ISA & PEPTalk

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Pilling & Co
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Baillie Gifford UK Growth Fund plc
Medium Risk

On June 30th Baillie Gifford assumed the management of what was Schroder UK Growth Fund plc. This investment trust had previously been stewarded by Richard Buxton when he was head of UK equity at Schroders but he left in 2013. Since then the trust has had two different lead managers and the share price return has not beaten the FTSE All Share in 2014, 2016 and 2017. Despite reducing their annual management fee from 0.65% to 0.5% the independent board of the trust has sacked Schroders and appointed Baillie Gifford to manage the portfolio instead. Immediately on announcement the price began to react as the discount to net asset value narrowed to 4%. There is very little gearing presently used to magnify returns or losses meaning the focus will all be on the manager's stock selection as the portfolio evolves. Borrowing is normally limited to 20% of shareholders' funds.

With BG's other eight trusts priced at a premium to net asset value and able to issue shares the scene is set for a re-rating of this stock. Headwinds to achieving that will be the substantial shareholdings on the register owned by Schroder investment plan clients and a large value investment house, both of whom may react negatively to BG's growth investment style. Therefore, early adopters of this idea need to be prepared to be patient. For their part the new managers could not be more optimistic in their rejection of the shadows cast by Brexit. Citing examples like Renishaw and Genus they say, "Rather than being dull and futile, investing in the UK market is for us a greatly rewarding exercise. This is simply because there are some tremendously exciting British businesses which we wish to help grow to become multiples of their current size in the years to come." It seems a while since someone was so complimentary about UK plcs.

Calendar year	2017	2016	2015	2014	2013
Total return	9.7%	10.5%	2.1%	-16.2%	38.0%

Priced at 195p on 6th July, the net asset value per share of this medium risk investment was 203p. If you have been struggling to identify a straightforward UK equity growth fund for the core of your portfolio this may be just the ticket.

If you receive a copy of PEPTalk and no longer wish to receive it please contact us via the usual channels or email us at compliance.co.uk and we will arrange this for you

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Economic Overview and Prospects for the Market

	5th July 18	3rd July 17
FTSE 100	7603.22	7377.09
FTSE All-Share	4180.73	4029.70
FTSE 250	20621.09	19320.43
Base Rate	0.5%	0.25%
$/£	1.322	1.294
Euro/£	1.131	1.137

Mike Talbot

Investment Manager

Despite some serious political risks one may be pleasantly surprised at the state of the global economy. Global growth remains buoyant, and it seems as though we haven't reached the final stages yet. Economic fundamentals point to further healthy growth across almost all advanced countries and most emerging markets. Global growth as a measure of GDP is estimated between 3.1% and 3.3% in 2018.

This is of course good news however does it relate to the performance of the markets? Market performance and alpha generation has been unusually poor in the first half of 2018. The majority of asset classes, cyclical equity sector and hedge fund style funds are underperforming cash. Such a situation is rare, especially when global growth and corporate profits look robust. If anything this is an indication of a potential lack of investor confidence, but undoubtedly other factors are playing their part.

On-going US trade tensions and negotiations will continue to dominate headlines. To date the higher tariffs imposed have been minor with negligible direct impact to the economy. The expectation is that trade wars are not going to escalate as every nation knows the costs of halting trade. That being said Berenberg and JPMorgan believe the greatest risk to their upbeat outlook is coming from the recently intensification in trade tensions. US rhetoric is ramping up, threatening a wider range of tariffs and investment restrictions on China and raising tariffs on US auto imports from the rest of the world. Taken together, these items would increase tariffs on more than 30% of US imports. If we continue to see a decline of confidence due to menacing 'trade war' headlines confidence could decline significantly which would slow consumption, business expansion plans and trade.

The US continues its strong economic momentum and is expected to sustain through 2019 moderating thereafter, with real GDP increasing by 3% in 2018, 2.8% in 2019 and 2.4% in 2020. Encouragingly this momentum is wide spread across many industries, with healthy growth in consumption, business production and investment, and exports. The stimulus from tax reform and an easing of regulations, plus the supportive financial conditions outweigh global and domestic uncertainties. Consumer spending has stepped up as a result of record unemployment, and a boost to disposable incomes from the Tax Cuts and Jobs Act (TCJA). Real consumption is expected to increase 2.8% annualised in the second quarter of 2018.

