fun starts. As long as you have picked some good funds, there's no need to watch them every day in the way you may be tempted to do with an individual equity. But you should keep an eye on your investments just to make sure everything is going to plan. This is where investing via a platform pays dividends, as they allow you to view the performance of individual holdings and the overall portfolio. Platforms such as Trustnet Direct provide a series of tools to monitor performance. You can buy more funds, add to existing holdings or set up a monthly investment plan.

Never panic when markets fall. Historically, the stockmarket has always risen over the long term (and I mean since 1900) and remember that you're in control, so you can add more money, remove it or take a break from monthly investing when times are hard.

Finally, ensure each investment is still performing as it originally did. If it has lost its year-in, year-out consistency, then consider selling out and reading up on one that is doing better.

Trustnet Direct offers a fund Healthcheck tool which keeps an eye on your investments and even highlights better options, should your existing ones lose their sparkle.●

JARGON

WHAT ARE THE TERMS I NEED TO KNOW?

Fund – a portfolio of investments made by a fund manager in a selection of companies, usually with a theme or purpose, for example UK smaller companies or technology. The jargon term is a unit trust or OEIC (open-ended investment company)

ETF – a computer-run fund that aims to track an index such as the FTSE 100, S&P 500 or gold price

Share – a direct investment in a single company, for example Vodafone or Lloyds

Investment trust – similar to a fund, but with a number of subtle differences. A trust invests in a range of companies but can also borrow money to invest more and the share price is not necessarily the same as its net asset value (NAV), adding to the confusion. Investment trusts are listed on the stock exchange

Active fund – a fund with a human fund manager who buys and sells investments

Passive fund – a fund that aims to replicate an index such as the FTSE 100. It tends to be run by a computer programme

Sector – funds are categorised by the sector in which they operate, whether that is a geographical region, industry sector or the amount of risk they take

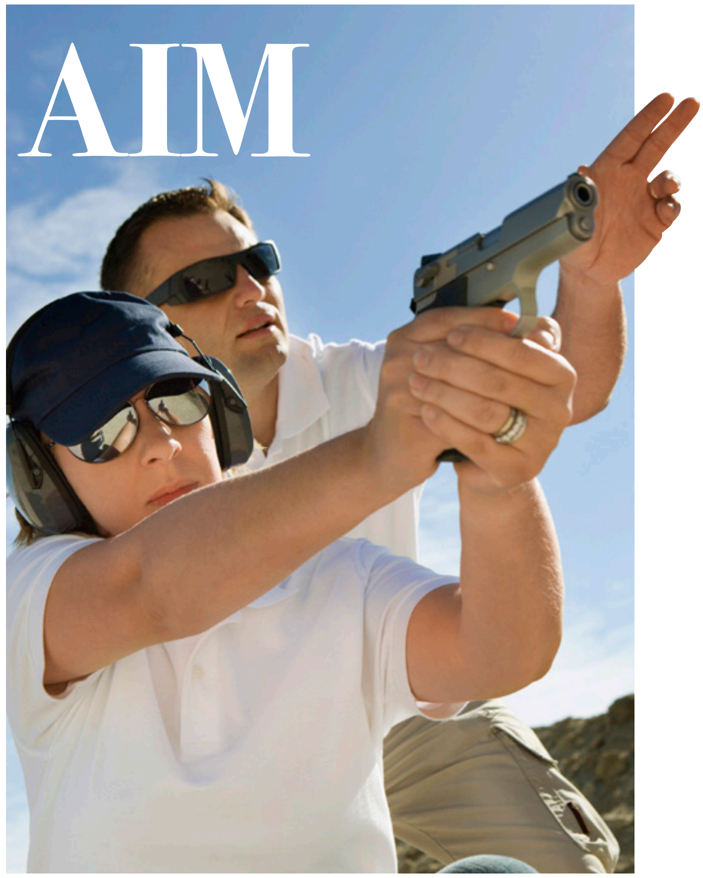
Risk – funds also categorise themselves by the amount of risk they aim to take. They often use terms such as cautious or defensive, through to moderate or balanced, and finally to higher risk or aggressive

Diversification – this describe how widely the fund spreads its risk across different investments, geographies or sectors. The more diversified, the more you are spreading your risk

Platform fee – the annual charge levied by a platform to administer your investments

Annual management charge – the percentage fee charged by the fund to manage your investments. This is deducted from your fund each year

CHANGE AIM



Rathbones' **Jo Rands** and **Alexandra Jackson** name three AIM stocks undergoing a change that should see them deliver better earnings and cash-flow

WE ARE ALWAYS SEARCHING FOR COMPANIES that are capable of transforming into "something greater". And, in our view, where better to find these than AIM? AIM is relatively illiquid and high risk, however, so we are careful to hold only a small proportion of our portfolio in this part of the market. We target companies undergoing some kind of change that will lead to better earnings and greater levels of cash-flow. This could be an external change, such as growing demand for its wares, or it may be internally generated, such as a new chief executive with a plan to improve the business.

