Warrants Alert

July 2018

INDEPENDENT ADVICE ON UK WARRANTS - PUBLISHED SINCE 1989

England's 6-1 thrashing of Panama in the FIFA World Cup had little chance of translating into a great feel-good factor to boost the domestic stockmarket, which is focused on international tensions at present. Markets seem obsessed for now with the spectre of global protectionism. President Trump's escalation of trade barriers with China in particular has caused some investors to take some risk off the table, but there has been no concerted sell-off to concern us unduly. Fund managers we have spoken to in the last month say the trade war may well have some selective impact in certain industries, but overall they do not believe it will have far-reaching consequences for the massive economies involved. That leaves us free to continue seeking out detailed analysis of individual opportunities, which we do this month with reports on a presentation by the manager of **Fidelity Asian Values,** the impact of two-way fund flows in the uranium market, important for **Geiger Counter,** and the valuation of small-cap mining shares held by **Golden Prospect Precious Metals.** And if we can finish in the same country where we began, if you are puzzled by the apparent disappearance of **Raven Russia,** we explain that too.

MARKET STATISTICS

Apart from the anticipated expiry of six covered warrants on the **FTSE 100 Index,** there were no changes of note in the average market statistics during the month. If pushed, we could say that corporate warrants became marginally more expensive from a very low base as some warrants held their ground while their underlying shares dipped in value slightly, but this sector still looks very cheap to us. It is quite reasonable that as both the corporate warrants and covered warrants markets have contracted, so has the level of investor interest. As we have noted on numerous occasions though, the fact that most investors are completely ignoring this sector means that price anomalies can both arise and persist, creating real opportunities for those left behind. Just consider the remarkable 176.6% rise in **Gresham House** warrants (GHEW) over the last year if you need some evidence. A year ago they looked good value on a CFP of 6.42%, and they look even better technical value now.

Warning: you should not buy shares or warrants with money you cannot afford to lose. This newsletter is intended for UK investors. This warning notice draws your attention to some of the high risks associated with warrants. The risks attaching to instruments and transactions of this kind are usually different from, and can be much greater than, those attached to securities such as shares, loan stock and bonds, such transactions often having the characteristics of speculation as opposed to investment. Warrants may involve a high degree of 'gearing' or 'leverage'. This means that a small movement in the price of the underlying asset may have a disproportionately dramatic effect on your investment. A relatively small adverse movement in the price of the underlying asset can result in the loss of the whole of your original investment. Moreover, because of the limited life of warrants, they may expire worthless. A warrant is a right to subscribe for shares, debentures, loan stock or government securities, usually exercisable against the original issuer of the securities. Because of the high degree of gearing which they may involve, the prices of warrants can be volatile. Accordingly, you should not buy warrants with money you cannot afford to lose. You run an extra risk of losing money when you buy shares in certain smaller companies including 'penny shares'. There is a big difference between the buying price and the selling price of these shares. If you have to sell them immediately, you may get back much less than you paid for them. The price may change quickly, it may go down as well as up, and you may not get back the full amount invested. It may be difficult to sell or realise the investment. Because of the volatile nature of the investment, a fall in its value could result in your recovering nothing at all. Changes in rates of exchange may have an adverse effect on the value or price of the investment in sterling terms. As with other investments, transactions in warrants, shares, and investment trusts may also have tax consequences and on these you should consult your tax adviser. Securitised Derivatives: these instruments may give you a time-limited right to acquire or sell one or more types of instrument which is normally exercisable against someone other than the issuer of that investment. Or they may give you rights under a contract for differences which allow for speculation on fluctuations in the value of the property of any description or an index, such as the FTSE 100 Index. In both cases, the investment or property may be referred to as the "underlying instrument." These instruments often involve a high degree of gearing or leverage, so that a relatively small movement in the price of the underlying investment results in a much larger movement, favourable or unfavourable, in the price of the instrument. The price of these instruments can therefore be volatile. These instruments have a limited life, and may (unless there is some form of guaranteed return to the amount you are investing in the product) expire worthless if the underlying instrument does not perform as expected. You should only buy this product if you are prepared to sustain a total loss of the money you have invested plus any commission or other transaction charges. You should consider carefully whether or not this product is suitable for you in light of your circumstances and financial position, and if in any doubt please seek professional advice. 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Corporate Warrants		Covered Warrants	
Average Warrant Price:	25p	SG Issues:	52
Average Premium:	6.13%	Calls:	49
Average Final Exercise Date:	9th December 2020	Puts:	3
Average Gearing Factor:	5.3 times	Average Final Exercise Date:	17th March 2019
Average Capital Fulcrum Point:	3.00%	Median Effective Leverage:	6.11 times

June was a fairly quiet month for most corporate warrants, although we did see a fall of a third in **Landscape Acquisition Holdings** warrants (LAHW), down to a mid-price of US$0.40 each (US$1.20 for three warrants, needed to exercise into one share). We suspect we may not see much more movement now, until there is some news from this cash shell, which listed last November.

