Alpesh Patel's Newsletter

Exclusively for ShareScope Alpesh Patel Special Edition Subscribers

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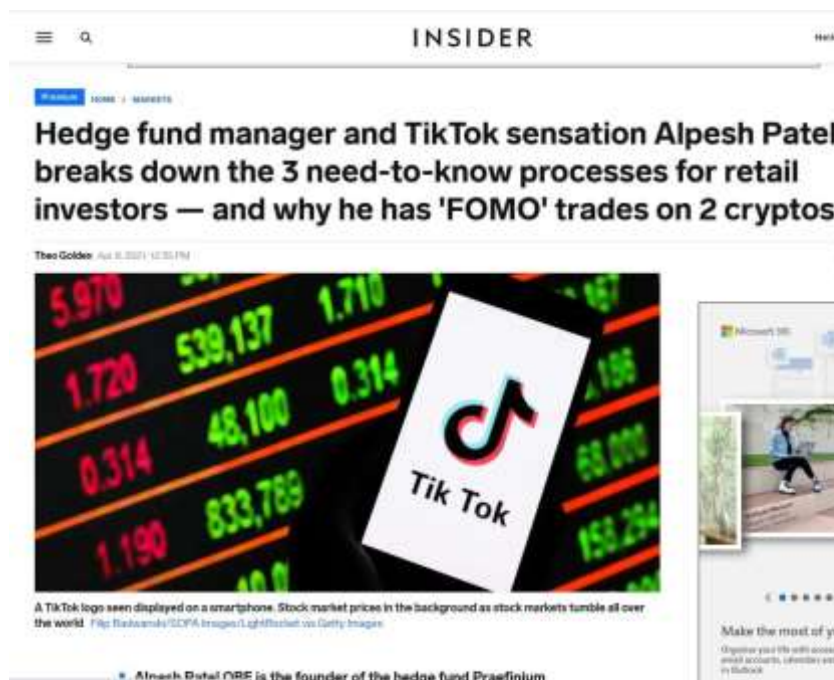
Overview

Delighted to be big on social media!



INSIDER

Hedge fund manager and TikTok sensation Alpesh Patel breaks down the 3 need-to-know processes for retail investors — and why he has 'FOMO' trades on 2 cryptos

Theo Golden

A TikTok logo seen displayed on a smartphone. Stock market prices in the background as stock markets tumble all over the world

- Alpesh Patel OBE is the founder of the hedge fund Praefinium

All time market highs but clearly some of last years winners are not the ones leading the drive in this expensive market – so what to do? Shift stocks and risk falls? I will cover this in more detail below.

Dow ends at 34,000 for first time; S&P 500 notches record as jobless claims hit pandemic low, retail sales surge

Despite the expensive market, earnings are holding up in many of last year's big winners.

03 List: U.S. 500 - All sectors - Alpesh Table (Linked)

No.	Name	Price% 2 weeks ago	Alpesh value/ growth rating
1	Nucor Corp	24.09	5
2	Baker Hughes Co	21.44	5
3	NortonLifeLock Inc	20.77	9
4	Schlumberger Ltd	20.66	6
5	Viatris Inc	19.63	4
6	Gartner Inc	15.84	5
7	Newmont Corp	15.43	7
8	Devon Energy Corp	15.25	4
9	Halliburton Co	15.22	6
10	Freeport-McMoRan Copper	14.83	7
11	Franklin Resources Inc	14.33	7
12	Seagate Technology PLC	13.79	7
13	Centene Corp	13.16	8
14	National Oilwell Varco Inc	13.01	4
15	Sealed Air Corp	12.84	8
16	Hess Corp	12.50	4
17	EOG Resources Inc	12.13	6
18	Lumen Technologies Inc	11.49	6
19	ConocoPhillips	10.70	4
20	CF Industries Holdings Inc	10.24	5
21	Leggett Platt Inc	10.13	6
22	Marathon Oil Corp	10.04	4

The most recent risers are not necessarily the most financially strong.