The Fed is expected to increase rates two more times this year, followed by three times in 2019 and twice more in 2020 bringing the rate up to 3.5% to 3.75% in late 2020, (above the current estimate of its long- run rate of 2.9%). Of course these are only estimates and if inflationary pressures grow the Fed may look to increase rates more aggressively which could derail the economic momentum. Inflation remains subdued but risk is now on the upside due to–stronger demand for materials from manufacturing, higher energy costs and Government spending. It will be important to keep an eye on this data going forward. This became apparent in March when we saw global markets sell off aggressively on concerns these indicators had turned negative.

In stark contrast the wind has been knocked out of the sails in the Eurozone. Confidence seemed to be growing from strength to strength in 2017, however this has been quickly eroded during 2018. JPMorgan still see a solid underpinning for regional demand in labour markets as momentum remains broad based and robust across all major countries. The Eurozone has added almost 8.5m jobs since the summer of 2013. There is an expectation private consumption will accelerate from 1.6% in 2018 to 1.8% in 2019 and 1.9% in 2020. Unfortunately trade wars, a higher oil price and political risk has made a dent in economic proceedings. Whether this is temporary we will have to wait and see. From a fiscal point of view the ECB declared it would bring forward the end of Quantitative Easing to December 2019.

Brexit still lingers on the minds of investors in the UK and overseas. The UK economy is reportedly about 2% smaller than it would have been had UK voters decided to remain in the EU. These concerns are fading and it is thought as long as the UK avoids a no-deal hard Brexit, positive trends in global demand should provide a healthy tailwind. The result, real GDP growth can accelerate from 1.4% in 2018 to 1.8% in 2019 before slowing a little to 1.7% in 2020. Consumer confidence is wavering as consumption growth falls for 3.1% in 2016 to 1.8% in 2017 due to rising import costs from a renewed drop in sterling squeezing real wages. Encouragingly the tight labour markets suggest there is plenty of room for a strong rise in real wages over the medium term. To contain inflation and to continue the normalisation process of interest rates, the Bank of England gave its strongest suggestion to date there would be a 0.25% interest rate hike in August. It is expected if the UK misses a hard Brexit deal the Bank of England will increase the pace of rate hikes, potentially seeing 2% per year in 2019 and 2020. The current softness in the housing market, mainly London and the south-east, is partly the product of weaker foreign demand. It is not likely to spread to other parts of the UK where conditions remain supportive.

Moving my focus to Asia, China's economy looks set to continue its strong growth over the next several years, but the pace of this growth is likely to moderate, reflecting an underlying gradual deceleration. Analysts at Berenberg project real GDP to grow by 6.6% in 2018, 6.4% in 2019 and 6.1% in 2020, which would be extremely impressive by western standards but lower than the 6.8% average annual growth recorded in 2016-17. China's transition towards reliance on domestic consumption and services continues, while moving away from export related manufacturing. The consequence of this is neighbouring countries will get the opportunity to pick up their slack. One area of interest for China is tech, while it is only a small proportion of GDP it is growing rapidly and contributing significantly to economic growth and productive capacity.

The Japanese economy has bounced back from a temporary decline in real GDP in the first quarter of 2018. GDP is forecast to rise by a solid 1.3% in 2018, but not as strongly as 2017 where it was 1.7%, (but above the 0.8-1% estimates set by the Bank of Japan which is encouraging). Business investment and exports remains healthy, but consumer spending remains limp when compared to gains in wages and personal incomes. Consumption is bound to be dented further once the scheduled VAT hike is imposed in late 2019, however we may see a short term boost in demand for high ticket items on the run up to this being actioned. Due to strong corporate gains, the level of capital investment is increasing. The gradual trend of rising dividends continues, this may persuade the Japanese consumer to increase spending. The Bank of Japan is the standalone Central Bank of the major economies that is likely to continue its aggressive quantitative easing targeting a 10 year Japanese Government Bond to yield 0%.

Finally a quick note on commodities seeing as they have improved by 6% year to date making them the best performing asset so far this year. Most of those gains have been driven from an increasing oil price. Even though we have experienced a de-synchronisation of developed markets growth upsetting other asset classes it hasn't mattered to commodities due to the level of consistent demand from China. The fading US dollar should provide a supportive macro environment for commodity prices, but the performance could vary widely depending on what happens to the oil supply growth.

Overall the threat of trade wars has not altered forecast so far. Naturally uncertainty will likely persist and recent developments point to rising risks and could weigh heavily on global risk appetite. Looking forward it will be important to gauge if trade wars as well as other political concerns dampens business confidence and spending. In the meantime staying long in equities especially growth equities versus bonds and cyclicals is worthwhile. Lower risk investors may prefer to invest in defensive equities over credit/cash.