CORPORATE WARRANTS - MAJOR PRICE CHANGES

One Month

Rises

Fidelity Asian Values	+11.8%
Geiger Counter	+6.3%

Falls

Landscape Acquisition	-33.3%
Ground Rents Income	-17.9%

Three Months

Rises

Fidelity Asian Values	+54.1%
Gresham House	+50.3%
Geiger Counter	+21.7%

Falls

Ground Rents Income	-54.3%
Landscape Acquisition	-33.3%
Golden Prospect Precious	-7.4%
Myanmar Investments	-5.9%

Twelve Months

Rises

Gresham House	+176.6%

Falls

Ground Rents Income	-74.5%
Fidelity Asian Values	-18.6%
Raven Russia	-17.6%
Myanmar Investments	-5.9%

COVERED WARRANTS MONTHLY MOVERS

In the covered warrants market there were not too many bright spots around for FTSE 100 giants this time around, with many stocks falling over the month. Banks were hit, with **Lloyds Banking** shares down by more than 7% to £0.612. The **SL29 Lloyds 0.985 Lloyds 18-Dec-20 calls** were down by 11% and the further out-of-the-money **SL07 Lloyds 1.231 18-Dec-20 calls** dropped by 26%. A small chink of light came from **Tesco,** which was a relatively strong performer, up by 5.4% to £2.58, dragging the rather optimistic **SL01 Tesco 4.00 21-Dec-18 calls** up by 4.8%, but **Whitbread** shares fell from £41.99 to £39.60, a drop of 5.7% that sent the highly-leveraged and out-of-the-money **SL05 Whitbread 60 21-Dec-18 calls** down by a thumping 59.71%. Observers have been keen to get an update on the likely spin-off of Costa Coffee, so a trading update released just as we go to press was eagerly awaited. For the first quarter of its 2019 financial year, Whitbread said that sales were ahead by 3.2%, with both Premier Inn and Costa UK contributing (although like-for-like sales were down in both cases). The release spoke of “good progress” in preparing Costa to be demerged. In April, Whitbread committed to demerge Costa from Whitbread as fast as practical and appropriate to optimise value for shareholders. The company says “constructive early steps have been taken

in preparation for the demerger and good progress continues to be made on the core infrastructure and efficiency work that was already underway. A further update on the demerger will be provided alongside the interim results in October 2018." That's it for now, and we suspect the SL05 covered warrants may be past their sell-by date by the time Whitbread really changes character.

WARRANTS ALERT TRADING PORTFOLIO (4)

After last month's big uplift, we are content enough to ride out a small retracement this month. The Trading Portfolio has slipped back by £320.43, or 2.24% over the month, but overall the return on this portfolio remains around 40%.

Holding	Type	Ticker	Number	Invested	Value Now	Change	% Change
Apple 150 21-Dec-18 Calls	Covered Warrants	SL36	1000	£2,072.50	£2,943.00	£870.50	42.00%
ETFS 2x Daily Long Ind Metals	Leveraged ETFs	LIME	500	£2,318.69	£2,500.00	£181.31	7.82%
Fidelity Asian Values	Subscription Shares	FASS	5000	£1,268.75	£1,250.00	-£18.75	-1.48%
Gresham House	Warrants	GHEW	3600	£2,906.90	£4,500.00	£1,593.10	54.80%
L&G FTSE 100 Leveraged (Daily 2x)	Leveraged ETFs	LUK2	5	£1,648.00	£1,600.00	-£48.00	-2.91%
Raven Russia	Corporate Warrants	RUSW	5000	£1,243.63	£1,000.00	-£243.63	-19.59%
Cash					£172.08		
TOTAL					**£13,965.08**		

