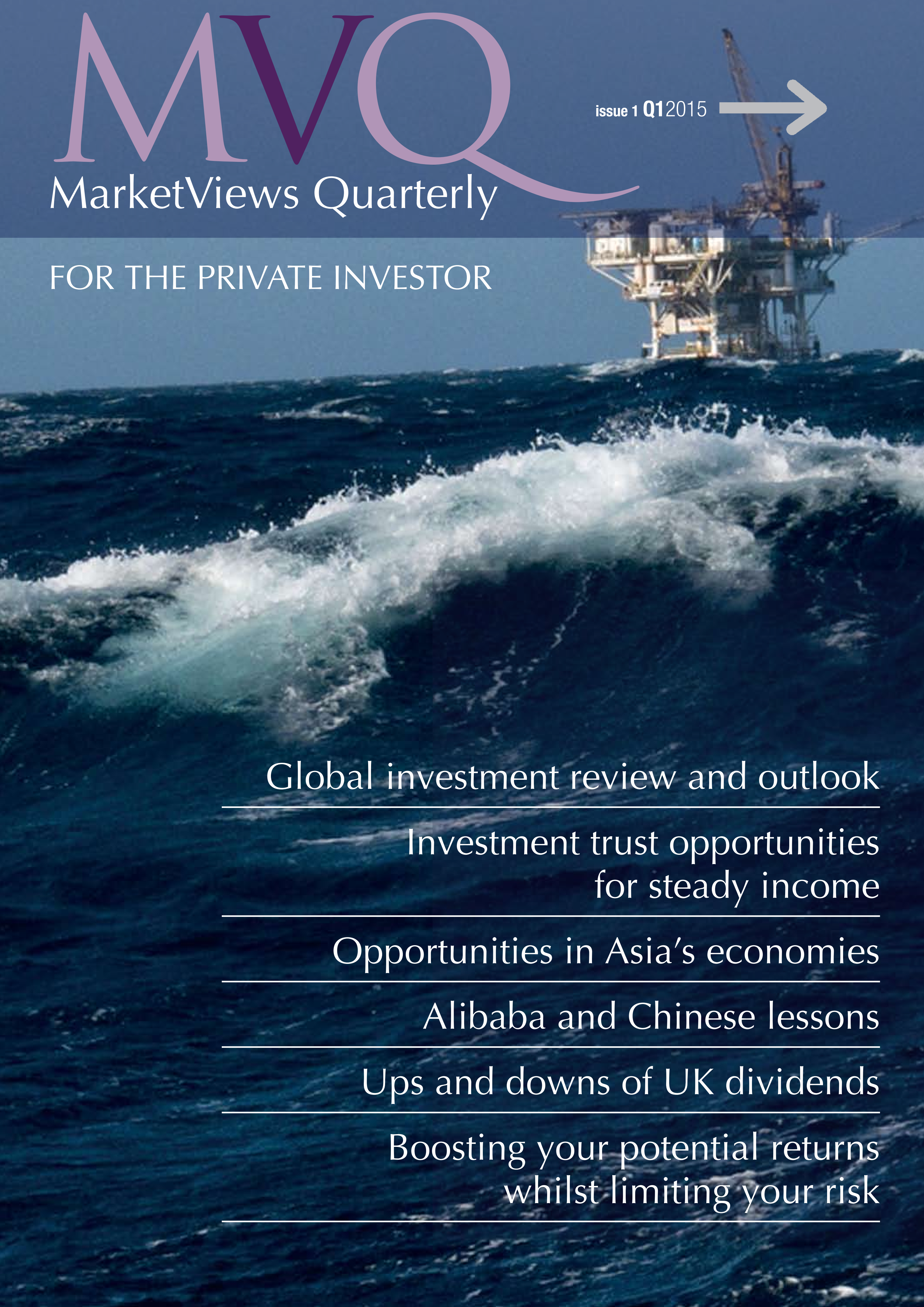


MVQ

MarketViews Quarterly

issue 1 Q1 2015

FOR THE PRIVATE INVESTOR

Global investment review and outlook

Investment trust opportunities for steady income

Opportunities in Asia's economies

Alibaba and Chinese lessons

Ups and downs of UK dividends

Boosting your potential returns whilst limiting your risk

MVQ
MarketViews Quarterly

Welcome to the first edition of MVQ, your quarterly window onto the investment themes and schemes currently quickening the pulses of some of the UK's best-known investment managers – and what those insights could mean for your portfolio.

Faith Glasgow
Managing Editor
Money Observer
magazine

We kick off with an issue slanted firmly towards two driving interests for both professional and private investors: the outlook for income investors, and emerging opportunities in the dynamic Asia Pacific region.

After almost six years of rock bottom interest rates, investors' quest continues for the holy grail of reliable income. But dividends, the cornerstone of most income-seekers' portfolios, have had a rough run recently. Retailers, banks, oil companies – the backbone of many income portfolios – have all been under the cosh, and dividends are suffering.

Nonetheless, says St James's Place Wealth Management on page 2, UK investors should not feel too despondent: the outlook is for a 5.5% increase in dividend payouts in 2015. Moreover, mid-cap dividends are growing markedly faster than those from the FTSE 100, with housebuilders, for instance, taking a more shareholder-focused approach than in former days.

Income sustainability, of course is key. But while it's possible to find great stocks that offer security of income flow, Aberdeen Asset Management argues on page 5 that this is where investment trusts really come into their own as 'a natural option for income seekers'.

For starters, with a portfolio of tens or even hundreds of companies, trusts reduce risk in comparison with individual stocks. And unlike unit trusts they also have the facility to hold in reserve some of their dividend income in prosperous years, so that they can maintain a steady payout to investors in leaner times. As a consequence, many investment trusts have made a big selling point of decades of dividend growth.

One challenge for many people holding internationally focused funds or trusts is that they actually know very little about the business dynamics of the region where their money is invested. On page 8, Henderson Global Investors provides a fascinating review of the powerful reform agendas set to drive markets in the Asia Pacific region, and some of the individual stocks set to benefit from the clean-up.

