Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

18th November 2016

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1 ylow	Date 1y high	Date 1y low
FTSE 100	6794.71	-0.487	-2.2	8.39	7097.5	5536.97	10/10/2016	11/02/2016
FTSE 250	17600.9	-0.332	-1.08	3.02	18342.1	14967.9	04/10/2016	27/06/2016
FTSE SmallCap	4897.55	0.0206	-1.69	7.53	5051.49	4145.59	10/10/2016	12/02/2016
FTSE AIM 100	3882.89	1.29	-2.14	14.7	3993.45	3075.85	04/10/2016	11/02/2016
S&P 500	2185.59	0.836	2.78	6.59	2190.15	1829.08	15/08/2016	11/02/2016
UK Treasury 10y yield	1.41	2.92	22.6	-28.4	2.00	0.61	30/12/2015	12/08/2016
Brent Oil Spot $	$46.98	2.88	-9.07	6.86	$52.915	$27.765	10/10/2016	20/01/2016
Gold Spot	$1225.99	-2.78	-2.38	14.6	$1366.48	$1053.12	06/07/2016	17/12/2015
GBP/USD	1.24495	-0.807	1.88	-18.2	1.52859	1.21697	19/11/2015	27/10/2016
GBP/EUR	1.1683	1.34	5.27	-18.3	1.4297	1.1066	17/11/2015	27/10/2016

I haven't much to say on the markets this week. Stock markets haven't changed that much and neither have currencies.

More importantly, bond yields continue to rise in the UK and US and if this is not offset by higher profits growth it is not good for shares. Gold has had another bad week (see more below), whilst oil has rallied slightly but is still down 9% for the month. This has finally fed through to lower petrol forecourt prices which will provide a small boost to household cash flows.

Should investors own some gold?

Gold has gained popularity with investors over the last decade or so. Even if you don't own gold you are aware that you can if you want to.

Lots of financial commentators thought that gold would rally if Donald Trump won the US presidential election but it has not. So I thought I'd take a closer look at the subject of gold and question whether it is something investors ought to own or think about owning,

One of the most interesting parts of investing is the subject of asset allocation. Should you spread your money across different financial assets in order to reduce your risks of big losses?

I think the answer to this question is definitely 'yes'. There are lots of studies out there which show that spreading your money around can reduce your risks compared to having it all invested in the stock market.

For years, this was done by splitting your portfolio between different proportions of shares and bonds. Now, with the development of exchange traded funds (ETFs) it is possible to have very sophisticated asset allocation strategies with assets such as property, commodities and precious metals as well as shares and bonds.

The whole point of spreading your money around is to have assets which are lowly or not correlated with one another. This means that when one goes up or down in value, a different asset doesn't go up or down as much or moves in the opposite direction. This can dampen down the returns of your portfolio during bull markets in shares but can limit your losses during a stock market crash.

Which leads me to the role of gold. According to the gold bugs out there, gold is meant to be a way of protecting yourself from events of financial armageddon such as hyperinflation. Unlike paper or electronic money, which can be created very easily by governments, the supply of gold is limited to what is already in existence and what is dug out of the ground every year. This is why some people see gold as the ultimate form of money and wealth preservation.

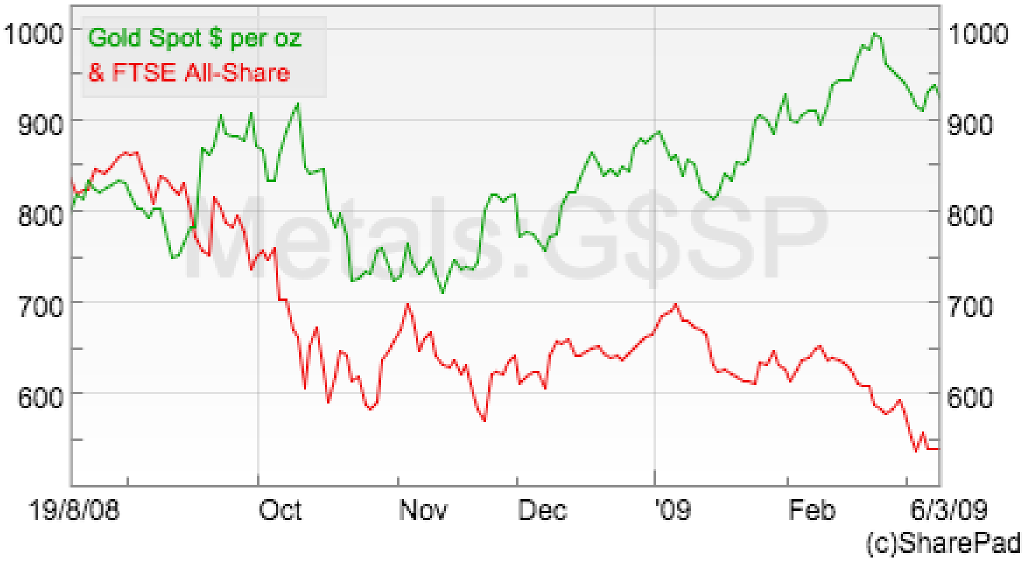
In price terms, gold has done better than shares during the last year (see table).

It also has done better (in price terms) over 10 years and 20 years:

Given the amount of money printing that has gone on in recent years and gold's performance, I can see why there is an argument for holding some gold in an investment portfolio. This is strengthened if you believe that governments promising big infrastructure spending will finance it with more printed money – leading to higher inflation.

But does gold really protect you in times of financial turmoil?

The chart below shows the price of gold vs the FTSE All-Share Index during the financial crisis starting in September 2008 until the stock market bottom in March 2009. Gold fared better than shares but still fell 20% before rallying. Could you have coped with that?