ACCROL PAPERS

ACCROL GROUP MAKES TOILET PAPER, kitchen roll and tissues sold by discount retailers. Aggressive pricing by stores such as B&M, Aldi and Lidl has helped them take market share from larger stores, a dynamic likely to gather momentum, and Accrol recently bought new machines to increase production as its clients try to fill a growing number of shelves. Unlike its competitors, Accrol doesn't pulp its own paper, which gives it flexibility and lets it shop around for a better deal. There is a risk of paper becoming more expensive to buy after the fall in sterling, however, and Accrol is one of the smaller players in the market.

BREEDON

BREEDON GROUP QUARRIES AGGREGATES (stones, gravel and sand) and makes cement mix and asphalt used in laying roads and building foundations. Infrastructure in the UK is in dire need of development and UK politicians of all stripes support greater spending on this sector, which should benefit Breedon. We also like its lean management team which is close to day-to-day operations. That has helped Breedon buy several smaller rivals and boost earnings – a tactic central to its strategy. Breedon will be vulnerable if construction spending tails off, so we are keeping an eye on the sector's output and the strength of the UK economy.

GBG

GB GROUP IS A NICHE TECHNOLOGY COMPANY, supplying firms with identity verification and fraud prevention software. This work dovetails with general customer analytics and it is starting to help clients determine who is buying its products, why and how to engage with them better. Acquisitions are also helping GB drive growth. Most of GB's clients only use one of its services, and it hopes to cross-sell more to boost margins. This is obviously a goal of many service companies and whether it can successfully achieve this will depend on its new chief executive and years of hard work.

SVS CHURCH HOUSE TENAX ABSOLUTE RETURN STRATEGIES

Nexus IFA's Kerry Nelson is using this fund until she gets a clearer picture of the economic and investment environment

THE POLITICAL WORLD HAS WITNESSED ENORMOUS TURMOIL in the last 12 months, but the response of markets, aside from some spectacular one-day falls, has been bullish to say the least. The FTSE 100 and the Dow Jones are among a number of indices that have reached all-time highs in 2017.

Many factors have contributed to this trend. The UK economy and, in particular, the UK consumer, have proved more resilient to the vote to leave the European Union than had been expected, although markets continue to be strongly influenced by sterling, which is itself sensitive to politics.

The election of Donald Trump as US president holds out the promise of tax cuts and increased public spending, although faith in the reflation trade has begun to wax and wane in recent months. Meanwhile the IMF is seeing improved growth in developed markets, while the oil price has picked up to around $50 a barrel.

Given this broad overall progress for stocks, we decided that it was time to take some profits and move our portfolios to a more defensive position, hence our decision to buy into SVS Church House Tenax Absolute Return Strategies.

The fund suits our needs as it aims to achieve positive returns over rolling 12-month periods with low levels of volatility. This focus on capital preservation was a key driver behind our decision to buy and suits the needs of our portfolios across all risk profiles.

Looking at the market trends of recent months, we can see headwinds on the horizon – higher inflation hindered first-quarter growth in 2017, perhaps as a delayed side-effect of Brexit, and yet there is still a chance of a rate rise in the near term.

With so many politically and economically charged decisions expected in the coming weeks and months, we want a product that is alive to these events, which is why the active nature of the fund appeals to us.

It also helps to justify the annual management charge of 0.875 per cent and ongoing cost of investing of 0.91 per cent.

The fund has delivered strong gains over the short and medium term, with returns of 8.13, 16.04 and 29.01 per cent over one, three and five years.

Holdings are diversified across asset classes, with a high proportion in cash and other low risk assets.

The fund's largest allocation is to floating rate notes (FRN) due to the manager's belief that the structure of interest rates in the UK is inappropriate for current economic conditions. It has made some sales where it senses deteriorating credit quality.

There are many conflicting signals both domestically and internationally and we believe this fund will allow us to lock in gains and build in some protection for our investors while we pause until the complicated political, economic and investment picture becomes clearer.●

***Kerry Nelson** is managing director of Nexus IFA*

TRUSTNET

JUNE PREVIEW

Myths & legends

The next issue of Trustnet Magazine will examine numerous investment maxims and find out whether each one more closely resembles fact or fiction. It will also look back at a number of “legendary” investors, revealing what made them great and who their closest equivalent would be in the current market.

Our sector focus will fall on AIC North America/Europe/Japan – three regions that have benefited from quantitative easing to one extent or another since the financial crisis but that have wildly differing records over the medium term.