Compass

January 2017

Foreword

By Annabel Brodie-Smith

The New Year is up and running and so is the market so far this year. The FTSE 100 had quite a rally, with a record breaking 12 day run of highs, at the beginning of January.

Of course no-one knows what will happen next, but the investment company that benefitted most from a change in sentiment last year was BlackRock World Mining. This was the AIC's best performing member up 101% in 2016 and this month manager Evy Hambro explains why the company performed so well and why he believes the outlook for the mining sector is improving.

The political changes of 2016 are continuing apace with Theresa May's Brexit strategy speech and Trump's inauguration this week. Arguably, Brexit and Trump are both symptoms of a general 'retreat from globalisation', to quote the title of a new book by Gervais Williams.

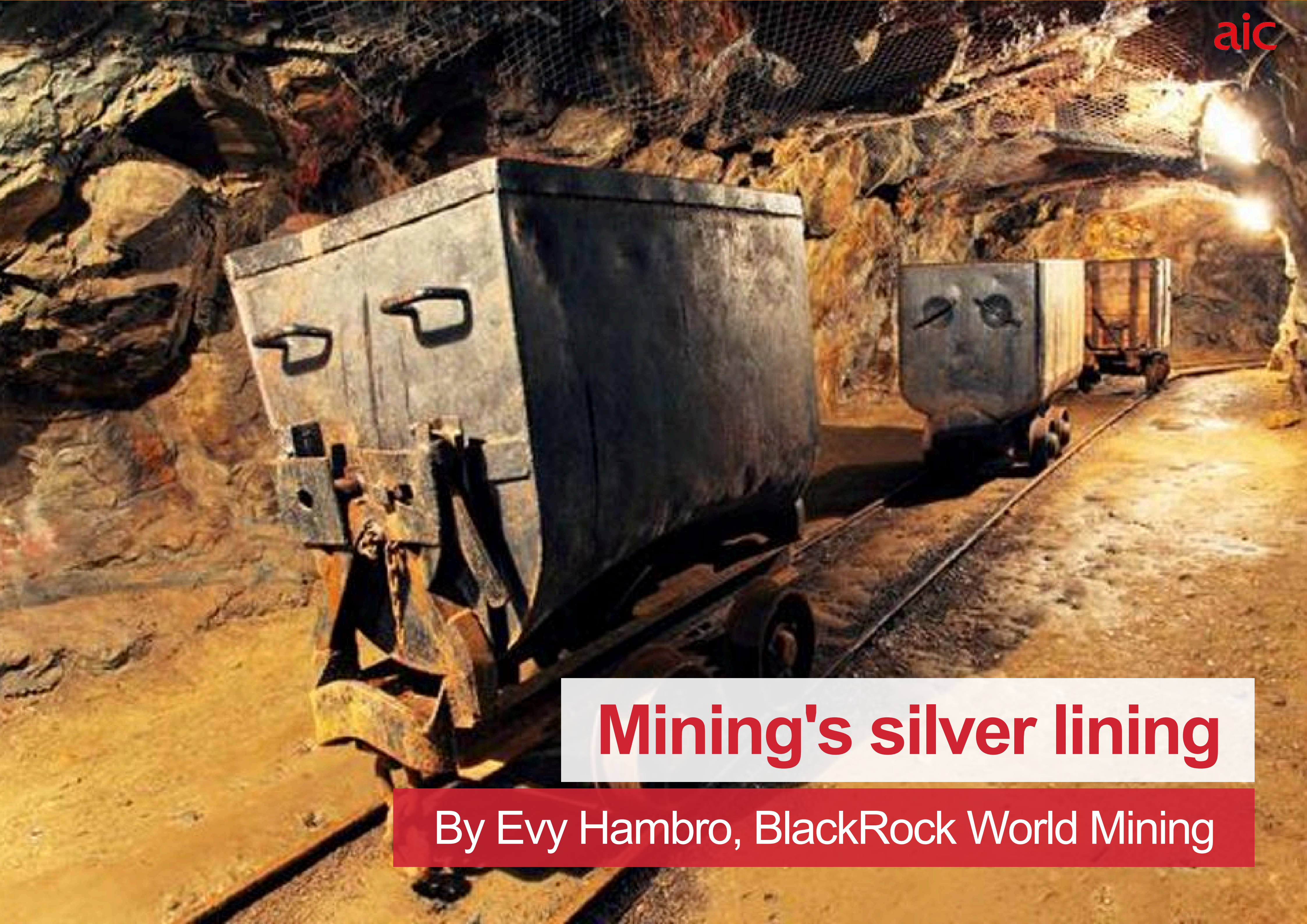
Gervais barely needs an introduction, but he's CEO of Miton Group and manages The Diverse Income Trust and Miton UK Micro Cap. Gervais has kindly summed up some of the book's insights into an article for us. He thinks investment strategies will change more in the next three years than they have in the last thirty years. It's thought-provoking stuff.