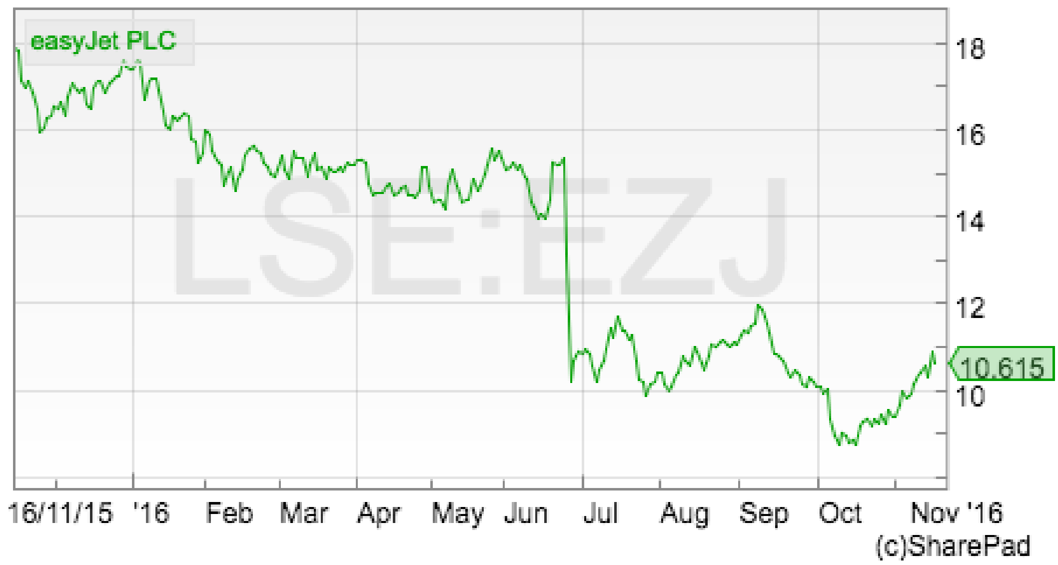


I admit to having very mixed views about gold. I can see a small role for it in a portfolio but wouldn't worry too much if I didn't own any. That said, spreading your money around and having some cash reserves has always made a lot of sense.

Companies in the news

This week I will be taking a closer look at easyJet, house builders and National Grid.

Share Discussion: easyJet (LSE:EZJ)



easyJet shares have had a torrid 2016. Worries about the company's prospects after the UK leaves the EU have supposedly weighed heavily on the shares, but the real source of investor concern should be its current and short-term profitability.

Full year results released this week did not paint a pretty picture. Pre-tax profits fell by 27.9% to £495m (£686m) but the proposed dividend per share of 53.8p was 2.5% lower than a year ago.

Airline shares are notoriously difficult shares to invest in. If history is any guide, then their profits and their share prices will move up and down a lot. This can make them unsuitable for long-term buy and hold investors.

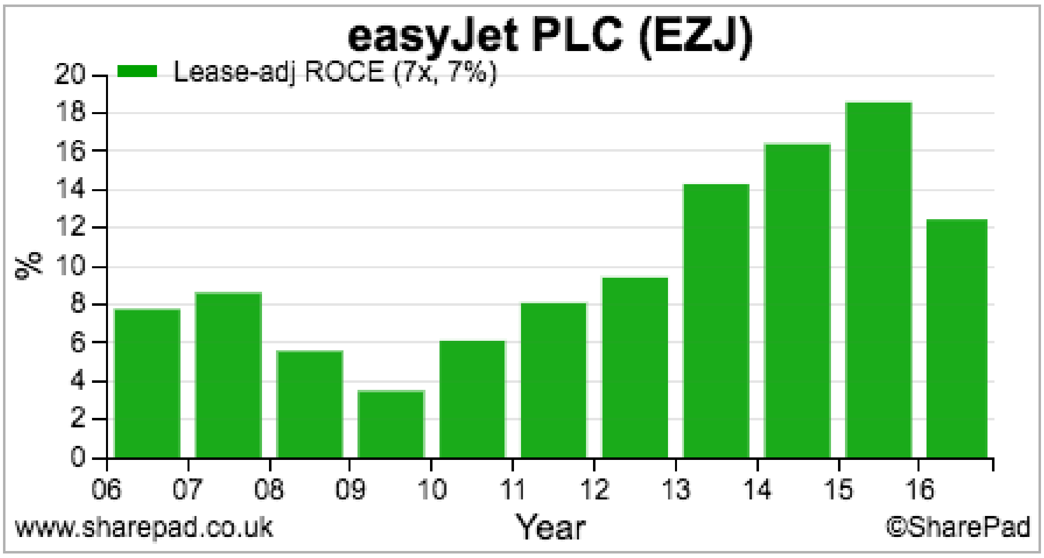
Take International Consolidated Airlines Group (LSE:IAG) - formerly known as British Airways - as an example. Its share price at the time of writing is 442p, a level it was also trading at back in 1994.

Low cost airlines such as easyJet and Ryanair have been much kinder to very long-term shareholders. Their leaner short-haul business models and the absence of big liabilities such as final salary pension funds has allowed them to prosper but during the last three years their share prices have become a lot more volatile as it has it has become harder for them to make money.