After a big rise in May, June was not such a great month for **Apple** shares, which have retreated from US$187.90 to US$184.72, sending the **SL36 Apple 150 21-Dec-18 calls** down from £3.169 to £2.948. That's disappointing, but the warrants are still reasonably ahead of our stop-loss of £2.70, so we are still holding them for now. We saw an interesting argument for the shares on CNBC, based on the diminishing number of buy ratings on the stock from analysts. According to the research, brokerage and advisory firm Strategas, which tracks these ratings, this lack of love from analysts is actually a positive contrarian signal. The number of Wall Street buy ratings on Apple are at a decade low. "It means you want to own the stock. What we've seen historically is when you have good stocks making new highs, and analysts are downgrading them, it's often a sign of future strength to come," said Chris Verrone, head of technical strategy at Strategas Research. "The analysts are missing it. It reminds us of Microsoft in ... 2013 when the stock was just starting to work again, and analysts couldn't get their head around it." Apple's third quarter earnings are due to be announced during this coming month (July), so those could be the next catalyst for a share price movement.

The **LIME ETFS 2x Daily Long Industrial Metals** ETFs started the month well, rising from US$7.1725 to a touch over US$7.80, but the price has since retreated quite sharply as worries over trade wars have depressed sentiment. The price has remained well above our stop-loss of US$6.00, but it has slipped back to US$6.65 at the bid price. President Trump's aggressive trade policy aside, a strong US dollar has also been a headwind for commodity prices. Because pricing is in dollars, a stronger dollar makes commodities more expensive for the rest of the world, other things remaining equal. For this reason there is something of an inverse correlation, and the dollar has been strong, supported by the US being at the leading edge of the interest rate cycle. From 89 at the end of March, the dollar index (which you can find online with the ticker code DXY) has risen to 94.6, fairly close to its recent peak just over 95. One other factor in the metals markets is that June kicked off a new round of wage negotiations for miners in Chile, which can often prove fractious and cause supply outages. So far, this year seems calm, with workers at BHP's Spence mine already agreeing a new collective labour contract, although we understand that talks at the key Escondida mine are continuing and are yet to be resolved.

Our holding in **Fidelity Asian Values** subscription shares (FASS) rose again over the month, to within touching distance of break-even after accounting for the nasty dealing spread. We still believe these subscription shares offer outstanding technical value, and remain holders with a stop-loss on the mid-price edging up this month from 18p to 20p.

Gresham House warrants (GHEW) have stood still at 130p, which we think is excellent after a 44% rise last month. We have no reason to take action, or to change our stop-loss of 114p. Much the same applies to **Raven Russia** warrants (RUSW) at 21p, with a stop-loss of 17p.

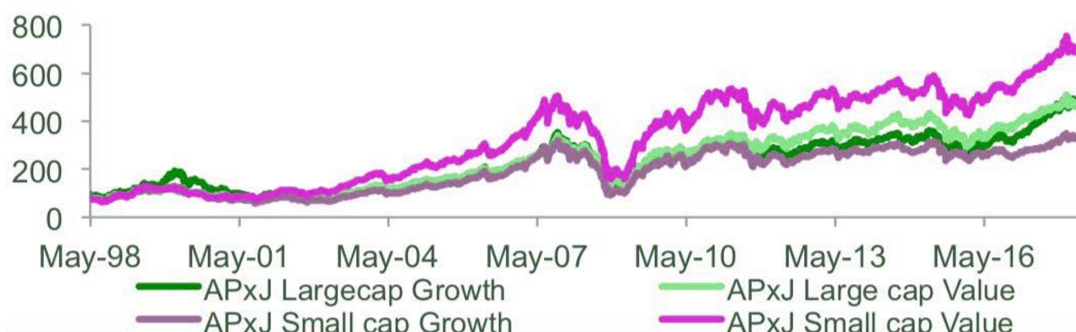
Last month we decided to buy into the **LUK2 L&G FTSE 100 Leveraged (Daily 2x)** product, which benefits from a tight dealing spread and no stamp duty. With the index at 7649 at the time, we bought five of the ETFs at £327.10 each, with no stop-loss. So far we have suffered a small loss, but as we said in the last newsletter, this holding is unlikely to be the most exciting or volatile – that is not the intention. The bid price now is £320, so we are just less than 3% down after modest dealing costs. We are not making any changes to the portfolio this month.

