

# EQUITY RESEARCH

## ASSET DIVERSIFICATION



**COLLINS SARRI STATHAM**  
INVESTMENTS

### Research Report

ADVISORY SERVICES

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### Natural Diversification via the balance sheet

Our last report discussed a possible balance sheet for a hypothetical “man on the Clapham omnibus”. Ignoring the liability side the example below details one hypothetical asset mix for different age groups. We have bolded below the investable assets.

Age Group	30-40	40-50	50+
<b>Long term assets</b>	£k	£k	£k
Property	200	300	400
Intangible assets / i.e. State pension / SIPP/ life policies	<b>10</b>	<b>20</b>	<b>50</b>
Personal effects/ Furniture	10	10	10
Realisable commodities gold coins / alt assets	-	-	-
Bonds/ NS certificates	<b>10</b>	<b>20</b>	<b>60</b>
Equities	<b>30</b>	<b>40</b>	<b>50</b>
<b>Short term assets</b>			
Cash /Cash ISA	<b>10</b>	<b>10</b>	<b>10</b>
CFD other cash positive Derivative assets	-	-	-
<b>Total Assets</b>	270	400	580
Portfolio Assets/ Total Assets	60 (22.2%)	90 (22.2%)	170 (29.3%)
Liquid Assets/ Portfolio Assets	50 (83.3%)	70 (77.8%)	120 (70.6%)
Illiquid Assets/ Portfolio Assets	10 (16.7%)	20 (22.2%)	50 (29.4%)

Source; CSS Investments Ltd

The above provides pointers for measuring asset mix weightings. Certain features are apparent which could be broadly relevant for the majority of individuals:-

- As the holders age increases; illiquid portfolio assets such as pensions are a higher proportion of the portfolio assets.
- Portfolio assets tend to be in the range of 20%-30% of total assets over the holder age groups (unless the holder sells his home and rents!)
- The holder of an illiquid portfolio ie pensions may have more/less control over it.
- The hypothetical individual has quite a lot of “natural” asset diversity via property and pensions that arguably he can do little about in the short-term.

Broadly this helps determine how to allocate / supervise assets within an asset mix.

The next step is to diversify an investment portfolio in that our focus is on an “optimal portfolio” of portfolio assets that will move independently of each other as possible. This means the portfolio return ( $\mu$ ) and risk ( $\sigma$  standard deviation) is managed.

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## **Asset Diversification is a key factor- how can this be determined?**

A number of assumptions / objectives were made to derive a balanced portfolio.

\*An objective to obtain a sector diversified FTSE 100 portfolio that uses the assumption that returns over the last 60 months (5 years) are representative of returns going forward.

\*A decision to take out mining companies due to a decision that exposure to China going forward is undesirable in the short-term.

\*Using equity average returns measured against the riskiness of those returns as measured by standard deviation, to derive a balanced portfolio that optimised returns and minimised portfolio risk.

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## Portfolio Particulars – individual equities details

### Aviva (AV.) BUY

Aviva is FTSE 100 listed life assurer/ fund manager/ savings/ pensions/ healthcare assurance specialist. The Sept-Oct 2014 sell off has brought Aviva back close to MCEV (488p)

Company	Aviva
Share Price	489
Target Price	550
52 Wk Hi/Low	535/412
Shares O/S	2.948bn
Market Capitalisation	£14.4bn
Avg Daily Volume	4.27m
Dividend Yield	3.20%

Source; Fidessa plc

#### Key Catalysts

Improving combined ratio (95.5%) at the interims could improve in H2 due to relatively benign claims environment/ absence of major large cat events. Steady embedded value (478p) should 4p-10p gain in H2.

Aviva's progress in reaching key metric objectives, cash (+7%), op profit (+4%), expenses (-8%) is taking place in the context of a rapidly changing UK pensions environment with further changes expected in 2015.

#### Key Risks to Price Target

- i) Aviva is subject to changes in pension market legislation in the UK and overseas
- ii) Sensitive to capital market events which may impact Aviva's capital surplus of £8bn
- iii) Subject to insurance market claims risks and in particular weather related risks.

**Please note the risk warnings and disclaimers on the last page of this document.**

### Bankers Trust (BNKR) BUY

The Bankers Investment Trust is a FTSE 250 listed investment trust run by Henderson Group, itself a FTSE 250 fund management co. An in depth report on Bankers Investment Trust was written on 9<sup>th</sup> October 2014 and is available on [www.css-investments.com](http://www.css-investments.com).