Movers and Shakers

Sally Greenwood

Chartered Wealth Manager

It has been a funny old market so far this year. We know that we are late in the market cycle and whilst lots of leading indicators still paint a fairly benign picture it feels as though another bout of volatility could be just around the corner. Against this background we have tried to identify sectors where we feel value exists, individual stocks that have strong stories to tell or collectives run by experienced managers able to navigate such choppy waters. These three themes have started to play out, as can be seen from our featured suggestions over the last twelve months.

In April we wrote about the infrastructure funds and how a slew of negative newsflow had contributed to the sector as a whole derating over the previous 12 months. We thought that this created an opportunity to pick up stock at good levels. The sector has started to come back as predicted with **HICL** and **John Laing Infrastructure** rising around 6.7% as investors see value in the sector.

The individual stock story success from April's PEPTalk is GB Group. The identity data intelligence firm posted excellent results, with a 37% surge in revenue leading to full year profit rising to £13.4m from £10.1m a year earlier. The Board stated that clear plans are in place for organic growth and they will continue to look for value add acquisitions.

The funds highlighted in the last year have given mixed results. **The Slater Growth fund** featured in April and the **JO Hambro UK Equity Income fund** from January have hardly moved. This makes sense as the FTSE 100, whilst seeing a fair amount of volatility at the start of this year, is now back at a similar level to where we started 2018.

Opportunities globally have been slightly easier to come by and this is reflected in the performance of the **Lindsell Train Global Equity** fund, which has registered a gain of 11.9% since January.

The one disappointment has been **BlackRock World Mining Trust** featured in January's PEPTalk and falling 10% in the intervening period. As concerns about currencies and politics have risen up the agenda, emerging markets and mining have struggled. Having recently taken an update meeting with Olivia Markham, Portfolio Manager of the investment trust, she firmly believes that the miners are generating high levels of free cash flow yields that are double their historic levels. New payout ratios are being regularly introduced by the new CEO's of companies such as Rio Tinto and Anglo American and management are becoming much more focused on creating shareholder value. She reiterated that she believes we are 2 years into a 5 year cycle, whereby the mining shares stock prices will be rerated to reflect these changes.

Finally, it would be remiss not to mention **Fevertree.** Highlighted as one of the share tips for 2017 it has performed tremendously and has risen more than 200%. Whilst we still like the stock and hold it for a number of clients, it is now moving on to the next phase of its growth plan and expanding in the US.

This is not without its execution risks and therefore it would be prudent for holders to trim their positions and lock in some profit. There is plenty of profit available to allow yourself a free ride from this point.

Movers and Shakers from previous ISA and PEPTalks					
Stock	When featured	Price when Featured (p)	Current price (p)	+/-%	View
Slater Growth fund	April 2018	550	560.11	+1.8	Buy
HICL	April 2018	134.40	143.80	+7	Buy
International Public Partnership	April 2018	140.40	142.6	+1.6	Buy
John Laing Infrastructure	April 2018	111.60	118.60	+6.3	Buy
PRS Reit	April 2018	101	103.50	+2.5	Buy
GB Group	April 2018	403	588	+45.9	Hold
JOHCM UK Equity Income	Jan 2018	146	143.40	-1.8	Buy
Phoenix Group	Jan 2018	708.61	664.50	-6.2	Buy
LT Global Equity fund	Jan 2018	200	223.89	+11.9	Buy
BlackRock World Mining Trust	Jan 2018	417	375.50	-9.9	Buy
Fevertree	Jan 2017	1105	3380	+205.9	Lock in profit

Rise of the Machines – Smith & Williamson Artificial Intelligence Fund

Darren Williamson

Investment Assistant

For decades films and television have depicted a future inhabited by smart machines and how they may affect our daily lives. Is Science Fiction now becoming Science Fact?

From voice-activated personal assistants to self-driving cars, artificial intelligence has the potential to be as life changing as the industrial revolution. The anticipated impact on production, transportation and healthcare are set to have a dramatic effect on the global economy. The wider effects are yet to be known.

Smith & Williamson is one of a number of fund managers to launch an Artificial Intelligence fund looking to invest in companies that are leading this revolution. The fund invests globally across a range of different sectors and seeks companies that are able to demonstrate revenue growth that is purely being driven by the development or application of AI.