CORPORATE WARRANTS NEWS

We caught up with Nitin Bajaj, the manager of the **Fidelity Asian Values Trust,** at a conference in London a fortnight ago. You may remember that Nitin had a cracking start as manager when he first took on the trust five years ago, but more recently his lustre has faded. Over the last year the trust is ranked 13th out of 15 trusts in its geographical peer group, ranked by net asset value performance. We have explained before that Nitin is a high-conviction manager who is not afraid to be different to the market and his peers, and over recent months his relatively cautious approach has meant he has missed out on some growth opportunities exploited by others.

Fidelity Asian Values is very focused on small cap value, which Nitin admits has not really been in favour. Even so, he remains completely convinced this is the right place to be, for the simple reason that it has historically been the most profitable approach. Over the long-term he anticipates equity returns of 7%-8% from Asia, but with the opportunity for much higher returns from selected small caps. The 18,000 or so companies in this universe makes for a large opportunity set, and Nitin believes he can gain an edge with his dedicated and well-resourced team. He is supported by five dedicated small cap analysts covering Korea/Taiwan, China/Hong Kong, ASEAN, India, and Australia. "The opportunity is massive", Nitin says, explaining that smaller caps are under-researched. On occasions he meets companies that have never met a potential investor before, and he feels he should be able to outperform by more than 2% per year.

That's the argument for smaller companies, and for the value tilt, Nitin showed us a 20-year performance chart for Asian shares grouped into four categories, large cap growth, large cap value, small cap growth, and small cap value. The latter clearly delivered the best historic performance.



Asian share returns, May 1998-2018, grouped by style and size; source Fidelity International

This is perhaps not what many Asian investors would expect, as many would think of it as a region for growth, but Nitin says that growth industries attract capital and talent that in turn creates more competition, leading eventually to falling margins and profits. Instead, he tries to focus on industries that are not in fashion, so that performance is the outcome of focus and hard work. Nitin says "I have no interest in the stockmarket or in stocks", which sounds a little alarming until he continues, "I am interested in businesses." For him, his work is all about really understanding the businesses in which he might invest, which entails "research, research, and more research", he says. Nitin says that is the best risk management tool he has.

Fidelity Asian Values certainly isn't an index-tracker or even an index-hugger. Rather, the trust's portfolio is unconstrained, and Nitin looks for good businesses that he can understand, run by people he believes he can trust, and where he can buy at the right price too. He then backs this conviction with a substantial position, the largest at the end of May being 3.3% of assets in Power Grid Corporation of India. As a utility with a regulated business model this is far from a darling of the market, but it meets Nitin's criteria. It says a great deal about the trust that it is underweight in a number of well-known stocks such as Tencent, Baidu, Alibaba and Samsung. The other really important allocation is currently to cash, at 13.3% of the assets. This reflects Nitin's caution about current valuations, and again indicates his willingness to back his judgement with a position that may be significantly different to the peer group.

What is interesting to us is that in spite of a soft patch of performance – which must be expected for a trust that runs a high-conviction portfolio – Nitin is sanguine about performance, saying this should "take care of itself" over time. The market clearly feels the trust is worth supporting, as the shares are trading very close to net asset value, and that makes it all the more surprising that the subscription shares (FASS) appear to be so out of favour. Even after an 11.8% rise over the last month to 28.5p, they are lowly-valued with high gearing of 14.3 times for a CFP of just 2.71%. That does not look at all demanding.

We have kept on tracking the uranium price, important for **Geiger Counter** subscription shares (GCS), and note the latest price is around US$23.05/lb. That is up slightly from last month's US$22.575, continuing the recovery from the US$20/lb level.

Long-term (30-year) price chart for spot uranium; source The UXC Consulting Company LLC

One new factor that has arisen is the proposed flotation of a specific uranium investment company on the AIM in London. A company called Yellow Cake is seeking US$150m-US$200m for its IPO, backed by US$25m from the Canadian firm Uranium Royalty Corporation, with dealing expected to begin in early July. Yellow Cake intends to be a major holder of physical uranium (U3O8) and intends to generate value for shareholders across a spectrum of