Microsoft sales surge on cloud services and PC demand

Investors take profits after 20% share price rise this year

Ticker		Name	Earnings Related Implied Move
DISH	UW	DISH Network Corp	12.63
ETSY	UW	Etsy Inc	10.62
UAA	UN	Under Armour Inc	10.40
TWTR	UN	Twitter Inc	9.62
UA	UN	Under Armour Inc	9.54
ROL	UN	Rollins Inc	9.42
ENPH	UQ	Enphase Energy Inc	9.37
ABMD	UW	ABIOMED Inc	8.55
ANET	UN	Arista Networks Inc	8.39

Source: Bloomberg

There is also a case that the FTSE 100 will catch up – or maybe that FTSE 250 is where growth is. Let me dive deeper below on my view.

FTSE 100 vs FTSE 250 (2000-2020)

Past performance isn't a guide to future returns. Source: Lipper IM to 31 December 2020.

Is Chasing Dividends in Stocks a Good Idea?

What defines a worthy stock for investment or retirement income? Unfortunately, for many investors, the answer is a stock that pays dividends.

While dividends are a factor (among many) that can be used to judge a stock. It isn't necessarily the most important or profitable determination to make when investing.

The world's greatest investor and some Nobel Prize-winning economists agree that a portfolio that focuses heavily on dividend-paying stocks is leaving money on the table.

Warren Buffet on Dividends

In 2011, Warren Buffett's Berkshire Hathaway announced they would be buying back shares in the company. Many shareholders wondered why their profits would be used this way instead of paying out cash dividends.

However, some years later, in an annual shareholder's letter, Buffet explained his position on dividends.

His opinion was that a company could do one of four things with profit.

1. **Reinvest in the company**
2. **Purchase other companies**
3. **Buyback shares**
4. **Payout cash dividends**

While the first three are certainly part of Berkshire's strategy, Buffet explained what he saw as the disadvantage of dividends:

1. Shareholders might require different levels of dividends.

2. Dividends are taxed as income, which is disadvantageous for long-term investors.
3. He was concerned that a dividend-paying stock could turn off potential investors who didn't want a surplus cash payout.

Buffet's Case Against Dividends

To surmise a case laid out well in this article from 2013 by Sam Ro. Buffet spells out why dividends might not be the best way to generate wealth.

He postulates that suppose two individuals own a company worth $2m that earns 12% on net worth.

This means a profit of $240,000 per year, which can either be taken out or reinvested (also accruing a 12% profit).

Additionally because investors are keen to buy into the company at 125% of the next worth. The value of what each owner has is $1.25 (total $2.5m).

The Result of Paying Dividends

However, if one shareholder wants dividends of one-third ($80,000) to be paid out and two-thirds ($160,000) to be reinvested in the company. This will result in an annual payout of $40,000 each.

As the company grows, this 12% profit is split between dividends (4%) and reinvestment (8%). Resulting in a net worth of $4,317,850 after ten years.

By this time, the dividend would be $86,357, and each investor would own half the net worth, or $2,698,656.

The Result of Full Reinvestment

While this is a fantastic outcome, Buffet suggests a more preferable and profitable method to consider. By leaving all company earnings and selling 3.2% of shares annually, the same $40,000 of returns would be earned in year one.

However, after ten years, this sell-off scenario nets a return of $6,211,696 by compounding these extra funds. By selling off shares annually, each individual's ownership will decrease from 50% down to 36.12%.

Still, because the company's net worth is higher. The shares' market value would be $2,804,425 — a full 4% greater than the dividend approach. To further understand Buffett's philosophy, we should take a look at Dividend Irrelevance Theory.

Dividend Irrelevance Theory

In 1961, Franco Modigliani and Merton Miller argued that a company's dividend policy doesn't affect its market value or capital structure.

Instead, they believed that its stock price was determined by its ability to generate future earnings combined with its attendant business risk.

They stated that dividends don't add value to a companies' stock price. And that dividends constitute a missed opportunity for reinvestment that, if anything, ends up harming a company.