I'm sure that you will be more familiar with some of their current holdings, Tesla, Netflix, Alphabet (Google) and Alibaba. However, they do not consider themselves a traditional "technology" fund.

The Fund is differentiated from their peers having built a proprietary AI stock selection tool to help screen the market for companies that may benefit from AI related software. This maybe a more established company such as Netflix but the Fund Manager has come across an Italian Utility name that could make significant cost savings due to AI. If successful they could experience a materially improvement to margins, within a regulated industry.

The performance of the fund since it was launched on 23rd June 2017 has been impressive and it has the highest return in the specialist funds sector over the past year. The size of the fund has now grown to over £86mln.

Due to the short track record and the nature of the industry we would categorise this investment as high risk, AI is still in its infancy and volatility should also be expected. The fund will look to reduce risks by investing in companies with a minimum market capitalisation of $250mln and by capturing opportunities from across the globe, mitigating fluctuating economic cycles.

We may not yet be using hover boards, flying cars and eating rehydrated pizzas but the future may not be that far away.

The table below shows the cumulative performance over the last year (source: Trustnet).

1M	3M	6M	1YR	Since Launch
+2.06%	+18.10%	+17.31%	+36.09%	+33.07%

Purchases will be in the Z share class with no initial charge and an annual management fee of 0.62%. Our standard commission rates will apply to purchases and subsequent sales. W**e would consider the fund to be high risk**.

Past performance provides no guarantees of future returns and the value of any investment made can fall as well as rise.

A Key Investor Information Document (KIID) must be read prior to any purchase and this available from us upon request.

China – Opportunity for long-term investors? High Risk

Terry Applegate

Chartered Wealth Manager

The past few months has been a difficult time for the Chinese stock market (Shanghai Composite), falling nearly 20% from its January peak (as of the end of June) hovering perilously close to 'bear market' territory.

Much of these falls have been brought about by the risks associated with the ongoing trade war with the US, with tariffs being implemented on imports by both sides. President Trump has stated that tariffs will be levied on $50 billion of Chinese exports starting in early July. Retaliation from the Chinese government is widely expected. This protectionist strategy does now present threats to the Chinese economy, and wider Global growth expectations.

There are a number of other key risks facing the country moving forward. China's debt-to-GDP (Gross domestic Product) has increased to 300% from 160% a decade ago, stoking fears of a 'bubble' waiting to burst. This has come about as the government spent trillions on infrastructure, with many unregulated ("shadow") banks lending to companies that may not be in a position to pay them back.

The residential property market has also shown signs of slowing.

On a more positive note, the world's second largest economy has seen economic growth remain fairly stable around the 6.5% level over the past few years. Although 2017 saw China export approximately $506 billion worth of goods and services to the United States (20% of its total exports), the country's economy has gradually shifted, relying more on its own consumer to maintain growth.

At this time of writing it is believed that the Chinese economy could weather the impact of trade tariffs, and it is hoped that a deal will be struck with the US and other trading partners.

Although it is always difficult to predict an entry point in to the market, for those investors willing to take a longer-term view then the recent market weakness may present an opportunity to add a small exposure to their portfolio.

Two investment trusts that we would like to bring to your attention are the **Fidelity China Special Situations (FCSS)** and **JPMorgan Chinese (JMC).**

Both trusts are aiming to provide long-term capital growth by investing in companies listed on the Hong Kong and China stock markets.

FCSS counts companies such as Tencent, Alibaba and Hutchison China Meditech amongst its largest holdings, whilst JMC also holds Alibaba alongside Baidu and China Petroleum & Chemical.

Fund factsheets and KID documents are available on request

Trust Performance – Discrete years

Name	05/07/2017 to 05/07/2018	05/07/2016 to 05/07/2017	05/07/2015 to 05/07/2016	05/07/2014 to 05/07/2015	05/07/2013 to 5/07/2014
Fidelity China Special Situations	15.14%	42.81%	1.24%	42.10%	23.22%
JP Morgan Chinese IT	16.32%	44.23%	-3.91%	16.48%	13.37%
MSCI China	15.12%	34.30%	-6.50%	30.39%	4.07%

Source: FE Trustnet

The trusts would be classed as **High risk**. Please note the trusts can gain additional exposure to the market, known as gearing, potentially increasing volatility. Past performance is not a guide to future performance. The Key Information document (KID) must be read prior to any investment being made. This is available upon request.