Taking the Asian theme a step further on page 11, James Anderson of Scottish Mortgage investment trust takes a look at the stellar rise of Alibaba – and draws some valuable conclusions about the nature of 'truly great companies' in general.

issue 1 Q12015

MVQ
MarketViews Quarterly

Contents

CLICK HERE for further information on the companies featured in this publication

Happy New Year?
Global investment review and outlook

Nigel Cuming Chief Investment Officer
Canaccord Genuity Wealth Management

Our asset allocation positioning throughout 2014 was remarkably consistent. If it could be summarised in one phrase it would be "stay long on equities but have some insurance against a market setback."

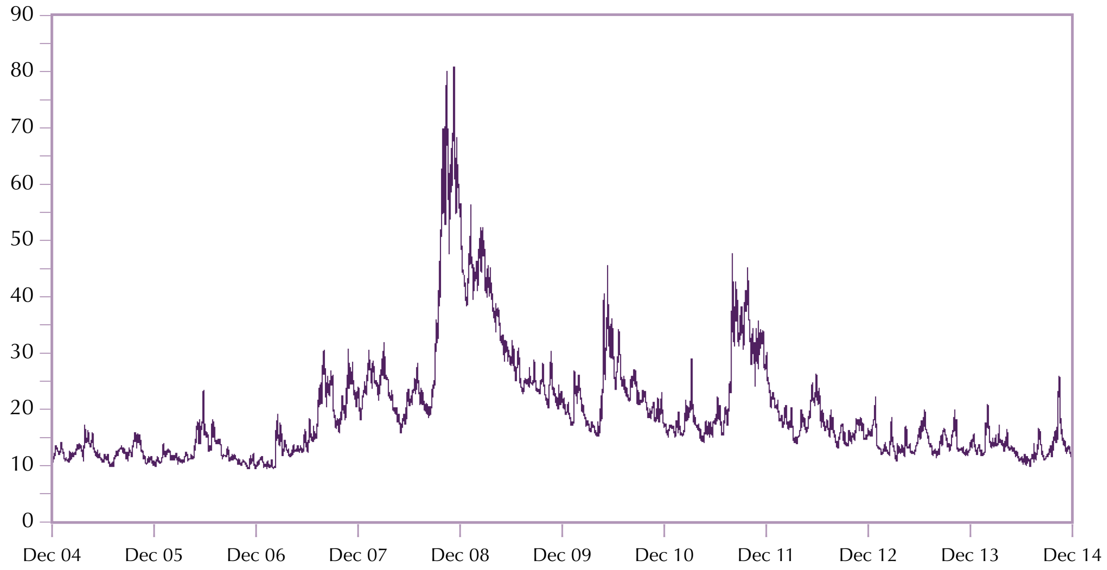
Whilst this stance resulted in some underperformance earlier in the year, our position was vindicated by events in the closing quarter. Volatility returned with a vengeance to the financial markets in early October (see Figure 1) after a protracted period of relative calm as equities reacted violently to the "perfect storm" of the Ebola crisis, concerns about the strength of the global economic recovery, the deteriorating geopolitical outlook and, in the US, the end of quantitative easing. Losses were extensive across all markets, as much as 10% in some instances (Nikkei) as the IMF cut its growth forecasts, German output shrank and Chinese demand for commodities waned.

However, toward the end of the month the news flow improved considerably with a strong pick-up in the US Purchasing Managers Index. Production, employment and new orders all rose significantly, as did consumer sentiment. In late October the much awaited bank stress tests were released by the ECB and, whilst the report showed 25 out of 130 banks had failed the test, most institutions had already taken measures to address the problems and as only 8 institutions were required to take further action the results were greeted with relief by the markets. We had been waiting for this setback for some time and were therefore able to "buy the dip" to take our model equity exposure closer to benchmark.

We enter 2015 with a constructive attitude towards risk assets and with equities remaining our favourite asset class.

Equity markets rallied in November. In the US strong employment data was released showing an increase in October employment of 230,000, with an upward revision to 225,000 for September. The market friendly victory of the Republicans who took control of Congress, coupled with an upward revision of Q3 GDP to 3.9% annualised, also cheered sentiment. In Europe ECB President, Mario Draghi, continued to hint that new monetary policy measures were on the way, leading to an increased expectation that fully fledged quantitative easing was possible in early 2015. News flow in the UK was mixed. Whilst GDP for Q3 showed solid annualised growth of 3% with retail sales bouncing back from a weak September, the Public Sector Net Debt figure for October was very high at £7.7bn due to weaker than expected corporation and income tax revenues. Furthermore, a set of poor trade figures were released, which were the consequence of the strength of sterling and weak external demand.

Fig 1 **VIX Index (implied US equity volatility) over 10 years**



Market sentiment was severely damaged in December primarily by the rapid decline in oil prices, the major catalyst for which was OPEC's shock decision not to cut its production quota from the current level of 30 million barrels a day in the face of short term over-supply in the market. This decision was driven by Saudi Arabia and will be very damaging to smaller producers such as Nigeria and Venezuela, not to mention Russia. This move can be interpreted as a highly political decision to damage onshore US oil production, much of which is unprofitable with oil at US$60. This is a short term experiment and it will be interesting to see how long OPEC is prepared to take the pain required to damage US production. There will be an adverse effect on the US economy if oil price weakness persists, as seems likely in the short to medium term. It is estimated that over a third of US GDP growth comes from the energy industry and energy related capital expenditure will be slashed next year as so many oil companies, many of whom are debt ridden, are no longer profitable.

However, despite the present equity market woes concerning a weak oil price, we should not lose sight of the fact that global oil demand grows at approximately 1% per annum so the present price weakness may not be sustainable over the longer term. The other important fact is that lower oil prices are beneficial for everyone except oil producers – global growth is boosted and consumers are given the equivalent of a tax cut. Whilst many commentators are suggesting that the oil price is an indicator of likely deflation in 2015, we feel they are missing the point. As David Smith summarised recently in the Sunday Times "there is good and bad deflation. Falling prices as a result of domestic deflation is bad. Falling prices as a result of a correction in global energy prices is good because real income growth is boosted". It is hoped that when the markets work through the December market volatility they will come to accept this point.