Finally, it's the time of the year when most New Year's resolutions have already fallen by the wayside. David Prosser explains in his article how saving small amounts of money and investing it can be worthwhile. After reading this you might be tempted to give up that daily cup of coffee or one restaurant meal a week.

Even if you're not prepared to forego such indulgences you might be surprised to know that if you had invested £50 a month in the average investment company over ten years you'd now have nearly £11,000 from the £6,000 invested. But if you'd invested the same £50 a month over 20 years in the average investment company you'd now have over £36,000 from £12,000 invested. Good things certainly come to those who wait!

See you next month.

Annabel Brodie-Smith, Communications Director, AIC



Mining's silver lining

By Evy Hambro, BlackRock World Mining

Mining's silver lining

Mining has been under something of a cloud after a difficult few years. But as Evy Hambro, portfolio manager of the BlackRock World Mining Investment Trust, explains, he believes the outlook for the sector is improving.

Mining companies have performed well in 2016. What's driven this performance and is it likely to continue?

The mining sector appears much more stable after experiencing a prolonged period of negative growth. Things had looked promising at the start of 2015 but the second half of the year saw a significant sell-off in shares. The sector fell by 36% at that time - caused by fears about a sharp slow-down in China, combined with concerns about mining companies' debt levels[i]. However, the start of 2016 saw mining rally strongly and it is now back to the levels that we saw in the first half of 2015. Several factors have contributed to this

One such factor is that mining companies have reduced their debt significantly – they have sold assets and generated more business. Investors are still light in the sector as a result of the second half of 2015, but commodity prices are rising and costs are lower. We do not believe we will return to the lows from last year, though mining shares can be volatile, and investors should keep this in mind.

What is the outlook for dividends from the major mining companies?

There are three main reasons we could see dividend growth from mining companies.

Firstly, if and when the major mining companies pay dividends, they do so in US dollars. As a result of sterling's recent depreciation, the dividend growth for UK investors will be significant, even if payments stay flat. However, there is always the chance that the currency could have moved against us since currencies are volatile and their strength or weaknesses change all the time.

Second, a number of companies cut their dividends to preserve flexibility on their balance

sheet during weaker points last year. Now they are in a better position, they can improve dividend payouts.
Finally, some companies removed dividends totally, and we believe it is likely those companies will re-establish payments. For example Glencore, which has not paid a dividend since September 2015[ii], has said it may resume dividend payments in 2017[iii].

Are supply and demand now rebalanced for industrial metals?

After prolonged periods of under-investment by commodity companies – as we have seen over the past four years – there follows a lack of supply. Capital investment peaked in 2012 after which expenditure by commodities companies has fallen, which is taking some mined commodities from surplus into deficit. In response, we are gradually seeing prices rise. However, the Trust doesn't look at prices in isolation; we also look at the value of shares. We will only invest if we identify a combination of attractive commodity prices and attractive valuation of shares.

Global economic uncertainty has driven investors to safe-haven assets, such as gold, as a form of portfolio insurance. Has this affected how you run the Trust?

We have been building our exposure to gold and silver over the past few years which has enabled us to benefit from strong performance and, in particular, higher gold prices, pushed up by increasing demand for the yellow metal. We only hold high-quality gold companies with strong management track records, such as Fresnillo and Avanco[iv], so we underperformed the gold index while investors rushed to companies in which we chose not to invest. That said, we didn't stray from our investment process or follow the herd and, by continuing to hold quality companies, we are getting that performance back.

How do you see China's economic slowdown affecting the mining sector?