Company	Bankers Trust
Share Price	527
Target Price	600
52 Wk Hi/Low	595/519
Shares O/S	112.1m
Market Capitalisation	£590.8m
Avg Daily Volume	83.2k
Dividend Yield	2.80%

Source; Fidessa plc

#### Key Catalysts

Bankers Trust net asset value at 554.9p has trended down from 604.2p (4<sup>th</sup> September 2014) the recent 2014 high. The 8.16% decline has outperformed the 12.2% decline in the FTSE 100 over the period 4<sup>th</sup> September – 16<sup>th</sup> October 2014.

#### Key Risks to Price Target

- i) Bankers Investment Trust is subject to equity market related risk factors
- ii) Sensitive to movements in net asset value in accordance with AIC formula
- iii) Bankers Trust investment track record may change / charges may change.

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### BP (BP.) BUY

BP recent weak newsflow, Rosneft, US Dept of Justice, lower oil prices during Q3/Q4 and knocked an improving story on E&P and shareholder returns. As the divestment phase winds down, we expect increased share buybacks /QTR dividends and improving clarity on liabilities.

Company	BP
Share Price	425
Target Price	500
52 Wk Hi/Low	524/416
Shares O/S	18.32bn
Market Capitalisation	£77.85bn
Avg Daily Volume	56.5m
Dividend Yield	5.60%

Source; Fidessa plc

#### Key Catalysts

Q3 on 28<sup>th</sup> October should see the board finally lift the provision for Macondo possibly by \$9-\$10bn to reflect the Barbier finding of gross negligence (now on appeal). The existing provision of \$3.5bn assumed negligence which is unlikely in our view. Still the recent sell off seems over done; market cap (\$123bn) now \$11bn under net assets (\$133bn H1 2014) pricing in the provision.

#### Key Risks to Price Target

- i) BP faces unknown final liabilities ref the US Dept of Justice/ Macondo spill that could reach in excess of \$18bn.
- ii) BP reserves and income statement are sensitive to its holdings of 19.75% of Rosneft a Russian oil major- BP is likely to be impacted by US sanctions on Russia.
- iii) Subject to oil market related risks, oil prices, royalty and tax regimes, nationalisation and seizure of oil assets in some countries and risks related to exploration and production.

### Carnival (CCL) BUY

Carnival Corp is a cruise line owner operator with brands, Carnival, Princess, Holland America, Cunard, AIDA, Costa, Ibero Cruises, P&O Cruises.

Company	Carnival Corp
Share Price	2180
Target Price	2400
52 Wk Hi/Low	£26/ £20.60
Shares O/S	216m
Market Capitalisation	£4.7bn
Avg Daily Volume	912k
Dividend Yield	2.75%

Source; Fidessa plc

#### Key Catalysts

Q3 2014 saw operating margins rise to 26.23% from 20.12% helped by falling fuel prices, a trend for FY14. The Fuel Conservation Program – expected to save \$2.4bn in costs is an encouraging tailwind for Carnival.

Carnival is also seeing top line revenue growth \$12.16bn v \$11.8bn at the nine month stage. Relatively strong pricing power and the demographic positives are in evidence.

#### Key Risks to Price Target

- i) Carnival's cruise liners are high maintenance assets with high rates of depreciation and impairment.
- ii) Carnival suffered reputational loss after the Costa Concordia disaster which entailed loss of life
- iii) Carnival is sensitive to US discretionary spending trends, the ageing demographic and fuel costs.

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### GSK (GSK) BUY

GSK is a leading global pharmaceutical company specialising in oncology, HIV, respiratory, cardiovascular, vaccine and consumer goods.

Company	GSK
Share Price	1336
Target Price	1600
52 Wk Hi/Low	1690/1324
Shares O/S	4.85bn
Market Capitalisation	£64.79bn
Avg Daily Volume	6.1m
Dividend Yield	6.04%

Source; Fidessa plc

#### Key Catalysts

Q3 2014 on 22nd October should clarify the next step post the China fine (\$500m) September 19<sup>th</sup> and GSK's bribery conviction.

The interims made clear GSK sees FY14 as "broadly similar to FY13" but investors are concerned over the potential for further slippage. The reversal to near 52 week lows should reward patient holders with Q3 also expected to see more clarity on the GSK pipeline.

#### Key Risks to Price Target

- i) GSK business risks include concentration on the performance of key drugs and litigation risks.
- ii) GSK recent sales performance has been weak with sales declines in its major territories.
- iii) GSK asset swap with Novartis could be subject to regulatory restrictions.