Our expectations for 2014 were for equities to make further progress, albeit far less than in 2013, and for bond yields to rise modestly. We were more optimistic for bonds than the consensus feeling that, in a low inflation world, central banks would not have to rush to normalise policy and whilst this has proved to be the case, prompting another strong year's performance from the bond markets, it is true to say that yields are now much lower than we expected. That said, there are very few market participants who expected to see the UK and US 10 year government bond markets yielding around 2% in December 2014 (Figures 3 and 4). We have participated to a certain extent in this rally as gilts and treasuries are held as diversifiers of equity market risk. However, we have generally been disappointed this year with the performance of equities, with the exception of the US (see Figure 5) which has continued to push on. We have decent exposure to this market both directly and also through our exposure to global healthcare, technology and infrastructure funds which have a high US component, all of which we are happy to continue holding into 2015.

Fig 2 **Brent crude over 3 years in US$**

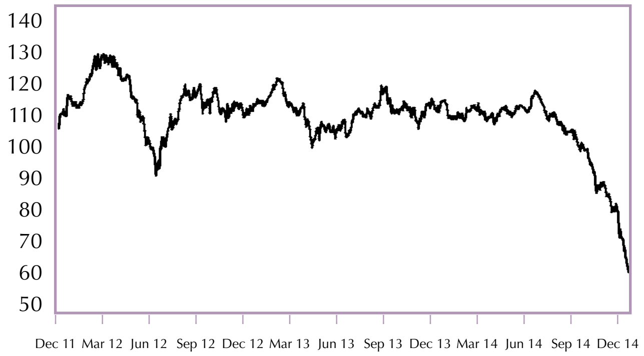


Fig 4 **10 Year Treasury yield year to date (%)**

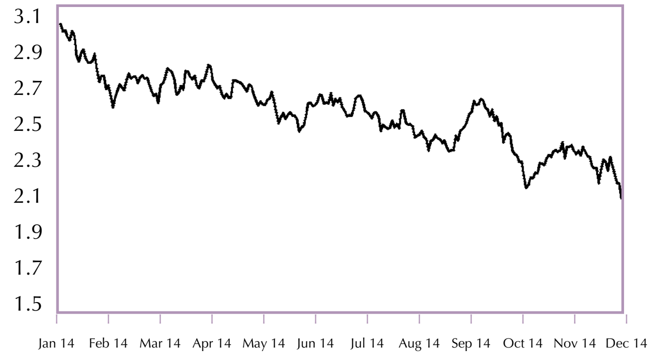


Fig 3 **10 Year Gilt Index yield year to date (%)**

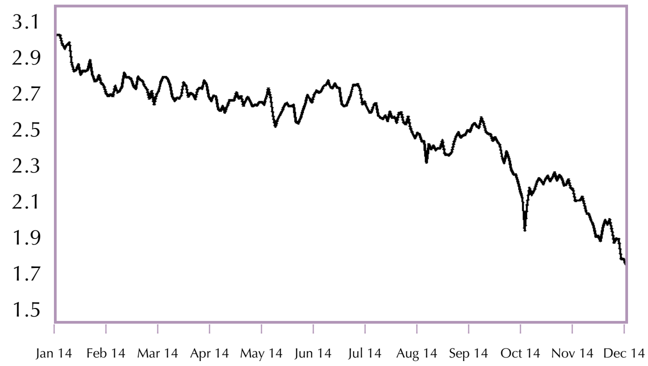
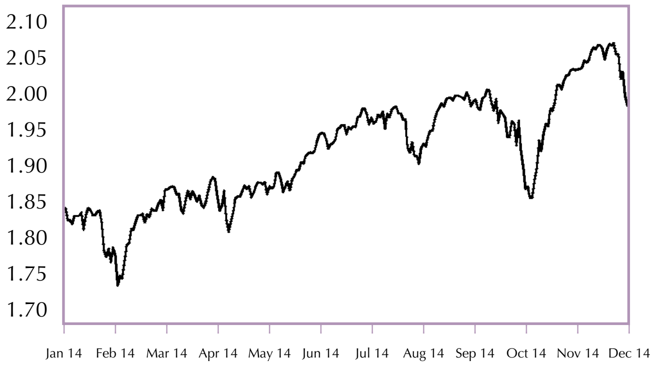


Fig 5 **S&P 500 Index year to date**



The influence that central banks have had on markets has been demonstrated by the extent to which we all have pored over every statement they have made this year, looking for hints and clues as to when the first interest rate rises will occur in the US and the UK. It has been a frustrating year listening to central banks because, although they have said a lot, all they have tried to do is support markets in times of nervousness and calm them when they are getting over-exuberant. The Federal Reserve Board will face a dilemma next year over the timing of its first move because with the economy expected to grow at 3% (this could be nearer to 4% if US consumers spend the near $100bn extra they will have as a result of lower oil prices), and with unemployment falling rapidly and likely to move below 5.5% early next year, a case could be made for sooner rather than later.

However, as inflation remains well below the Fed's 2% target, and because the labour market is not as strong as the improving unemployment numbers suggest, we remain of the view that the Fed will sit on their hands for at least the first half of the year and possibly longer.

ECB President, Mario Draghi, continues to hint at the introduction of fully fledged sovereign government bond buying in the New Year. Whilst we would welcome any measures which would weaken the deflationary forces which prevail at present, given that both government bond yields are already extremely low and that home ownership is lower generally in Europe than in the UK and the US, we are not sure how beneficial this move would be. However, we are mindful of the fact that the ECB is likely to finally join the QE party and, with relatively cheap equity valuations and good earnings growth, we may see a better performance from European equities in 2015.