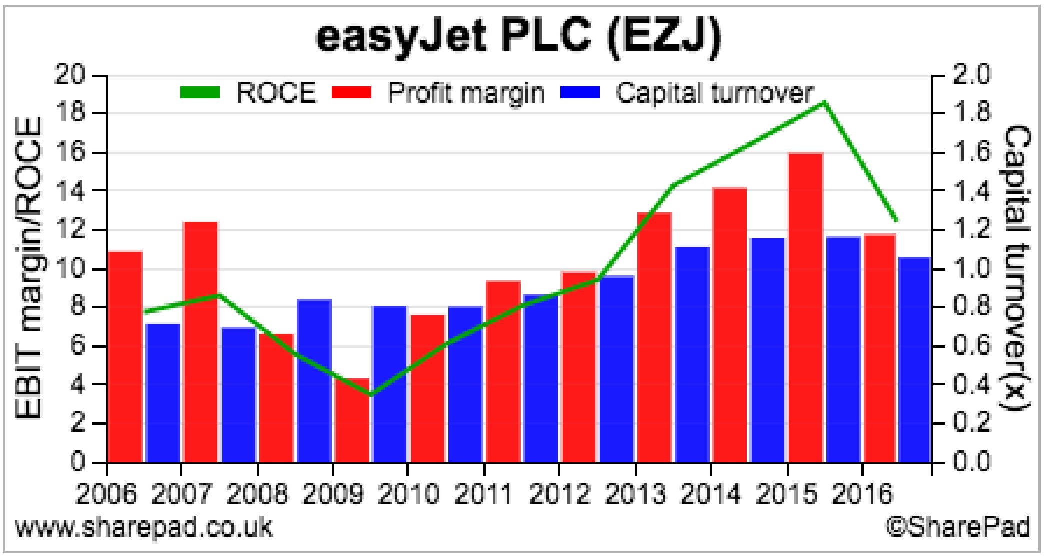
Studying an airline company's financial position and performance can be a little daunting to private investors. Their accounts and news releases are packed full of lots of different numbers. These are all very useful in their own way but there's no reason why a private investor cannot learn a great deal about whether its shares by regularly asking a few simple probing questions such as:

- Is the return on capital employed (ROCE) increasing or decreasing?
- Are profits being turned into cash?
- Are future profits likely to move up or down?
- Are the shares cheap or expensive?

Let's look at each of these in turn in relation to easyJet.



Since 2009, easyJet has delivered an impressive improvement in ROCE. At the end of 2015 it was over 18% which made it look like a very good business. 2016 has seen a sharp fall in ROCE which is worrying. You can shed more light on why ROCE has declined by doing something called Dupont analysis (click **here** to read more about this) which looks at the key determinants of ROCE - profit margins and capital turnover.

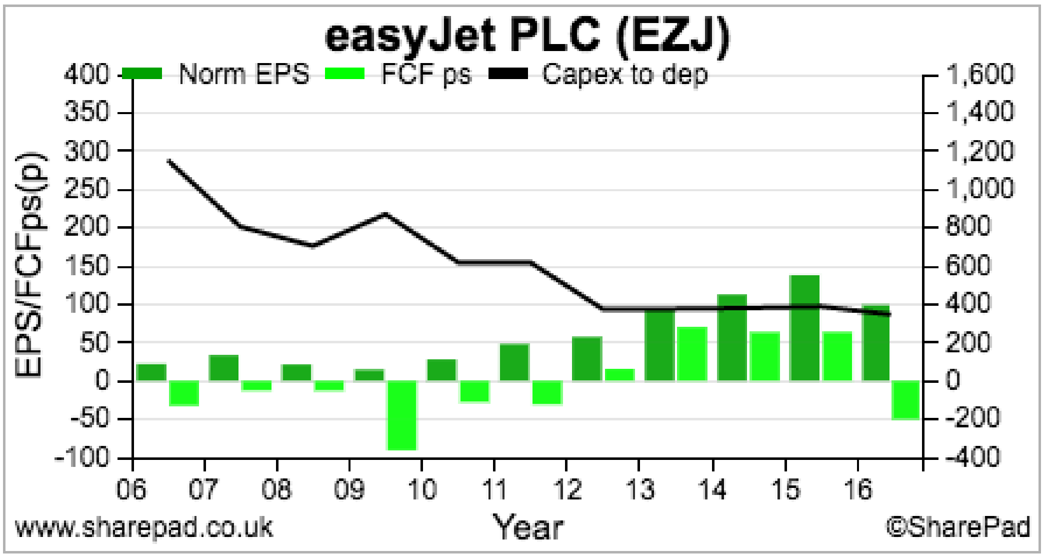


We can see here that profit margins have declined sharply. Capital turnover has fallen as well.

The trend on profit margins needs to be closely watched. The key worry is that easyJet's fares (essentially its revenue per seat flown) are falling. Although the company carried 6.6% more passengers last year and its planes were 91.6% full (its load factor) its revenue per seat fell by 6.4% to £58.46. It cost per seat fell by 2% to £52.26 - helped by lower fuel costs. Profit per seat was £6.20 down from £9.15 in 2015 - a big fall.

Cheap fuel prices are encouraging airlines to provide more capacity on the market. However, airlines cannot escape the basic laws of demand and supply. At the moment it looks as if there are too many planes chasing too few passengers and this means fares have to fall to fill up the planes.

easyJet is not really helping matters in this respect. It grew its capacity by 6.5% in 2016 to 80 million seats and is planning on a further 9% growth in capacity in 2017. This might strengthen easyJet's long-term competitive position at Europe's leading airports but will surely put further downwards pressure on profit margins and ROCE in the short-term, despite the company's cost cutting efforts.



Turning profits into free cash flow is not easyJet's strong point. The reason for this is shown by the black line on the chart. easyJet is spending nearly four times its depreciation charge on new assets - it has been considerably more than that in the past - due to aggressively growing its fleet.

This has taken its toll on the company's free cash flow but has been justified by the improvements in ROCE. Now that ROCE is falling, low or negative free cash flow may be a warning sign that easyJet's spending might start doing more harm than good.

City analysts are pencilling in another sharp fall in profits with consensus EPS of 85.3p. There is a danger that this number will come down further as more of them update their forecasts following this week's results. According to SharePad, Numis updated its forecasts on 15th November and is forecasting 2017 pre-tax profit of £399m and EPS of 80.6p.

TIDM	Name	Close	fc PE	Norm EPS	fc Norm EPS	fc Norm EPS %chg
EZJ	easyJet PLC	£10.60	12.4	99.3	85.3	▼-14.1
RYA	Ryanair Holdin...	€13.97	13.0	115.6	107.2	▼-7.3
WIZZ	Wizz Air Holdi...	£16.61	9.8	137.0	170.3	▲24.3

easyJet shares have bounced quite sharply in recent weeks after a long period of weakness. A month ago the shares were around 880p and given EPS of 99.3p for 2016 were on a PE ratio of just 8.9 times. Now, based on consensus EPS of 85.3p, they trade on a forward PE of 12.4 times at 1060p and consequently look more expensive. Consensus EPS forecasts of 104p for 2018 might also be considered too optimistic if fares keep falling or the economy is weaker than expected.