### HSBC (HSBC) BUY

HSBC is a top financial institution, headquartered in the UK with its core businesses in the UK and Hong Kong.

Company	HSBC
Share Price	619
Target Price	700
52 Wk Hi/Low	703/589
Shares O/S	19.18bn
Market Capitalisation	118.7bn
Avg Daily Volume	18.5m
Dividend Yield	4.79%

Source; Fidessa plc

#### Key Catalysts

Our expectation is for HSBC to rethink the share buyback (ditched for 2014) but left open for 2015. We are expecting 2014 dividend to be 52 cents. HSBC's recent US settlement of \$550m (mortgage bond mis-selling) despite the fact the securities sold never missed a coupon or capital payment looks very odd in our view. Our expectation is for further impairment decline, alongside higher net interest margins as boosting HSBC looking ahead 6-12 months.

#### Key Risks to Price Target

- i) HSBC core franchise in Hong Kong could be impacted by significant popular unrest directed against the China installed government.
- ii) Risks include litigation and fines stemming from HSBC's ownership of the Household franchise in the USA, PPI mis-selling and capital markets activities including LIBOR.
- iii) HSBC withdrawal from smaller countries and repositioning is underway but will result in a smaller global footprint.

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### Unilever (ULVR) BUY

Unilever is a leading consumer goods company operating in personal care, foods, refreshment and home care. Unilever brands include Hellmanns, Flora, Ben & Jerry, Magnum and Persil.

Company	Unilever
Share Price	2465
Target Price	2700
52 Wk Hi/Low	2729/2306
Shares O/S	1.283bn
Market Capitalisation	31.65bn
Avg Daily Volume	2.22m
Dividend Yield	3.72%

Source; Fidessa plc

#### Key Catalysts

A multiple reversal back to 19.9x from 22x reflects concerns over end retail demand in core markets and a slower Asia Pacific/ emerging market. Ahead of the key Q4 period and with prelims on 21<sup>st</sup> January 2015 expectations have been lowered. However trading should not obscure the benefits of the Slim Fast exit and re-positioning that saw profit grow €400m to €2.82bn at H1. The reversal present a reasonable entry into a very solid performer.

#### Key Risks to Price Target

- i) Unilever €2.5bn pension liability is sensitive to movements in discount rates.
- ii) Unilever trading performance is sensitive to competitive, supply chain and demand factors.
- iii) Unilever is seeing debt levels rise, due to higher capital spending / promotional activity.

### Vodafone(VOD) BUY

Vodafone is a leading telecommunications group with significant presence in EU, Middle East, Africa and Asia Pacific.

Company	Vodafone
Share Price	187
Target Price	220
52 Wk Hi/Low	252/184
Shares O/S	26.5bn
Market Capitalisation	49.58bn
Avg Daily Volume	52.5m
Dividend Yield	5.96%

Source; Fidessa plc

#### Key Catalysts

Vodafone guidance for 2015 EBITDA £11.4bn-£11.9bn is the post Verizon split expectation and achievable in our view. Vodafone is investing heavily via Project Spring and other 4G spectrum acquisitions which will only abate by 2016. Ahead of 2015 interims on 11<sup>th</sup> November the short term outlook remains very closely aligned with Vodafone's potential vulnerability to an acquisition approach – and its attractions to a US operator as a one stop shop.

#### Key Risks to Price Target

- i) The slowdown in large EU economies is likely to impact Vodafone's EU operations and increase competitive pressures.
- ii) Vodafone remains overexposed to voice communications and needs to increase its revenues from data services
- iii) Vodafone valuation is sensitive to perceptions of the company as an acquisition target.

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**HOLD:** The company’s valuation appears to reflect investor expectations in the short-term. Alternatively the company is awaiting key developments that will impact on the share price. Investors are advised to await the resolution of these key developments.

**SELL:** The company’s valuation appears too high having regard to material uncertainties, declining profit prospects or has sizeable funding requirements. A sell recommendation may also be applied where the board have failed in key objectives or appear to be frequently changing strategy. A sell recommendation means the analyst expects the share to fall to the price target on the note.

**NEUTRAL (Not Rated):** The analyst does not maintain a view in either direction.

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Please be aware that the following disclosures of Material Interests are relevant to this research note:

**Aviva, Bankers Investment Trust, BP, Carnival Corp, GSK, HSBC, Unilever, Vodafone**

**Relevant disclosures: < 2>**

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