activities relating to uranium, based on the fundamental premise that the commodity is structurally mispriced in the current market (with c.75% of the world's 2018 uranium production projected to cost more to produce per pound than the current uranium spot price). Yellow Cake says it will use its expertise to generate value through the ownership of physical U3O8 together with a range of activities and opportunities connected with owning physical U3O8, such as the trading of U3O8, optimisation of logistics associated with the trading of U3O8, generating revenue from the lending of physical U3O8 and uranium-based financing initiatives such as commodity streaming and royalties. In particular – and this seems to be the really key information for now - Yellow Cake has entered into a long-term supply contract with JSC National Atomic Company Kazatomprom, the world's largest, and one of the world's lowest cost, producers of uranium, under which Yellow Cake will purchase up to US$170m of U3O8 at US$21.01/lb, which will be stored in the Port Hope and Blind River facilities run by Cameco Corporation in Canada. Taking into account the company's working capital requirements, Yellow Cake may also purchase additional volumes of uranium by separate agreement with Kazatomprom or on the spot market in the event that the net proceeds from the offering exceed US$170m. The contract also carries the rights to future purchases of up to US$100m per year, with the ability to lock in the purchase price of U3O8 for a period prior to making the purchase.

At US$170m, this purchase of uranium would represent approximately one quarter of Kazatomprom's annual production (2016 marketed production, prior to Kazatomprom's recently announced production cuts as reported by the World Nuclear Association) and approximately 5% of 2016 global marketed production. This makes it very significant, and is another factor that should help to support future uranium prices. On the other hand, Yellow Cake is something of a competitor for Geiger Counter in terms of attracting speculative flows of capital targeted at a recovery in uranium. The two are different, because Geiger Counter's exposure is to other uranium-related stocks rather than directly into the commodity, but nevertheless, with Geiger Counter trading on a premium to its NAV, we worry that Yellow Cake may steal some of its thunder.

For now, Geiger Counter shares are on the rise, up by nearly 10% over the month to 21.8p, with the subscription shares up by 6.3% to 5.475p. It does not surprise us that the subscription shares have lagged the ordinary shares, as their high valuation is already discounting a great deal of growth. That remains true now, on a CFP of 25.83%, with gearing of 4 times.

Geiger Counter also released its half-year results during the month, for the six-month period to 31st March. This was a tough spell for the fund, which saw its NAV contract by 23% in spite of a slight rise in the uranium price over the period. The chairman's statement says it was "affected by the rebalancing of the Global Uranium ETF." Geiger Counter, remember, invests in uranium-related company shares, and the problem was that the US$367m Global X Uranium ETF, based in New York, rather outgrew its index and announced a change of investment policy as a result, shifting to a broader index, thereby reducing its exposure to small-capitalisation stocks in the sector. The managers say this saw technical selling of positions such as Nexgen, Geiger Counter's largest holding. Even so, the managers say they remain optimistic and believe the "deep value offered by equity investments in the sector offers significant investor opportunity." They say the low price of uranium has begun to achieve more investor recognition now with the launch of the physically backed uranium ETF, Uranium Participation, and the proposed IPO of Yellow Cake.

Around the time the last newsletter was being prepared, Rob Crayfourd, the co-manager of **Golden Prospect Precious Metals,** was giving his views on the outlook for the rest of the year, at the 121 Mining sector panel event. Rob acknowledged there are reasons for the lag in gold mining equities, which have performed poorly against the underlying metal. He says that even well-run companies have executed M&A poorly, buying at the top of the cycle and destroying capital, which is of course something that has concerned investors. He thinks 2018 could be an inflection year, after 2015 when "everyone thought companies were going to go bust, 2016 we had a relief rally, 2017 was more of a consolidation, and then we're going into 2018 and it's a bit of a 'show me' market – people want to see whether these companies can actually deliver, do they keep returning capital – and we've seen larger companies

generally focusing on paying down debt, increasing dividends, and as a result we have no greenfield projects coming through the pipeline. So we have a real shortage of new projects coming to add supply, and we can see demand looks generally pretty robust, so it looks like a tightening market, but the market still needs to see discipline."

At some point, shareholders will presumably want to see capital expenditure resume, but Rob says there are a couple of things that are very different from ten years ago, when we had the last build cycle. "Firstly, passive money has become a much bigger factor, which obviously focuses on larger cap, more liquid positions, so that's taken capital away from smaller cap equities, which is one of the reasons that we're seeing a bit of a shortage of equity funding. And also permitting – permitting, environmental regulations – the barriers to actually building new projects are also much higher. So whilst it's discounted the value of some of the smaller cap equities, I think they should actually be trading at a higher level because they've actually started off down that permitting process, drilled out to a certain degree, and as we've seen with a lot of companies now allocating capital to smaller cap explorers, they've actually found they are much better users of capital than the larger major cap companies."