If easyJet can recover its previous levels of profitability and ROCE then there's a case for arguing that the shares could offer good long-term value. However, they are likely to be of more interest to short-term traders at the moment. Here sentiment is key and is likely to be driven by changes to analysts' forecasts, the oil price and the economy.

Sector Discussion: Housebuilders

TIDM	Name	Price	%chg 1w	%chg 1m	%chg 1y	1 y high	1 y low	Date 1 y high	Date 1 y low
BDEV	Barratt Developments PLC	479.65p	▲3	▲2.34	▼-16.7	634p	332.6p	29/12/15	6/7/16
BWY	Bellway PLC	£24.28	▲1.85	▲7.91	▼-1.1	£28.48	£16.89	30/12/15	6/7/16
BKG	Berkeley Group Holdings (Th...	£24.525	▲2.62	▲1.93	▼-21.9	£37.57	£22.70	16/12/15	6/7/16
BVS	Bovis Homes Group PLC	823.5p	▲2.36	▲6.26	▼-16.9	£10.24	627p	23/6/16	6/7/16
CRST	Crest Nicholson Holdings Ltd	458.2p	▲5.14	▲15.2	▼-11.3	604p	335p	25/5/16	6/7/16
GFRD	Galliford Try PLC	£12.955	▲1.93	▼-1.18	▼-8.06	£15.47	785p	13/1/16	7/7/16
MCS	McCarthy & Stone PLC	170.5p	▼-1.1	▲1.79	▼-22.2	287p	140.3p	19/1/16	7/7/16
PSN	Persimmon PLC	£17.29	▲2.92	▲3.91	▼-7.29	£22.19	£12.89	26/2/16	6/7/16
RDW	Redrow PLC	418.4p	▲1.43	▲10.4	▼-7.23	473.2p	275.6p	29/12/15	6/7/16
TW.	Taylor Wimpey PLC	150.05p	▲4.71	▲5.37	▼-18.9	210.3p	115.8p	24/5/16	27/6/16

Housebuilding shares have been reasonably strong in recent weeks but still remain some way below their 52 week highs. The sector took a battering following the result of the EU referendum but a flurry of trading updates this week seems to have been taken well by investors.

Where possible, I've summarised the companies' comments on sales volumes and average selling prices in the table overleaf.

All this looks very healthy and has been combined with optimistic comments about buying land at good prices and the commitment to paying out big dividends to shareholders.

Company	% change sales vol	% change av selling price
Barratt	19	?
Bovis	5	10
Crest Nicholson	5	20
McCarthy & Stone	19.5	8
Redrow	6	6.2
Taylor Wimpey	?	?

Yet there are some grounds for caution as well. Barratt talked of weakness in the London market and has been cutting asking prices there.

Barratt, Bovis and Taylor Wimpey are also operating from fewer sites which may be seen as a sign that demand is beginning to slow down. Some analysts cut their 2017 profit forecasts for Bovis to reflect their lower expectations of sales volume growth.

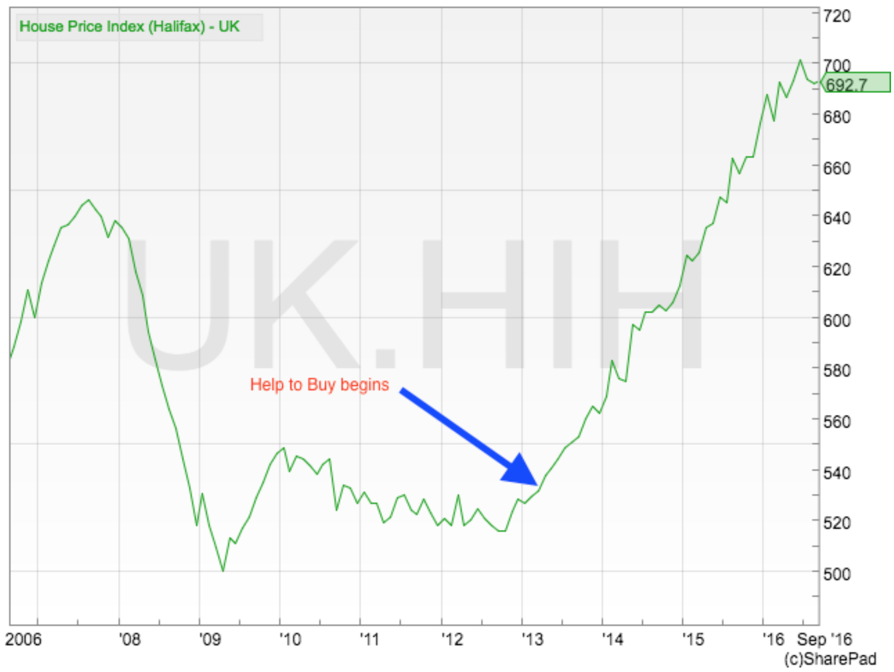
One of the attractions of investing or analysing the housebuilding sector is that it is quite easy for private investors to go and do some primary research which might give them an edge over professional investors. I find the housing market fascinating because I think it is a very good bellwether for the economy in general.

In recent months, I've been keeping an eye on some local housing developments in and around where I live in Essex. There's quite a few on my regular cycling routes and I can regularly see how fast the houses are going up.