Both men went on to win a Nobel Prize in Economics in 1985 and 1990. However, their theory — has some criticism from those who feel that it falls short in a practical sense.

Do Dividends Matter?

Yes and no. While dividends indicate how much cash a company is generating. They are not definitive, ironclad proof that a company is generating cash and sales.

As Steve Coker from Cedarstone Advisors points out. Between 1995 and 2012, Apple Inc. paid no dividends yet generated billions of dollars for its shareholders.

He notes that because cash was not exiting the company, reserves built up and increased the stock price. Which benefited shareholders who still owned their percentage of this accrued cash.

When analysing whether a company is a quality investment, dividends are important, but they're not everything.

What Does This mean For Investors?

Taking all of this information together, what should investors do? While dividends are one factor determining how good a stock is. It is far from the only consideration a smart investor should make.

Instead of looking for dividend companies to generate income, investors are better served identifying stocks with good growth potential. And then selling some shares to generate revenue.

Per Buffet's calculations — and the work of two Nobel-winning economists. This, is preferable to relying on a few percent of dividends when a stock could quickly drop by 10% or more. Also, it's more profitable.

How to Make Your Child A Millionaire

As we all know, becoming a self-made millionaire is no mean feat more so for a child. However, through saving, some well-timed or wise investments, and a little financial education, you can set your kids on the right path. Here is a list of several methods that show you how to make your child a millionaire.

Junior ISA

A junior ISA is permanently tax-free. They come as either cash ISAs or as an investment wrapper. In the 2020/2021 tax year, investors could place as much as $9000 per year that will be locked away until a child's 18 birthday, at which point it becomes a regular ISA.

This graph shows how only £25 per month could turn into £11,000 by the time your child is 18 years of age.

However, for parents, choosing the suitable Junior ISA is essential. Depending on the age of your child, an investment wrapper could be the right choice. Investing tends to outperform cash over the

long term; however, investment comes with more significant risks. Cash ISAs tend to perform slow and steady but typically produce returns below the stock market.

Stakeholder Pension

Of course, if you want your child to become a millionaire, you'll need to start saving early. Setting up a stakeholder pension for them once they are born is a great way to get them on the way to a comfortable retirement. You can contribute a maximum of £3,600 per year, but basic-rate tax relief of 20% means this will only cost you £2,880 per annum. With just 6% annual interest, this pot would rise to £516,134 by the time they are 38 years old.

If combined with a large junior ISA, this could leave your child well on the way to seven figures.

Investing

If you want the best returns, you should consider investing. While it is riskier, the rewards are often much more significant. Paul A. Merriman makes the case in a Marketwatch post that $1 a day can result in seven-figure gains from small-cap value stocks.

By investing $365 per day in low-cost ETFs at around 12% a year, the parents' $6,570 could compound into $20,348 by the time their child is 18. By setting up an individual retirement account (IRA), this child can then add this money tax-free and watch it grow.

Holding onto these funds at a 12% compound interest rate throughout their working life is where this method really delivers. The nest egg could grow to a staggering $4,185,342 by their 66th birthday.

Financial Education

Of course, setting up savings and pension funds for your kids is just one method. Another, favoured by Warren Buffett, is about teaching children financial literacy from an early age.

Indeed, Buffet is so serious about this that in 2011 he created a children's cartoon series *Secret Millionaires Club.*

Buffet has many lessons to give anyone about financial management, but for kids and parents, he keeps things simple.

An article in Moneywise underlines six economic principles that the legendary investor thinks should be taught to investors' next generation.

Chief among his advice is teaching financial literacy as early as possible. Setting a good example and demonstrating the value of even a tiny level of savings are all tools that should be passed down to younger children.

Buffet also suggests that instilling children with an entrepreneurial spirit and a constant desire to learn are vital factors for ensuring financial independence.

Turning Your Kid Into an Investor

Of course, we won't always be around to help and look out for our kids. So teaching them how to invest while we can is an excellent idea.

With the bulk of our brain growth happening by three years of age, your can teach financial concepts in these formative stages.