Rob continues "as long as we keep seeing this capital discipline, whether that be dividends, buying back shares, or we see M&A, we aren't seeing any new projects being added, which just means we are extending that positive market, that tighter supply/demand type metric, so that it should extend a more positive outlook."

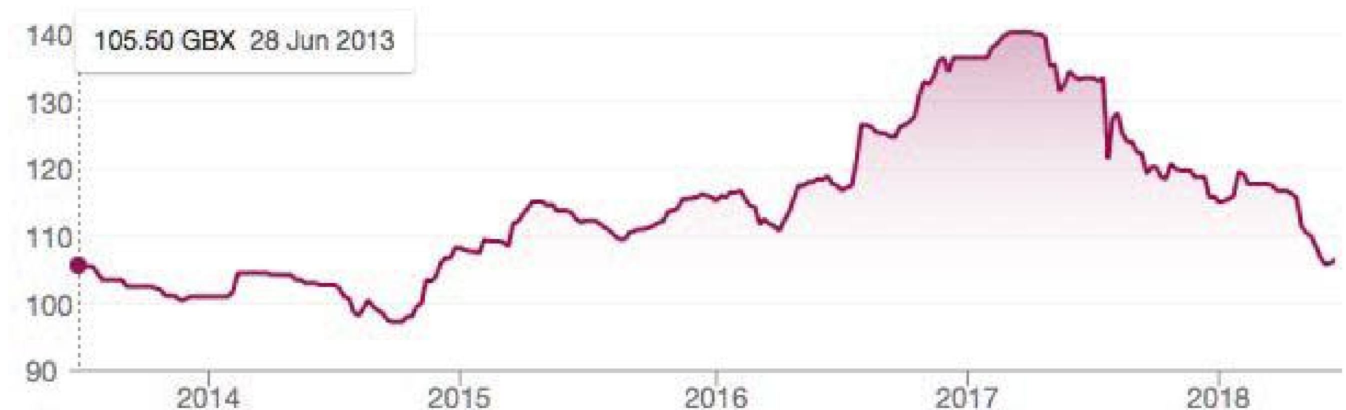
It hasn't been sensible over the last 20 or 30 years to own gold stocks, as they have not performed well and have de-rated, but Rob says we're at a point now where there is strong value in the sector, where instead of gold stocks trading at 2x NAV, some small caps are at a 50% discount. This, crucially, means that a higher gold price is not necessary. So while Rob is personally constructive on the gold price, he stresses that the trust does not need a higher gold price for a lot of the stocks, which stand up on their own. Looking forward, Rob says that because Golden Prospect Precious Metals is closed-ended, this gives him the luxury of being able to access less liquid stocks and to take a longer time frame. He hopes that perhaps some companies might merge, which could help valuations, which are much higher for the larger companies.

It sounds to us as though Golden Prospect shareholders might need some patience to sit and wait for valuations to improve, which might take time. The subscription shares (GPSS) do have some time, to November 2020, but the problem here is that they are already discounting a lot of future growth. The CFP of 29.18% is the highest in the market, and unless the shares really get motoring sooner rather than later, we think the subscription share price of 4.5p is vulnerable to time value erosion.

Simon Thompson, the companies editor at the Investors Chronicle magazine, has recommended **Gresham House** warrants (GHEW), and has a 177p price target for them. We certainly think the warrants ought to participate in any further rises for the underlying shares, as their premium is modest at 130p, with 118.73p of intrinsic value. Gearing is 3.4 times for a CFP of 2.37%. The company, meanwhile, continues to build out its executive team, most recently appointing Heather Fleming, formerly at Fidelity, to the newly created role of Head of Institutional Business. She said "I am very pleased to join Gresham House and look forward to working closely with the existing team to help drive institutional fundraising and deliver the next phase of growth. Local authority and corporate pension schemes are increasingly allocating more of their capital to alternatives assets, and Gresham House's specialist alternative strategies are ideally placed to meet this demand by generating appealing returns in a cost-effective manner from illiquid investments including infrastructure, housing, forestry, private equity, and renewables."