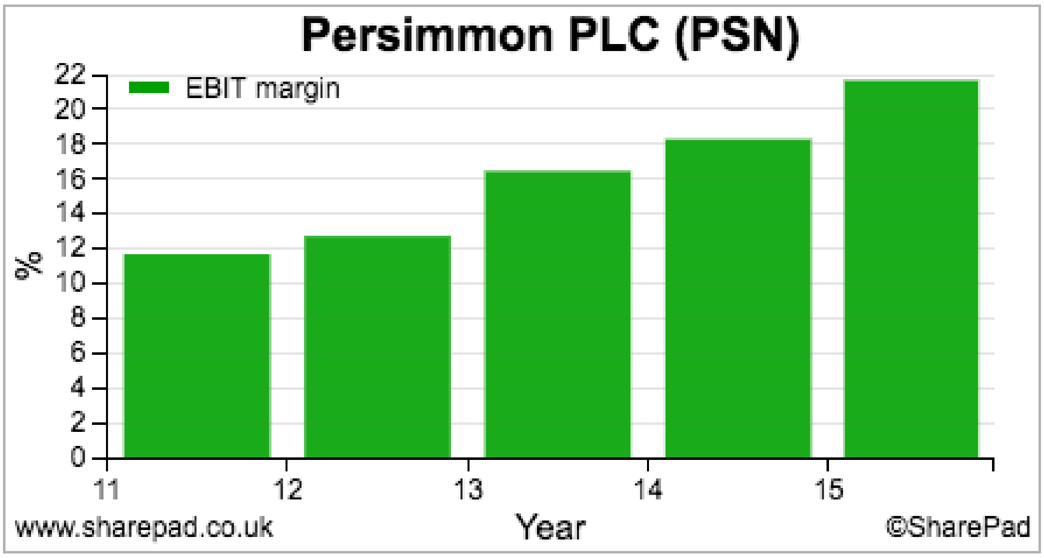
The builders are also advertising these developments on websites such as Rightmove which is a great way to keep an eye on your local market. A couple of weeks ago, I noticed that prices at a local development of high end 4-5 bedroom houses have been reduced. I can also see that a lot of large family houses on the secondary market seem to be taking a long time to sell.

I may be wrong in my judgement but my gut feeling is that the local housing market is slowing down. If prices in London are indeed slowing or falling then it would not be unreasonable to expect a ripple effect outwards into surrounding counties such as Essex.

The direction of house prices is all important to the profitability of housebuilders. Rising prices can turbocharge their profit margins. Falling prices can slash them.



If you have read my previous articles on the housebuilding sector, you will know that I have cited the government's Help to Buy scheme as a major concern of mine. I believe that it has been responsible for a significant rise in house prices since it was introduced in April 2013 (see previous chart) but has also allowed builders to boost their margins (see Persimmon as an example of this below).



There no sign that house prices are about to imminently fall off a cliff but this market can change quickly and analysts don't tend to be very good at predicting when it will happen. However, my guess - and it is only a guess - is that house price inflation which has significantly outstripped wage inflation for the past few years will slow.

Given that the builders say they are buying land that will give them good returns on capital at current house prices, they only need modest price inflation to keep on earning good profits. Cost pressures such as skilled labour could eat into profit margins slightly.

TIDM	Name	Close	fc PE	fc Yield	ROE	TTM price to NTAV	EBIT margin	10y ago EBIT margin
BDEV	Barratt Developments PLC	469.5p	9.0	7.3	14.3	1.5	17.6	16.9
BWY	Bellway PLC	£24.01	7.1	4.7	22.4	1.6	21.9	19.2
BKG	Berkeley Group Holdings (The) PLC	£24.19	6.0	8.3	23.4	2.0	26.3	18.8
BVS	Bovis Homes Group PLC	805.5p	7.3	5.6	13.9	1.1	17.5	24.0
CRST	Crest Nicholson Holdings Ltd	448.9p	7.4	6.3	21.3	1.8	20.3	
GFRD	Galliford Try PLC	£12.84	8.4	7.4	18.2	2.4	5.7	4.5
MCS	McCarthy & Stone PLC	168.5p	9.5	3.4	12.0	1.4	14.9	
PSN	Persimmon PLC	£17.10	8.9	6.4	22.6	2.6	21.7	23.1
RDW	Redrow PLC	414.6p	7.2	3.4	21.4	1.5	18.9	17.1
TW.	Taylor Wimpey PLC	148.5p	8.5	7.4	18.6	1.9	20.3	13.3

The uncertainty about the sustainability of high house prices and high profit margins is the chief reason why housebuilders trade on single digit PE ratios. I still prefer price to net tangible asset value (P/NTAV) to value this sector and would suggest that anything approaching 2.0 on this measure is starting to look highly valued.

If you want to read more of my analysis on this sector you can read my recent article in the Investors Chronicle **here**.

Share Discussion: Is National Grid losing its lustre?

National Grid shares have been a reliable income payer for many years. Transmitting electricity and gas across national grid networks is about as stable and predictable a business you will find listed on the stock exchange.

Despite being subject to regular price caps which limit what it can charge its customers, the shares have been a firm favourite with investors. Even if you have not reinvested your dividends you would have made a total return of over 100% during the last decade from the shares.

The shares have behaved very strangely in recent months. They shot up following the result of the EU referendum, presumably because investors saw it as a safe haven for their money. During the last month they have plummeted.

The company's half year results announced last week were pretty dull and there was nothing really in them that should have frightened people. My guess as to why the shares have sold off recently is probably due to the rise in the interest rates (yields) on government bonds.