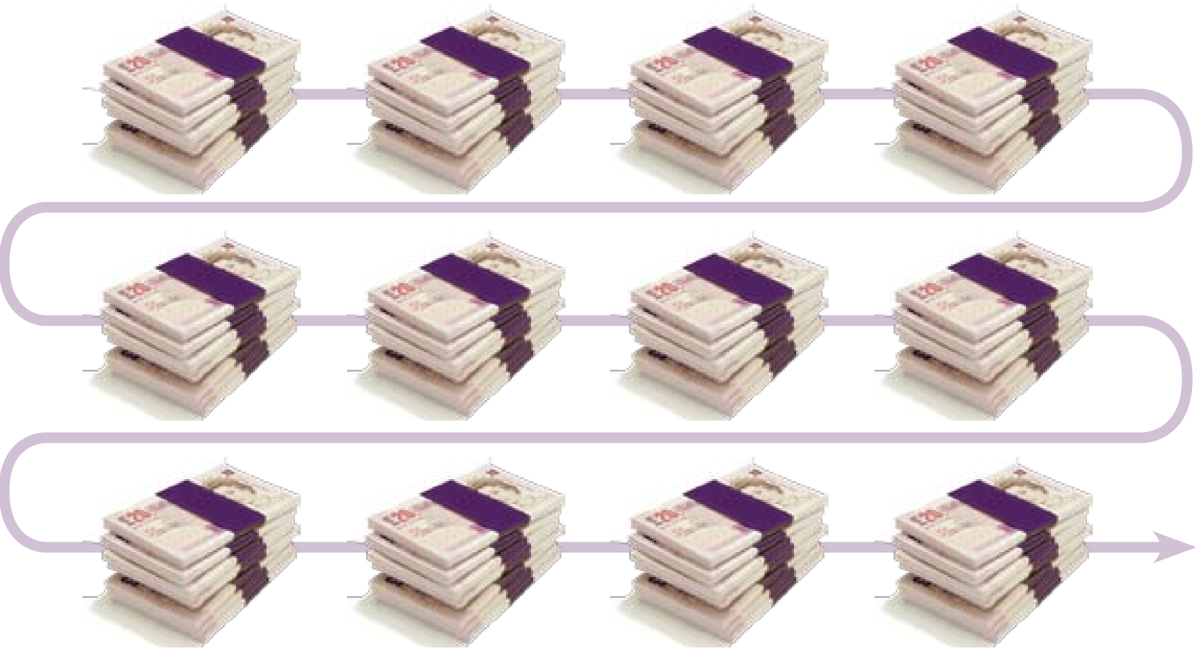
There are always a variety of potential banana skins for financial markets and 2015 will be no different. Political uncertainty in Greece will be an early contender for the headlines. In addition to the known geopolitical hot spots, there are some presently forgotten (such as Ukraine), that provide scope for a junk bond sell off due to a weak oil price and increasing strains on Emerging Market currencies on the back of a strong dollar. 2015 is likely to be a more volatile year than 2014, especially as the central banks will be diverging in their policies with the US and the UK looking to normalise at some stage whilst the ECB should finally join the Bank of Japan in fighting deflation. There are a variety of elections in Europe and we are already very mindful of the damage political uncertainty could do, both to sterling and sterling assets in the first half of next year.

However, we will enter 2015 with a constructive attitude towards risk assets and with equities remaining our favourite asset class. We are hopeful that the pick up in economic growth which occurred in Q2 2013 is at least sustainable and will hopefully accelerate. Most of our asset allocation and sectoral calls have worked this year so no significant investment positioning changes are anticipated in the short term but we will remain, as always, vigilant to the opportunities that market volatility creates.

CONTACT
Canaccord Genuity Wealth Management

Investment trust opportunities for steady income

Aberdeen Asset Management PLC



The long-awaited interest rate rise did not appear in 2014 and increasingly it seems unlikely to appear in 2015 either. In the latest Monetary Policy Committee minutes, the members voted unanimously to keep rates at record lows in the face of deflationary pressures. Money markets are now suggesting there will be no rise until the end of 2015 at the earliest.

Jeremy Whitley *was appointed Head of UK and European Equities in July 2009. Previous roles at Aberdeen include Senior Investment Manager on the Global Equity Team as well as the Asian Equities Team based in Singapore. Jeremy graduated with an MA (Joint Hons) in English and Art History from the University of St Andrews and an MBA from the University of Edinburgh.*

This has an impact for all financial assets: It means that the income available from bonds, particularly developed market government bonds, remains low. We believe, therefore, that investors now need to look beyond these traditional sources to achieve an above-inflation income. This paucity of income options comes at a time when income is in increasing demand, as an ageing population needs to support itself in retirement.

The good news is that retirees now have the flexibility to seek alternative options beyond annuities for income, but they need to consider how they are going to achieve a steady and reliable income stream. The problem with moving away from traditionally 'safe haven' assets, such as government bonds, is that it can introduce greater volatility into an investor portfolio and – perhaps more importantly – into the income stream received.

We would suggest that investment trusts offer some protection in this respect. They have a number of structural advantages in the way they receive and pay out income. Notably, investment trusts have the ability to reserve income they receive from dividend or interest payments; in contrast, unit trusts have to pay out everything they receive. This means investment trusts can set aside income in fat years, to pay it out in lean years. This helps give investors some stability.

Many trusts have used this facility wisely and built up significant reserves. Statistics from the Association of Investment Companies show a number of trusts have up to 10 years' worth of reserves, while one to two years' worth of reserves is commonplace. These reserves can help ensure investors do not see significant variability in their income if there are dividend cuts for stocks within the portfolio – which is always a risk, however scrupulously we select our stocks.

This ability to reserve income has helped ensure that many trusts have a lengthy dividend history, growing their dividends year on year. This may sound like a niche point, but those relying on income from their investments need it to grow at least in line with inflation, in order to preserve their purchasing power. According to AIC statistics, there are 35 investment trusts that have grown their dividends for at least 10 years in a row. This is another source of stability for income investors.

Costs can also erode both income and capital from investments over time. The costs for investment trusts have historically been lower than those for unit trusts because investment trusts do not pay commission to financial advisers. Now commission is being phased out and the playing field has levelled a little, but the investment trust sector has reduced the annual management fee of trusts in many cases, leaving many trusts still looking competitive on costs.

Within the investment trust universe, there is a range of options for income seekers. These range from standard equity income funds to more esoteric options such as infrastructure, convertible bonds or commercial property. This allows investors to diversify their income stream, which – we believe – is increasingly important at a time when income opportunities are becoming more idiosyncratic and scarce.