China is the world's leading producer of coal and gold, and the world's leading consumer of most mining products, so there's no doubt the sector has been affected by fears about its slowing GDP growth. In the second half of last year there was an incredibly strong negative sentiment towards China. However, this year the fears on China have receded and investors seem more comfortable with the direction in which Chinese fiscal policy - meaning questions of taxation and public spending - is travelling[v].

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[i] 30/06/15 – 14/12/15, Datastream, sterling terms, represented by the Euromoney Global Mining Index, November 2016
[ii] DividendMax, November 2016
[iii] Bloomberg.com, March 2016
[iv] BlackRock, September 2016
[v] Bloomberg, September 2016

Annual performance (%) to last quarter end (GBP)	30/09/15-30/09/16	30/09/14-30/09/15	30/09/13-30/09/14	30/09/12-30/09/13	30/09/11-30/09/12
Euromoney Global Mining Index (TR) currency?	69.68	-39.50	-5.19	-19.77	-3.46
FTSE Gold Mines Index currency?	137.5	-30.7	-15.2	-53.3	-10.4

The Euromoney Global Mining Index performance figures are based on total returns net of taxes and dividends, with income reinvested. The FTSE Gold Mines Index performance figures are based on capital appreciation only. Past performance is not indicative of current or future results and should not be the sole factor of consideration when selecting a product. It is not possible to invest directly into an index.

Why globalisation's peaked

By Gervais Williams, Miton

Why globalisation's peaked

By Gervais Williams, Fund Manager, Diverse Income Trust and Miton UK Microcap & author of ‘The Retreat of Globalisation’

Gervais Williams, Fund Manager and author of 'The Retreat of Globalisation'

For decades it’s been consensual for politicians to promote the globalisation of trade, both on the left and the right of the political spectrum.

The reduction of trade barriers has raised many millions out of poverty. And the globalisation of trade is estimated to have added an extra 45% to the world growth since 1990. During this period many companies have enjoyed strong trading conditions, and buoyant cashflow that has funded good wage growth, a rising tax take, and growing dividends (the amount that a company pays to shareholders) that has increased the value of our collective savings and pensions.

Changing pattern

But since 2008 the pattern has changed. Despite ultra-low interest rates, and rising market valuations, many companies have pulled back on their ongoing investment in the future. Lower levels of capital expenditure are now coming through with productivity stagnating.

As tax takes slow, governments are finding it harder than expected to close their budget deficits. Even the new jobs being created are now more temporary in nature as companies are less certain about the future.

These changes are now leading many to question the wisdom of globalisation. Social attitudes rarely change. But when they do, they can change more abruptly, and more radically than most assume. This is underlined by the recent results of the UK’s Referendum on the EU and the election of Donald Trump.

> **"The changing political climate is prompting the first significant change in economic policy for three decades."**
>
> – Gervais Williams

Major economic turning point

Going forward, the changing political climate is prompting the first significant change in economic policy for three decades. In the past free trade agreements were seen as vote winners, but now they're becoming politically toxic. We are entering a major economic turning point. The Retreat of Globalisation seeks to look forward to identify some of the potential changes that could lie ahead. In future, the market winners and losers could look very different.

For example, the Chinese economy was one of the big winners of globalisation, particularly over the last fifteen years. It hasn't happened by accident. They have had to work at it. For example, after the Global Financial Crisis, the Chinese economy was vulnerable to a sharp slowdown in world demand for its goods, and a potential setback with regard to their long term goal of generating additional employment.

So, in 2009 the Government embarked on a giant period of investment in Chinese infrastructure. Many will have read about the new cities, transport links and power stations that have been built over recent years. These boosted Chinese growth, and helped the world economy to recover after the Global Financial Crisis.