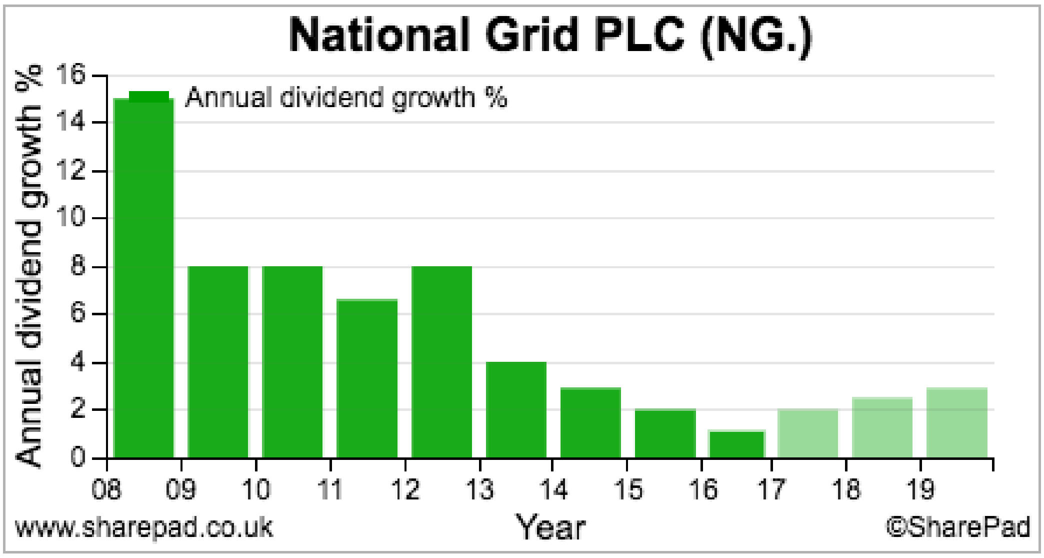
Utility shares such as National Grid are often seen as bond proxies - good alternatives to bonds - given their generous and reasonably predictable dividends. UK bond yields have been rising steadily for the last few weeks as expectations of inflation - due mainly to the fall in the value of the pound making imported goods more expensive - have increased. Shares of water companies have also fallen and underperformed the market.

But if this is the reason for the share price fall, could the market have overreacted?

My view is that this is possible. You see, inflation might be good for National Grid and its shareholders. Regulators tend to allow it to increase the value of its assets and cash flows in line with inflation (Retail Prices Index in the UK).

This means that National Grid could be capable of increasing its dividends in line with inflation for a good while. In fact, this is the company's stated dividend policy.

The problem at the moment is that inflation has been low. This means that National Grid's dividend growth has been slowing. Its half year dividend increases by just 1.1% to 15.17p.



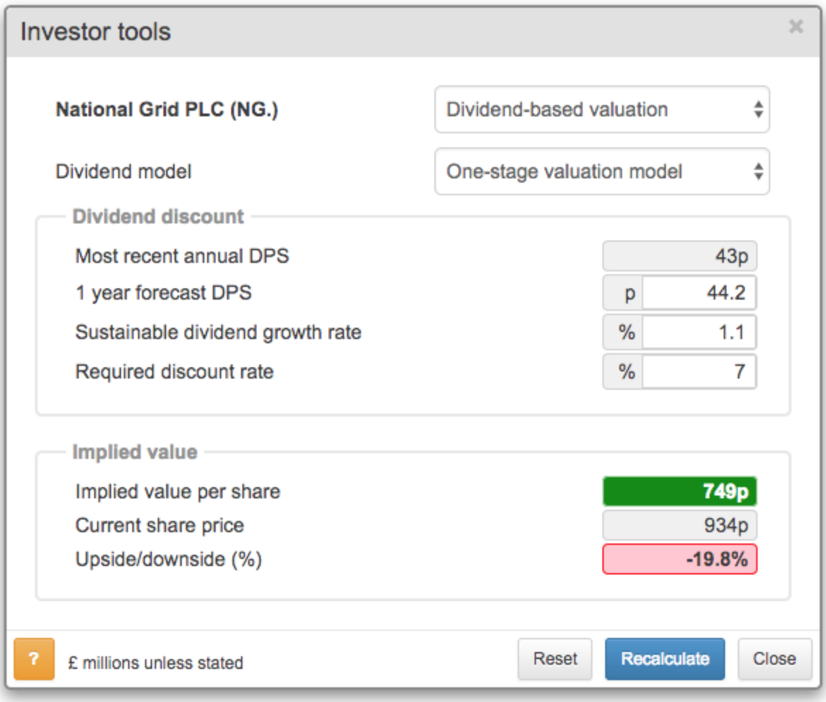
But what if inflation started to increase? What would that mean for the valuation of National Grid's shares?

You can try and answer this question for yourself using the simple dividend valuation model in SharePad. This is an established method for valuing shares. You will find it by clicking the green 'Investor tools" button in the top right hand corner of the SharePad screen.

If you select 'Dividend-based valuation' and then 'One-stage valuation model' you can estimate the value of National Grid shares with just three numbers:

1. Next year's forecast dividend per share.
2. A discount rate - the required return or interest rate investors demand to invest in the shares. I've chosen 7% as I see National Grid as a fairly low risk business.
3. An estimate of sustainable long-term growth rate in dividends per share

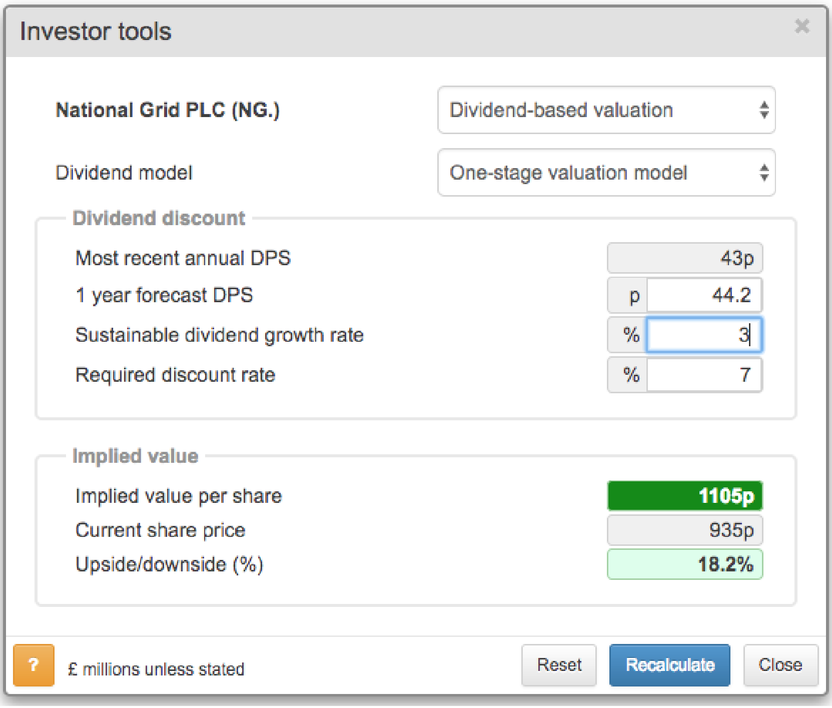
SharePad will automatically give you the consensus estimate of next year's dividend per share, but you can choose your own numbers for any of the three variables. If you assume inflation - and therefore dividend growth - will stay at 1.1% then the model says National Grid shares are only worth 749p or around 20% less than the current share price.