Within our range at Aberdeen, there are a number of trusts that aim to provide this reliable, growing income stream to investors, alongside some growth in capital. All of these trusts use the Aberdeen investment approach, which we have designed to ensure stability and minimise volatility. A key part of our process is uncovering those quality companies with resilience in different economic conditions and investing in them for the longer term. The companies in our income portfolios will therefore have the ability and appetite to pay dividends consistently.

Murray Income Trust is one of our flagship income trusts. It launched in 1923 and has built a lengthy dividend history. It has increased its payout to shareholders every year since 1974 and its shares currently yield around 4% income annually. The fund is focused on the highest quality UK blue-chip companies, all of which will be globally competitive and have strong balance sheets: Unilever, GlaxoSmithKline, Pearson and Prudential all form part of its top 10 holdings.

It has been managed by Charles Luke since 2006, in collaboration with the wider Aberdeen UK equity team. As well as targeting a diversified blend of income-generative companies, Luke writes call options to boost the income on the trust. This may limit the capital growth potential, but ensures that the dividend remains high and consistent.

I have managed the Dunedin Income Growth Investment Trust since 2009, which is another option for income seekers. This is also underpinned by the Aberdeen investment philosophy. I focus on those companies I know well, where I've met management and tested their commitment and responsibility over time. I also want companies that represent good value. Although Aberdeen's style is by no means 'value' investment, we always want to ensure that we are paying a fair price for the companies in which we invest.

The advantages of looking to markets outside the UK for income have been well-documented. According to the most recent Henderson Global Dividend index, global dividends are likely to hit $1.2 trillion in 2014, with further growth expected in 2015. It found that underlying dividend growth was 9.7% year on year. Perhaps more importantly, it found that the strongest areas of growth were in the US, Europe, emerging markets and Asia Pacific ex Japan, which all saw double-digit dividend increases. In contrast, the UK, Canada and Japan lagged behind. For us, this makes the case for looking beyond the UK for income.

A lot of global income-focused unit trusts have been launched in recent years to capitalise on this burgeoning global dividend culture. Murray International Investment Trust , in contrast, was launched in 1907. Managed by Bruce Stout since 2004, Murray International has a 4.2% historic yield and has grown that income consistently for more than a decade. Its five-year dividend growth has been 6.3%.

The trust has exposure to 26 economies and Stout's focus is on identifying firms that are increasing both earnings and dividends. This approach helps ensure that the dividend is secure and comes from a variety of different companies. Diversity should bring additional stability.

Interest rates rises may not bail out income seekers, but there are other options available to create a diversified, stable and inflation-protected income stream. We believe investment trusts are a natural option for income seekers.

CONTACT
Aberdeen Asset Management PLC

Opportunities in Asia's economies

Mike Kerley Fund Manager Henderson Far East Income Ltd

Unfortunately, in recent times, developed markets have been veering on a downwards trajectory as global growth concerns come to the fore once again. The negativity is built on a number of fronts: geopolitical issues and poor macro-economic numbers adding fuel to deflationary fears in the Eurozone; the possibility of disorderly sell-off as the US Fed starts to raise interest rates; idiosyncratic scenarios such as ISIS and Ebola materially impacting investor sentiment.

In contrast to the developed market gloom, the Asia-Pacific region is, we believe, different: there's a powerful 'reform' agenda creating specific catalysts which may drive markets there. With changes of leadership in China, Thailand, India and Indonesia, a region-wide clampdown on corruption and a drive to improve efficiency, investor perceptions are beginning to shift for the better, along with share prices. The improving backdrop warrants a closer look.

Chinese SOEs: the lumbering giants are getting fit

State-owned enterprises (SOEs) have been instrumental in the Chinese economic growth story. Recently however, there has been a drive to reshape these bloated structures into companies focused on shareholders rather than market share or job creation.

The hope is those SOEs with improving operating efficiency should contribute to China's economic growth, reinvigorate private sector investment and help revitalise the economy by creating a more competitive business environment. Coupled with President Xi Jinping's well-publicised anti-corruption measures, this is likely to improve investor returns in the medium-term.

The SOE **PetroChina**, is one of our top picks. The new management, installed in 2013, is more focused on the returns from invested capital, which should resonate well with external shareholders. Other SOE energy providers that have made positive progress in restructuring have outperformed the overall market. Furthermore, we believe PetroChina is well positioned to benefit from recent gas pricing reform: the government is raising gas prices by effectively linking them to oil.

India – powering forward

Across the Bay of Bengal, 'Modi Mania' for the newly-elected Prime Minister, Narendra Modi, is beginning to drive real change in political and economic attitudes. Expectations are high, and there is already evidence of the new administration beginning to address legacy stalled projects, by simplifying project approval and land-acquisition processes.

Coal shortages are a major issue for the power sector and economy as a whole. With the newly-formed government committed to '24/7' power supply across India, augmentation of national coal output is of vital importance.

Coal India is one beneficiary. With a virtual monopoly in domestic coal production, a lot of cash on its balance sheet, an undemanding valuation and increasing commitment to return cash to shareholders (as highlighted by the recent special dividend), we view this as an attractive investment proposition.

Korea – tapping reserves

The newly-installed Finance Minister, Choi Kyoung-hwan, recently announced a raft of tax measures aimed at unlocking billions of dollars in corporate cash reserves. The government plans to discourage companies from hoarding cash by cash by imposing tax penalties on excess reserves after wages, capital expenditure and dividends have been taken into account. Investors hope this will boost the historically low dividend yields of Korean companies, and hence raise share prices.

We exercise some caution however. **Hyundai Motor**, with low valuations and a large net cash position, was exposed to the new policy, but recently it announced a substantial land acquisition which has depleted reserves and disappointed investors. It goes some way to show that while there are changes being made at the government level these have not necessarily trickled down to the corporate level yet. We remain positive; this likely means only delays.

Indonesia - bringing the islands together

The people of Indonesia, and the third largest democracy in the world, chose Jowoki Widodo in July last year as their president following the failure of Susilo Bambang Yudhoyono to push through necessary reforms.

Undeniably a long list - first in line is energy, where fuel subsidies have led to an over-reliance on oil and a 20% strain on the total government purse. It's not an easy task as, even though the knock-on effect frees money for other reforms (around $30bn), it risks social unrest with the impact felt by many companies and individuals alike.