Compass Group — Medium Risk

Sally Greenwood

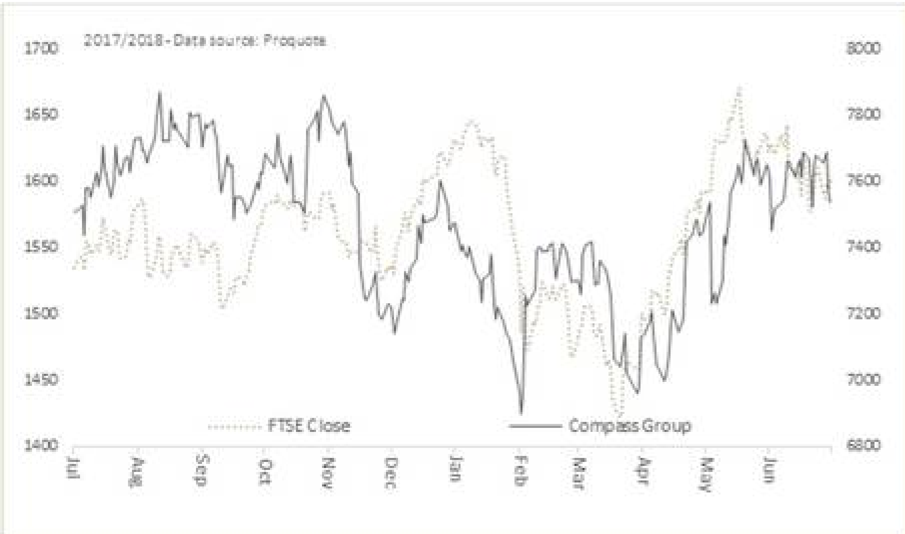
Chartered Wealth Manager

The FTSE 100 company Compass is enormous. It serves 5 billion meals a day in 50,000 locations in 50 countries. This can clearly be a positive or negative factor and in this case I think it uses its size to its advantage. Rather than one brand the company provides its services through dedicated specialist brands, depending on who the underlying client is, e.g. Chartwells is their specialist provider of catering to the education sector and Levy Restaurants UK, the hospitality partner to many of the UK's iconic sport, leisure, heritage, performing venues and exhibition centres. They then break this down further into smaller, individual companies so the end client truly gets a personalised, specialist experience. The management of the different divisions have all been with Compass for 15 years+ giving real stability.

Despite its size, growth opportunities remain. Contract catering is still a highly fragmented market place with 50% served by lots of small players or individual businesses. The US in particular provides ample scope for growth. It now contributes 62% of the Group's Earnings Before Interest & Tax (EBT) and this looks set to continue to grow.

In May when their first half results were announced, revenue and profit had fallen back a little way as trading in Continental Europe had been subdued, and FX had moved adversely. However, the second half looks like it will be stronger with margins expanding from decent levels already and 15% earnings per share growth forecast.

In May 2017 the company paid a £1bn special dividend, equivalent to 61p per share. Whilst this is not going to be repeated this year, there is the real possibility that as a result of the huge cash flow the company throws off a special dividend could once again be paid in 2019. Buy.



Requirement to provide quarterly statements

Peter Jacques

Clients Accounts Manager

Following the implementation of the MIFID II regime there is now a requirement for us to provide you with a statement detailing your assets held with us on a quarterly basis.

As such, rather than producing half yearly valuations as at the 5th April and 5th October together with a statement detailing the previous six month cash movements up to the valuation date, we will now send **quarterly** valuations as at 5th April, July, October and January together with a statement detailing the previous three month cash movements up to the valuation date.

For Client Web Access (CWA) clients they will be automatically delivered to the document section of your online account. For postal clients this will unfortunately mean you receive twice as many statement packages then previously.

For ISA clients on the automatic quarterly income distribution system there will be no change to the payment frequencies. As we will be issuing full quarterly statements we will no longer be posting income payment advices detailing the specific income entries which make up each payment as the information will be on each quarterly statement, however Client Web Access (CWA) clients will still receive an income payment advice in the document section of their online account.

Please note clients may receive their income payments into the bank prior to receipt of their quarterly statements. If you want to guarantee a breakdown at the time of payment you should request to become a CWA client to receive the bespoke income advices.

CWA clients also benefit from a reduced custody fee as well as not receiving the increased paperwork we now need to provide you with.

If you do wish to elect for CWA you should email us at compliance.co.uk and quote your account number(s)

View your portfolio on line with
Client Web Access (CWA)

You can also see all your contracts, valuations, cash statements and PEPtalk.

To activate simply email
compliance@pilling.co.uk

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