However, if you think inflation is going to be much higher in the future - say 3% - then the valuation would increase to 1105p – a premium of 18.2% on the share price at the time of writing.

I'll leave you to decide for yourselves what the right valuation for the shares might be.

The other thing you can do is to reverse engineer the share price and work out what rate of dividend growth it is implying. To do this, you simply take away the forecast dividend yield from your chosen discount rate.

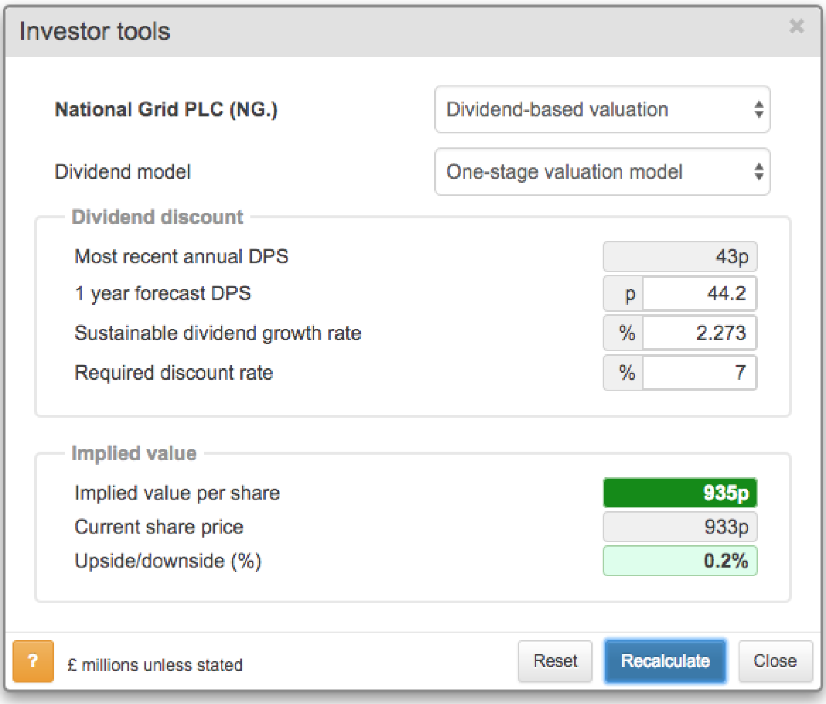


With a forecast dividend of 44.2p per share and a share price of 935p, the forecast dividend yield is 4.73%. So with a 7% discount rate, the implied dividend growth at 935p is:

7% - 4.73% = 2.27%.

Note that this formula only works if the implied dividend growth is less than the discount rate. If you think that dividend will grow faster than the implied rate you might buy the shares or sell them if you think the implied growth is too high. If the forecast dividend yield is more than your discount rate, the share price is implying that future dividends will be lower or cut.

Just to prove that this formula is correct, I will plug a future growth rate of 2.273% into the dividend valuation model. As you can see below, it gives 935p per share – very close to the current price.



Filter of the week: looking for distressed shares

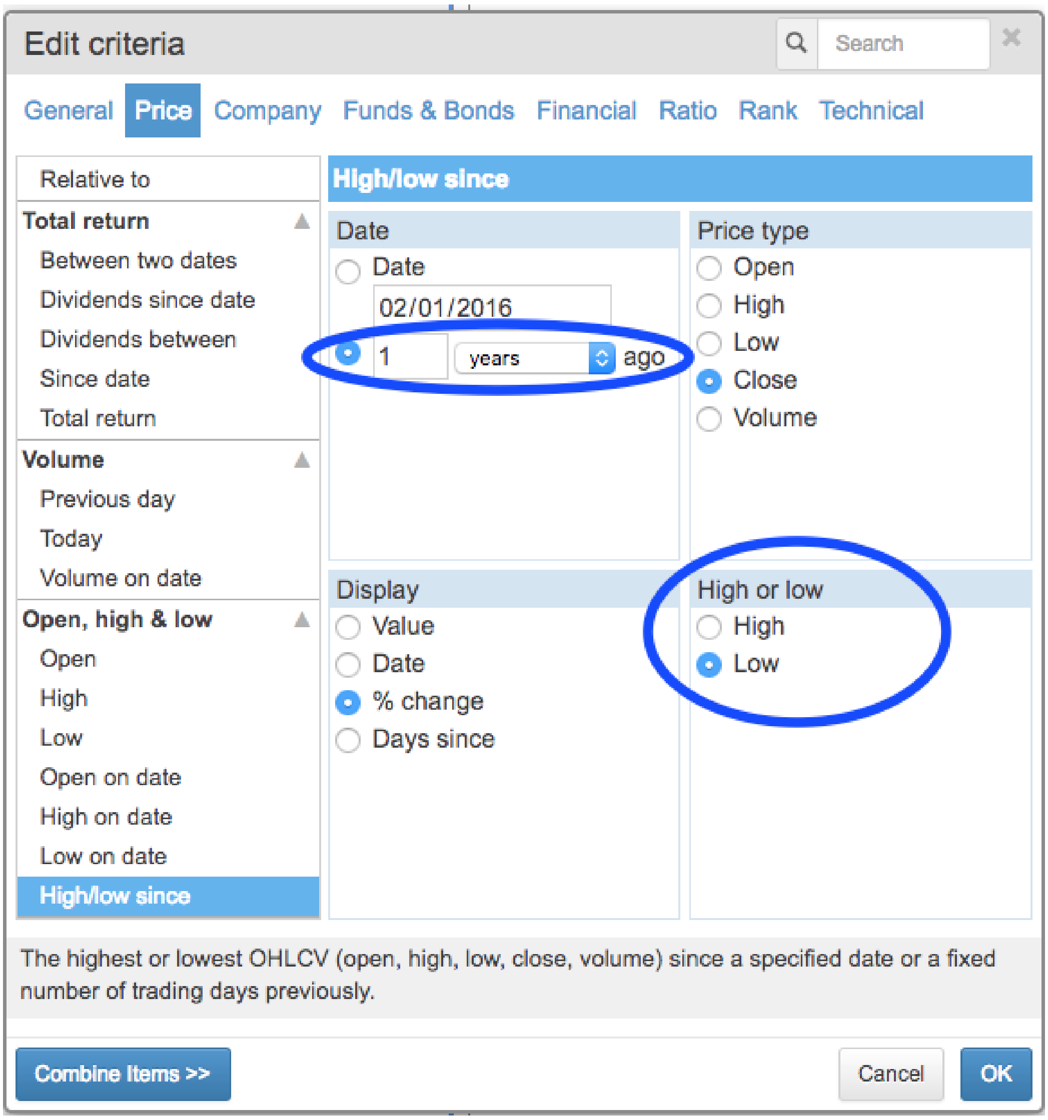
This week's filter shows you a very simple way to find unloved or distressed shares. It can be easily done in both ShareScope and SharePad.