While that might seem young, this study by the University of Cambridge suggests children can grasp basic money concepts aged 3-4.

The pandemic — and resultant enforced homeschooling — provided an opportunity for many parents to orient their children towards money management.

An intriguing blog on Your Money showed how children could learn about budgeting, risk and reward, cost of living, and investing.

Conclusion

A mix of intelligent investing and education is required to help your children retire as millionaires. Consistent savings and a combination of investments and junior ISA are all that it takes to net seven-figure retirement funds. However, teaching financial guidance is a must.

I'll return to Warren Buffett for the final word. He suggests that the number 1 financial mistake parents make with their children is teaching them financial literacy too late.

To conclude, it's never too early to start saving, investing, or learning.

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The Truth About Hidden Fees Fund Managers Charge

Research from SCM Direct has laid bare a pattern of hidden costs charged by fund managers. The wealth management firm, run by Alan and Gina Miller, has been a long-term advocate of greater transparency in the investment industry.

However, their findings may come as a surprise to some, with many fund managers charging double or triple their 'at a glance' fees.

Breakdown of Fees

SCM investigated the breakdown of fees on Fidelity and Hargreaves Lansdown for the 20 most significant funds in the UK All Companies sector. Their research exposed what they believe is a lack of transparency that is running rampant in the industry.

Hargreaves Lansdown's average net charge for funds in the sector was 0.78 per cent. However, when platform and transaction costs, plus performance fees, were added on top, the charge rose almost double to 1.5 per cent.

It was a similar story for Fidelity. On their website site, their fees show as 1.07 per cent. However, once performance fees and platform costs were added, this shot up to 1.49 per cent.

With the JPM UK Equity Core fund, Hargreaves gave a net charge of 0.33 per cent. When all the charges add up, the fund costs 1.09 per cent.

Miller's Mission

This is not the first time the Miller's have voiced their displeasure at the state of UK fund managers. Since 2012, their True and Fair campaign has sought reform in the investment and pensions sector.

In recent years, Gina has also drawn attention to "price fixing" in the industry. In 2017, she investigated 683 funds with £320bn under management and found that 70% had identical charges.

MiFID II

The MiFID II regulations from 2018 have forced the hands of many fund managers, exposing the hidden fees they've hidden from investors for years. The financial consultant Lang Cat underlined this in a post from 2018, revealing the scale of these extra charges.

Their research of charges suggested investors were paying an average of 30% more than advertised. However, in some cases, such as the JPM Global Macro Opportunities Fund, this number was as high as 85%.

Now, as SCM Direct has shown, this problem has arguably worsened in recent years.

Is It Time to Leave Fund Managers?

For years, investors tolerated Hargreaves Lansdown's high fees because of their excellent service. However, with more competition entering the market, many have become sceptical about their value.

For example, Hargreaves Landsdown charges 0.45 per cent on the first £250,000 invested. Between £250,000 and £1million it's 0.25 per cent, and 0.1 per cent on the next million. These fees are higher than those offered by similar funds.

The Scale of Fees and Lost Returns

According to an analysis by Candid Financial, the fees and lost returns involved are considerable. They looked at four investment options: Hargreaves London, Close Brothers, AJ Bell and Interactive Investor.

Hargreaves had the highest fees, with Interactive Investor charging flat fees of £9.99 and £19.99 for ISAS and Sipps, respectively.

If you invested £100,000 with each platform over 30 years, with an annual growth of 5%, this is what you would lose in fees and lost returns.

Hargreaves London: -£121,307
Close Brothers: -£103,144
AJ Bell: -£102,787
Interactive Investor: -£85,962

Fees should be a significant consideration for investors. The lack of transparency among fund managers can make a massive difference to returns.

Why Investors Should Be Cautious About Funds

Other hidden fee tricks that funds use were exposed in recent years. M&G and Jupiter were shown to be charging administration fees far above their rivals.

Indeed, by applying blanket admin fees and retaining any surplus, these funds were pocketing significant returns at their investor's expense.

By indexing their admin fees to profits, each percentage increase saw them draw in more money, despite admin costs being a fixed expense.