Other reforms include education and agriculture, and infrastructure investment, where a focus on ports, railways, toll roads, and dams (for farming), should serve to decentralise manufacturing and release pressure from crowded urban areas. In this respect, **Telekomunikasi Indonesia**, the country's largest telecommunications provider, is one that may benefit from such renewed investment.

The stock examples in this article are intended for illustrative purposes only and are not recommendations to sell or purchase any investments. Nothing in this document is intended to or should be construed as advice.

Before investing in an investment trust referred to in this document, you should satisfy yourself as to its suitability and the risks involved, you may wish to consult a financial adviser.

The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

This document is not a recommendation to sell or purchase any investment. It does not form part of any contract for the sale or purchase of any investment.

CONTACT
Henderson Far East Income Ltd

Alibaba and Chinese lessons

Scottish Mortgage Investment Trust PLC

James Anderson, manager of the Scottish Mortgage Investment Trust, gives us an insight into the rise of Alibaba and the lessons that can be learnt from this exciting company.

Tolstoy's aphorism that 'All happy families are alike' has a corporate equivalent

Last year I wrote an article discussing the significance of Amazon for investors and the global economy. I argued that identifying transformative companies at a very early stage and owning them through to maturity is central to investment success.

The returns from such extraordinary winners can far outweigh the oscillations of normal companies or the headlines blaring of daily market movements. This requires endurance. Even great companies have trying times.

But it is finding the potential giants of the future that is most alluring. Their occurrence is not random. They are concentrated by sector, geography and especially management philosophy. I suggested a year ago that the next great global company was Alibaba. Scottish Mortgage owned a stake as an unquoted investment. It was valued at £44 million in our Interim Report last autumn. A year later the same holding was worth £148 million. Today Alibaba itself enjoys a market capitalisation of around $250 billion – or a bit more than BP and Glaxo combined.

Alibaba displays characteristics that are sufficiently common amongst great companies as to suggest that Tolstoy's aphorism that 'All happy families are alike' has a corporate equivalent. They look not at all like the unhappy companies that litter our indices. They have founders with vision. Alibaba is unimaginable without Jack Ma. He is now China's richest man but more significantly the dreamer who convinced 17 questioning friends that he could overthrow US e-commerce dominance from his Hangzhou apartment. That these partners still control the firm horrifies many but delights us. Far better their commitment than the impatience of

A trader works on the floor of the New York Stock Exchange after Alibaba Group's initial price offering (IPO) on 19th September 2014 in New York City.

The New York Times reported that Alibaba had raised $21.8 billion in their initial public offering so far.

fund manager capitalism. For, as at almost all great companies, Alibaba pays little attention to immediate earnings prospects or the mantras of shareholder value.

As Ma remarks: "Customers first, employees second, and shareholders third." His aspirations are almost boundless. Many investors fight shy of such ambition. Instead we believe that once the ultimate scale of any business is known and defined then it is of little interest to the forward-looking. Already Alibaba has moved into territory it once could not imagine. Chinese finance is already reeling from its attacks.

Alibaba is both cause and symbol of the transformation of China. The imagined China of forced industrialisation, of belching steel plants and party ideology is being superseded by innovative, transformative and potentially uncontrollable private juggernauts. Alibaba's marketplace generated 14.5 billion orders in the year to June. The company is still growing 50% year on year. Its sales volumes are bigger than those of Amazon and eBay combined. China is not imitating but leaping ahead. Alibaba, Tencent and Baidu are well ensconced amongst the world's top 10 internet companies by capitalisation. The East coast of China is the only global rival to the West coast of America as the cutting edge of global capitalism. It is no wonder that Mark Zuckerberg has taught himself to speak Mandarin.

Ultimately the great companies of North West America and South-East China are shockingly similar. Beyond their parallel mental models they bring huge challenges to the world. As investors we have to become accustomed to companies that have little need of capital or of public quotation. Alibaba, like Facebook, built its dominance as a private company. By the time of its first official trade it was valued at over $200 billion. The boundary between public and private is blurring rapidly. Sadly this is hard for individual investors to negotiate.

The global competitive landscape will be dominated by this breed of super-ambitious competitors. As they expand and flex muscles that are now intimidating in financial and intellectual scale, the prospects of traditional, conservative managerial behemoths will dim. We fool ourselves if we believe that their threats will be confined to some unfortunate but peripheral internet casualties. What up until now has affected retailers and newspapers is just starting to undermine the business models of our largest companies. The greed of bankers has survived the crash but their businesses may not survive the advances demonstrated by Alibaba and Tencent. For BP and Glaxo it may be demeaning that they are now half the size of Alibaba but their future may be much worse.

As the ambitions and ethos of the great technology companies move beyond narrow electronics and e-commerce, then the business world will be ripped apart. If Elon Musk proves that electric cars and solar energy are the economic future, if Illumina's exponential improvements in genomic sequencing show up how little of the current drugs industry is beneficial to our health, then there is much pain ahead for what is said to be safe and secure in our market indices. And that is before Google's planned solution to death.

James Anderson
Investment Manager

James graduated BA in Modern History from Oxford University and after postgraduate study in Italy and Canada, he gained an MA in International Affairs in 1982. He joined Baillie Gifford in 1983 becoming a Partner in 1987

James headed our European Equity Team until July 2003 when he became Head of our Long Term Global Growth Team. James is manager of the Scottish Mortgage Investment Trust PLC, and is a member of the Investment Advisory Group.

Baillie Gifford
Calton Square, 1 Greenside Row, Edinburgh EH1 3AN

CONTACT Baillie Gifford

www.bailliegifford.com

Important Information and Risk Factors

The views expressed in this article are those of James Anderson and should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect personal opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This article contains information on investments which does not constitute independent investment research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned. Investment markets and conditions can change rapidly and as such the views expressed should not be taken as statements of fact nor should reliance be placed on these views when making investment decisions.

This information has been issued and approved by Baillie Gifford & Co Limited and does not in any way constitute investment advice.