It involves looking for shares with prices that are trading at 52 week or even multi-year lows. I see this approach to investing as similar to shopping for clothes in the new year sales - when shops sell all the stuff that nobody wanted to buy for Christmas.

Most of the shares in these filters will have something wrong with them but from time to time you can unearth a gem that the market has overlooked or failed to appreciate that its poor fortunes are only temporary and it can recover. I run this screen most mornings.

This filter is very easy to set up with the following criteria:

- **Price % change since year low** - set to maximum of zero for shares trading at their 52 week low. I have set the maximum to 1% to get a list of shares trading within 1% of their 52 week low.
- I've also filtered for shares with a minimum **market capitalisation** of £100m



SharePad has produced a list of 11 shares trading within 1% of their 52 week low. I have then added some extra columns to the table to give me a bit more information.

Filtered FTSE All-Share sorted by Name (11 matches)

Phil Oakley - New lows Add criteria i Exit

%Chg since 1 y low Min: Max: 1 Edit

Market Cap. (intraday) (m) Min: 100 Max: Edit

No.	Name	TIDM	Market Cap. (current)	Price	%Chg since 1 y low	1 y low	Date 1 y low
1	Aggreko PLC	AGK	£1977.9	772.25p	▲0.948	765p	16/11/16
2	Berendsen PLC	BRSN	£1566.5	907.5p	▲0.276	905p	16/11/16
3	Carpetright PLC	CPR	£127.4	187.5p	▲0.806	186p	16/11/16
4	ITE Group PLC	ITE	£338.2	129p	▲0.194	128.75p	25/2/16
5	P2P Global Investments PLC	P2P	£668.5	785.75p	0	785.75p	17/11/16
6	Redefine International PLC	RDI	£670.5	37.36p	0	37.36p	17/11/16
7	Regus PLC	RGU	£2123.7	229.3p	▲0.791	227.5p	16/11/16
8	TalkTalk Telecom Group PLC	TALK	£1768.2	185.15p	0	185.15p	17/11/16
9	Topps Tiles PLC	TPT	£159.5	81.375p	0	81.375p	17/11/16
10	UNITE Group PLC	UTG	£1220.5	549.75p	▲0.687	546p	16/11/16
11	VPC Specialty Lending Investmen…	VSL	£272.1	71.125p	▲0.887	70.5p	16/11/16

Once you have set up your filter and given it a name, you can apply it to any list of shares in ShareScope or SharePad (e.g. AIM).

If you want to expand your search for distressed shares then you could easily look for shares that are trading at 3 year, 5 year or even 10 year lows.

Filtered FTSE All-Share sorted by Name (6 matches)

Phil Oakley - 3 year lows Add criteria Exit

%Chg since 3 y low Min: Max: 1 Edit

No.	TIDM	Name	Market Cap. (intraday) (m)	Price	%Chg since 3 y low	3 y low	Date 3 y low
1	GMD	GAME Digital PLC	£96.1	56.25p	0	56.25p	17/11/16
2	P2P	P2P Global Investments …	£669.2	786.5p	0	786.5p	17/11/16
3	RDI	Redefine International PLC	£673.2	37.515p	0	37.515p	17/11/16
4	TALK	TalkTalk Telecom Group …	£1765.8	184.9p	0	184.9p	17/11/16
5	TPT	Topps Tiles PLC	£161.5	82.375p	▲0.152	82.25p	16/11/16
6	VSL	VPC Specialty Lending I…	£269.7	70.5p	0	70.5p	17/11/16

Now use the research tools in ShareScope and SharePad to see if these deserve to be distressed or whether you have unearthed a bargain.

I hope that what you'll get from reading my analyses is that all we can do is make the best judgment based on the information we have. None of us has a crystal ball. I want you to practise using your own judgment.

Filters and rankings are all very well but they can lead you into buying shares without fully understanding the risks associated with any one company – and investing should be about limiting your risks as much as possible. You will be a better investor if you can review and assess the financial characteristics of a company and satisfy yourself that, on the whole, the investment case is positive.

We give you the information and tools to do this and hopefully, from my articles, you are learning the questions you need to answer.

My aim is that slowly but surely you'll develop the skills to eliminate weak/risky stocks from your watchlist and spot those with the best chance of success.

If there are any areas of investment analysis which you struggle with, please email me at **analysis@sharescope.co.uk** and I will attempt to address your issues in future newsletters.

This newsletter is for educational purposes only. It is not a recommendation to buy or sell shares or other investments. Do your own research before buying or selling any investment or seek professional financial advice.