But they have also involved a huge amount of funding. The problem is that the sheer scale of infrastructure investment simply overwhelmed the needs of the Chinese economy, in spite of its ongoing growth. Whilst some of the investment did initially address bottlenecks in their economy, progressively much of the investment was directed at more marginal projects and a significant amount that has almost no real economic value whatsoever. This is now causing problems. Much of the infrastructure spend is failing to generate sufficient cashflow to fund

During 2016 the Chinese authorities have let their banks free-wheel, rolling over interest payments in additional debt. There's been a surge in accounts receivable, and other IOU's, with a cashflow shortage becoming more pressing, and the consequential losses more obvious. Some are seeking to address their problems with a series of price rises, which is now coming through with inflation and higher export prices of Chinese goods.
A few years ago it was unthinkable that the Chinese economy might become so difficult, but now it might be facing a period of stagflation. All this underlines the scale of change facing markets. The Retreat of Globalisation identifies some of the strategies that fund managers can

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utilise to safely steer their clients through the next few years. Expect more economic and market change in the next three years than we have had in the previous three decades.

Sources:

The reduction of trade barriers is estimated to have added an extra 45% to the growth of world GDP since 1990. – Macrostrategy – Julien Garran

During the year there has been a surge in accounts receivable, and other IOU's, but the cashflow shortage is becoming ever larger, and it's getting harder to hide the losses. China treadmill to deflation 12th Oct Andrew Lees, Macrostrategy.

This can be viewed as closing the safety valve on the inflationary pressures within their economy. It is quite possible that the Chinese economy could face a period of stagflation during 2017. Andrew Hunt Economics Global Weekly Review 16th December 2016.

IMF – Global Trade Liberalisation and the Developing Countries, 2001.

The Economist – China's financial system: The coming debt bust, 7th May 2016.

FT - China debt load reaches record high as risk to economy mounts, 24th April 2016.

FT - China escapes deflation but are rising global prices on the way?, 14th October 2016.

Small savings get big

By David Prosser

> **"Give up your daily cup of high street coffee and invest the money instead, and you could generate a pot of cash worth more than £100,000 over the next 35 years"**
>
> **– David Prosser**

If your new year's resolution for 2017 is to spend less and save more, it's worth taking a look at the Pension Village website maintained by financial services company LV. Its calculators allow you to work out the long-term impact of making even very small savings today – and the figures are remarkable. Give up your daily cup of high street coffee, for example, and invest the money instead, and you could generate a pot of cash worth more than £100,000 over the next 35 years, assuming an annual investment return of 5 per cent. Cut down on one restaurant meal a week and the long-term dividend could be £96,000.

These numbers are realistic for two reasons. First, what seem like trivial sums of money in isolation add up to very substantial sums over long periods of time, as long as you're disciplined enough to keep putting them aside, week-in, week-out. Second, you get the benefit of compound interest – the fact that you're continually earning returns on the returns you've already earned as well as the savings you're making; again, over the long term, the effect is dramatic.

Regular saving in practice

How, then, do you turn theory into practice? That is, what's the best way to put, say, your £2 daily saving on coffee towards long-term savings?

Well, the first point to make is that this idea isn't going to work unless you're consistent, so you need some form of regular savings vehicle into which you can sweep your savings – on a monthly basis, say. Ideally, the sweep should be automatic, so that you don't have to remember to do it.

At the same time, you'll also need to think about where this money is invested. The safest option is a bank or building savings account, but the returns on such accounts look unattractive in the current low interest rate environment. Moreover, over very long term periods, stock market investments have in the past outperformed cash savings. In the short term, these investments can fall in value as well as rise, but if you're investing to produce a return over many years, or even decades, you can afford to take this risk.

Investment companies offer a solution

Investment companies are collective investment vehicles that pool savers' money to invest in particular assets – some funds offer a broad exposure to the UK stock market or to global markets, while others are more specialist. Many funds offer regular savings schemes that allow you to contribute as little as £25 a month via a direct debit. You also have the option of holding your funds within a tax-free individual savings account.

Investing in the stock market this way has another advantage too: you get to benefit from a statistical quirk known as pound-cost averaging. Very simply, the idea is that in months when the value of the fund has fallen, your fixed cash sum investment buys more shares in it – so when the price recovers, you've got a larger holding. This can help smooth out some of the ups and downs of stock market investment.

Investment company regular savings plans aren't for everyone – you must be prepared to take a long-term view and be comfortable with your money falling in value as well as rising. But if you're looking for a disciplined way to channel even small amounts of cash into a long-term savings plan, they offer a convenient and attractive option.

David Prosser is the former Business Editor of The Independent, Personal Finance Editor of the Daily Express and Deputy Editor of Money Observer magazine

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