The Trust is listed on the London Stock Exchange and is not authorised or regulated by the Financial Conduct Authority. The value of their shares, and any income from them, can fall as well as rise and investors may not get back the amount invested. Scottish Mortgage invests in emerging markets where difficulties in dealing, settlement and custody could arise, resulting in a negative impact on the value of your investment.

The Trust's risk could be increased by its investment in unlisted investments. These assets may be more difficult to buy or sell, so changes in their prices may be greater.

Ups and downs of UK dividends

St. James's Place Wealth Management

As the traditional sectors for providing generous dividends face tough conditions, investors are looking elsewhere for their market-beating yields.

Before the financial crisis, investors in search of income knew that certain sectors could be relied upon to deliver generous dividends and market-beating yields. Banks were always at, or near, the top of the list; food retailers and utilities were good bets, too, as were the big pharmaceutical companies and oil and gas majors.

Today, the picture is quite different. Most banks struggled to survive the financial crisis and, although HSBC still offers a reasonable yield, the sector as a whole has little appeal for the income investor.

As for the food retailers, 2014 was their annus horribilis. Tesco is forecast to pay a dividend of around 4.6p for the 12 months to February, a third of the 14.76p it paid out at the same time in 2014. Analysts do not expect a recovery any time

soon, with the dividend for 2015 expected to be just 5.3p (www.digitallook.com). Tesco delivered the most headlines last year but Morrisons was not far behind, and Sainsbury's also signalled that dividends will be lower in the future.

'UK supermarkets are suffering from structural changes in the market, and it will take a long time for them to re-engineer their business models,' says Justin Cooper, Head of Shareholder Solutions at Capita Asset Services.

The outlook is far from certain for other erstwhile income sectors, too. Utilities have become political footballs and their fate will not be known until after the general election. Oil and gas majors, BP and Royal Dutch Shell, have traditionally been among the highest dividend payers in the market, but last year they were hit by rising costs and a strong pound in the first half, followed by falling oil prices in the second. If lower oil prices continue, dividends are almost certain to be affected.

And yet the future is not all bleak. Capita predicts that underlying dividends in the UK will rise 5.5% to £83.7 billion this year, having increased by less than 2% last year.

Over the long term, too, dividends have been growing steadily, as Chris Reid of Majedie, manager of the St. James's Place UK Income fund, points out. 'Income from the FTSE All-Share has increased by an average of 7% per annum over the past 10 years. We have some fantastic income providers in the UK,' he says.

Dividend growth across the market is clearly a positive trend, but deeper analysis provides further clues about where best to look for income, not just now but in the future. FTSE 250 dividends are increasing significantly faster than those in the FTSE 100, albeit from a lower base. In the third quarter of last year, for example, the main index accounted for almost 89% of total pay-outs, but dividends fell 1.1% year-on-year. The FTSE 250 accounts for just over 9% of total pay-outs, but dividends within the index rose 7.6%.

'The FTSE 100 is unusual because so many companies report in dollars or euros and derive profits from overseas,' says Cooper. 'So when the pound is strong, dividends suffer, particularly if they are declared in dollars and then converted to sterling. Equally, these companies are more sensitive to global economic turbulence. Mid-cap stocks are more domestically oriented, and tend to be more cyclical, so they do better when the UK economy is recovering.'

House builders are an example of this trend. Not only have they recovered dramatically from their post-crisis lows, but they are also determined to adopt a more disciplined approach to capital – and that means returning more money to shareholders through dividends rather than investing in overpriced land. In other words, they are making sure that the amount they pay out in dividends is well covered by earnings.

'When you are looking for dividend growth, the most important thing to look for in terms of sustainability is cover,' says Alex Stewart from broker Shore Capital. 'On that basis, buying the highest-yielding stocks may not always be the best policy. Investors should instead focus on security of income flow. A company such as food producer Cranswick, for example, has raised its dividend every year since its IPO (initial public offering) in the 1970s. That's sustainable growth for you.'

On a sector basis, tobacco stocks, large alcoholic drinks companies, telecoms providers and transport groups are often mature businesses, with a tendency to reward their investors. The first two may raise eyebrows among ethical investors, but smoking and drinking continue to deliver profits, while telecoms stocks such as BT, Vodafone and even TalkTalk tend to generate plenty of cash.

Vodafone has traditionally been one of the largest dividend payers in the UK – in the first quarter of last year it returned almost £16 billion to investors following the sale of its stake in US mobile operator, Verizon. Now a smaller business, it has pledged to remain a generous distributor of dividends in the future.

Of course, predicting where income growth will come from is not an exact science. Majedie's Reid adopts a focused approach, seeking out companies that are likely to pay market-beating dividends in the future: 'You have to look for companies that are raising their game. We look at their six-year history and their forecasts for the next three years. We then carry out four tests: how they make money, the strength of their balance sheet, their competitive position and their valuation. The idea is that the 60 or so companies in our fund will leapfrog the competition over three years.'

Reid's approach is highly specific but, like other income seekers in the market, he believes earnings cover is crucial. 'It is a question of looking at the dividend, seeing how much it costs and how much it is covered. For us, the cash dividend cover should be 1.3 times and rising.'

With interest rates still at historic lows, the search for income is increasingly important. Against that backdrop it is worth noting that, even though income from the FTSE 100 fell last year, the index is still yielding around 3.5%. It is reassuring to know that the main index still beats bank accounts hands down.

Past performance is not indicative of future performance. The value of a fund or any income produced may fall as well as rise. You may get back less than the amount invested. An investment into equities will not provide the security of capital associated with a deposit account with a bank or building society.

Societe Generale

Boosting your potential returns whilst limiting your risk

It's hard to deny the attraction of boosting your returns, but couple it with the threat of unlimited losses, and many investors will quickly turn the other way. However, trading on leverage does not have to be at the expense of unlimited losses, as is the case for CFDs and Spread Bets. It doesn't even have to be in the pursuit of bumper returns. It can in fact be used defensively to reduce capital at risk, or to provide a degree of protection to a portfolio.

What do we mean by leveraged trading?

Leveraged trading means getting exposure to an underlying asset without paying the full cost. Anyone who has bought a house with a mortgage has done it. Consider an example where you buy a house worth £300,000 with a deposit of £50,000 and a mortgage of £250,000. For £50,000 you have exposure to an asset worth £300,000.