The Cost of Investing in Funds

In an excellent and comprehensive article by the late Vanguard founder John Bogle, he outlines four separate hidden costs that could lose investors 33% in returns.

Transaction Costs
Mutual Funds and ETFs buy and sell shares of funds. These transaction costs can add up quickly because of their high volume, as index funds buy and sell shares as investors enter and exit the funds. Bogle puts these transaction costs at around 0.5%.

Cash Assets
Shares should outperform cash. However, many funds keep cash as they await opportunities. This, according to Bogle, means 5% in cash = 0.3% in a missed opportunity for investors.

Sales Loads
Buying into a loaded fund can cost around 5%. Investors can avoid this by using an advisor, which could cost about 1%. However, even if you bypass an advisor, you could be set to face brokerage fees.

Compound Losses
Bogle suggests these charges total around 2.27%. This total may not seem huge, but when

compounded, they become significant. He suggests that actively managed funds will shave a staggering 1/3 off of your actual returns after 40 years.

Conclusion

Investors should be careful when considering funds for investment or retirement. SCM Directs research confirms the scale of hidden and misleading fees, while John Bogle's work demonstrates the damage to returns by investing in fund managers.

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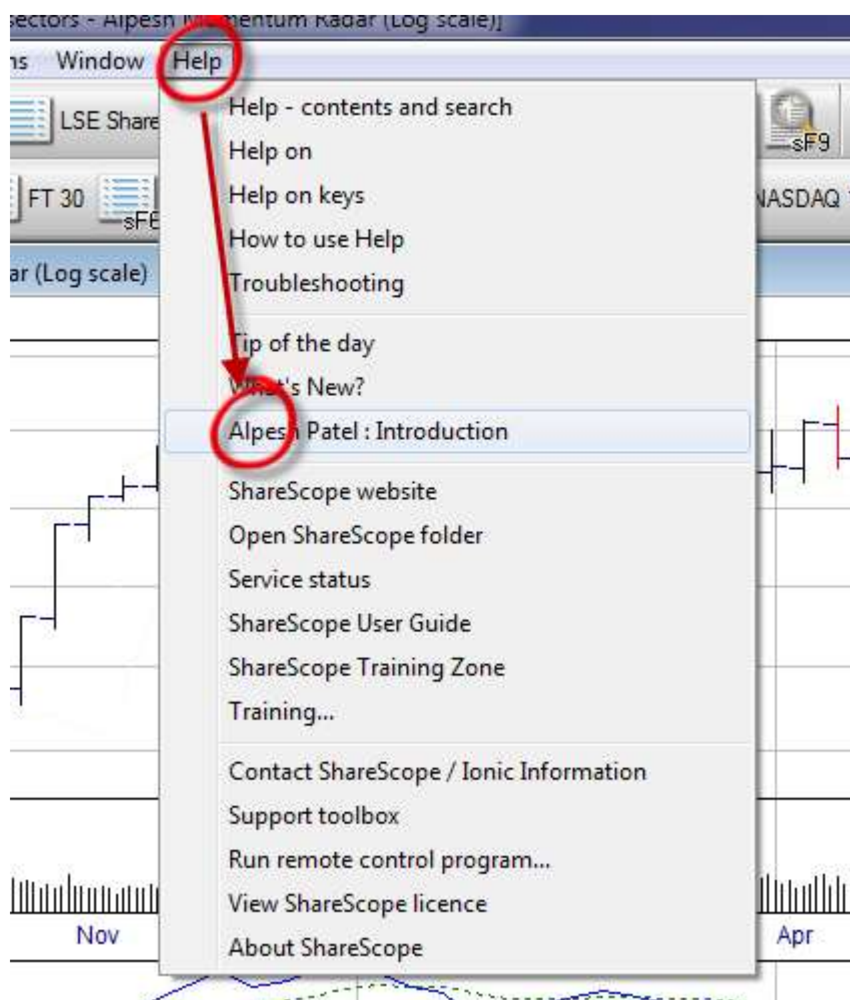

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