Theoretically, if your house increases in value by 10% to £330,000 you could sell it, pay back the bank and pocket the remaining £80,000. That's £30,000 more than you invested, and a 60% profit from a 10% rise in the house price.

In investment terms we call this 6 times gearing as your profit is 6 times greater than the move in the underlying asset.

SCENARIO 1: HOUSE VALUE INCREASES BY £30K

House price	£300,000	£330,000 (+10%)
Mortgage	£250,000	
Invested capital	£50,000	£80,000 (+60%)

Importantly, there is another lesson to learn. Gearing works against you too. If the house falls in value to £270,000, your equity would be slashed to £20,000 as you still owe the bank £250,000.

SCENARIO 2: HOUSE VALUE DECREASES BY £30K

House price	£300,000	£270,000 (-10%)
Mortgage	£250,000	
Invested capital	£50,000	£20,000 (-60%)

Beware of unlimited risk

Our mortgage example highlights a bigger danger for certain leveraged products. What if your house fell in value to £225,000? If you sold now you would not only lose all your invested capital, but you would have to find an extra £25,000 to pay back your £250,000 mortgage. In the world of spread betting and CFDs this is a very real scenario, and your losses can far exceed your initial investment.

Play the markets your way with your risk fixed

The good news is that leveraged returns don't have to be at the expense of unlimited risk. Leveraged Exchange Traded Products (ETPs) enable you to boost your potential returns in rising or falling markets without ever risking more than you invested. You can use them for a day, a week or even a year, and for a whole variety of different purposes.

Furthermore, because they are listed on the London Stock Exchange, they are supported by live buy and sell prices throughout market hours and governed by the rules of the LSE. And to keep it simple, you don't need a separate account for Leveraged ETPs, they trade in an existing stock broking account or Self Invested Personal Pension (SIPP), just like a share.

Looking at an example: **Infinite Turbos**

Societe Generale has three main types of Leveraged ETP. The right one for you will depend on how long you want to invest, what you want to trade and how much risk you want to take. For this article we are going to look at the example of Infinite Turbos, the latest offering from Societe Generale.

Infinite Turbos can be linked to a single stock, an index, a commodity or a currency pair. However, instead of paying the full cost of buying it outright, an Infinite Turbo allows you to benefit from its full price movement with only a fraction of the capital invested, much like our mortgage example earlier. As such, you can buy more for the same level of investment and boost your potential returns, or you can reduce your capital at risk by gaining the same exposure for less money.

There are two types of Infinite Turbos. If your view is bullish, and you expect the market to rise, you could amplify your potential returns with an Infinite Long. If your outlook is more bearish, and you expect markets to fall, you could look to the range of Infinite Shorts.

A key feature of all Infinite Turbos is the Knock Out Level which works as a built in stop loss mechanism, and ensures that you can never lose more than you invest.

An example trade: **Infinite Long on the FTSE 100 Index**

To demonstrate how Infinite Turbos work, let's say that the FTSE 100 Index is trading at 6,500, and you believe it is set to rise by at least 5%. Having looked at the range, you select IT10, an Infinite Long on the FTSE 100 Index with a Finance Level of 5,700, a Knock Out Level of 5,800 and gearing of 8.13 times.

What this all means is that the price of IT10 will rise or fall based on how far above 5,700 the FTSE 100 Index is trading. 8.13 times gearing means IT10 will move 8.13 times faster than the FTSE 100 Index before costs. Plus, the Knock Out level of 5,800 means that IT10 will expire if this level is ever touched.

The cost of IT10 is £0.80 per unit, which is calculated by subtracting the Finance Level (5,700) from the FTSE 100 level (6,500). In this case we also have to apply a scaling factor of 1,000 to reduce the trading size. We call this Parity and without it IT10 would cost £800 per unit. But dividing everything by 1000 makes IT more palatable at £0.80 per unit.

EPIC	IT10
Type	Infinite long
Underlying Asset	FTSE 100 Index
Underlying Asset price	6,500
Ask price	£0.80
Finance level	5,700
Knock out level	5,800
Parity	1,000
Gearing	8.13

What happens next?

As the table below shows, there are three things that could happen next. If we're right and the FTSE 100 Index rises 5% we would make a profit of £0.325 per unit, a 40.63% return on the initial price of £0.80.

If we're wrong, and the FTSE 100 Index fell 5%, IT10 would fall 40.63% to £0.475 per unit. The worst case scenario however is that the FTSE 100 Index hits the Knock Out Level of 5,800. If this was to occur IT10 would expire immediately and some or all of your capital would be lost. The amount repaid would depend on the level of the FTSE 100 Index over the next three trading hours.

FTSE 100 Index starts at 6,500			
Scenario	FTSE 100 rises 5%	FTSE 100 falls 5%	FTSE 100 hits 5,800
New index level	6,825	6,175	5,800 or lower
New price for IT10	£1.1250 (6,825 – 5,700)/1,000	£0.4750 (6,175 – 5,700)/1,000	dependent on recorded level
Profit on IT10	£0.3250 (+40.63%)	-£0.3250 (-40.63%)	Up to 100% loss

Choosing an Infinite Turbo

In this article we have kept it simple and only used one example product, IT10. In reality there would be a lot more choice across a wide range of different indices, each with a variety of long and short exposures with gearing ranging between 3 and 15 times. This means that you can find a product to suit your view.

What costs and fees are involved?

Like our mortgage example at the start, an interest rate equivalent to approximately 1.5% to 2.6% per year is pro-rated and deducted from the price of an Infinite Turbo each day.

What risks should I be aware of?

The key thing to understand is that your losses can exceed a direct investment in the underlying asset, and as we have seen, the value of the product can go down as well as up. Importantly, the underlying assets can be volatile which can lead to large movements in price; either for you, or against you. The Knock Out Level will protect you from unlimited losses, but if it is touched the product will expire, and you could lose all of your investment. The last important point is that Infinite Turbos are issued by a Societe Generale company, as such any failure by Societe Generale to make payments due may result in the loss of all or part of your investment.

CONTACT Societe Generale