Ground Rents Income Fund has released its interim results for the six months to 31st March, showing a net asset value of 123.4p, fully diluted, down around 4% over the period. This was due to a portfolio devaluation, the latest punch to a company on the ropes after the 'doubling grounds rents' scandal that erupted quite suddenly last year. The company was largely a victim of collateral damage, as it was the builders of new houses that were the main

protagonists here, and the fund only had a relatively small number of problem ground rents that it seemed to deal with fairly and swiftly (although its process will not complete until next year). The fund has limited exposure to leasehold houses. Of the total number of units in the portfolio 15% are houses, which generate only 11% of total ground rent income. None are subject to perpetual 10-year doubling review patterns, which have attracted some recent focus in the media. Furthermore, the fund has no exposure to perpetual doubling ground rents and only minimal exposure to 10-year doubling assets, which account for only 4% of total ground rent income. These three assets double a maximum of three times before reverting to having either no further review or an indexed-linked review cycle.



Ground Rents Income ordinary share price, five years to June 27th 2018; source Google Finance

Even so, the reputation of the sector was clearly sullied, reducing demand and pricing, knocking both the trust's net asset value and the level of discount on which the shares are trading. At 106p, the shares are back to where they stood five years ago and on a 14.1% discount to the fully diluted NAV, whereas they would trade around NAV before this scandal. Many investors would obviously prefer now to simply leave it alone. James Agar, Investment Director of Brooks Macdonald Funds, Investment Adviser to the fund, said "while the group continues to provide secure, upward-reviewing income from a large diversified portfolio, we believe current trading in the group's shares and the subsequent price discount to net asset value is largely based on investor sentiment towards the ground rent sector, given the government's proposed leasehold reforms. We welcome the government's aims to reform and simplify many aspects of property legislation as we believe that a system is needed that delivers a more equitable, transparent and better service for homeowners. Ground rent reviews, as well as additional revenues generated by our active asset management of the portfolio, has enabled the group to continue to deliver its target of at least maintaining the annual dividend per ordinary share, while working towards full dividend coverage in the next four years." The company is still buying ground rents and making further acquisitions, presumably at more attractive yields now, using its £19.5m credit facility. James Agar finishes his review on a positive note as well, saying "the income premium for ground rents over these comparably-defensive instruments continues to look attractive, given ground rents' secure, upward-only-reviewing income streams."

The problem is that soured sentiment can take a long time to repair, given that grounds rents will not be central to many investors' requirements, and we think the comparatively wide discount may well persist for some time, while new legislation is implemented. For now, the fund is focused on maintaining, rather than growing, its dividend, which at 3.92p per year provides a yield of 3.7% on the current ordinary share price. That's not bad, but it's not too difficult to find yields of 4%-plus in the property sector that arguably have less sentiment-driven risk, so we don't feel the yield in itself is sufficient to attract investors and close that gap to NAV. Accordingly, we are not greatly enthused about the warrants (GRIW) at 8p, in spite of what looks like a cheap technical valuation, with high gearing of 13.3 times and a CFP of just 0.48%.

Myanmar Investments said that 202,905 warrants (MILW) were exercised under the original exercise terms, with the strike price of US$0.75, for the period ending on 21st June 2018. This leaves 15,143,602 warrants in issue. Under the new terms, with an exercise price of US$0.90 and a final expiry date of 31st December 2021, gearing is 3.5 times for a CFP of 2.50%. That is decent technical value, but we have issues with the underlying fund, the liquidity, and the dealing spread that mean it is unlikely to become a recommendation.

Raven Russia has changed its name to **Raven Property Group,** changing the ticker codes for the shares to RAV and for the warrants to RAVW. The terms of the warrants remain the same. This change crept up on us, we must admit, as it was not flagged in the annual results, and we cannot find very much information about the reasons for the change at all. In the details of the AGM there is a single line saying that the proposal was being made "after discussion with major shareholders", but that's it. We can only assume the company was finding the name was not helping its rating, or else that it may have future plans to spread its wings, geographically.

Ironically enough, we would say that Russia's international reputation is undergoing a period of rehabilitation now, helped by the FIFA World Cup, which is presenting the country in a good light so far. The Financial Times also reported "there is increasing optimism about the World Cup host." An article last week cited several enthusiastic fund managers who like Russian stocks on cheap ratings following sanctions applied this year. These managers point to the economic cycle, falling share prices as a result of geopolitical unrest and swingeing sanctions, and the high income that many Russian stocks produce. The article says that Russia is currently the 'bargain basement' of the emerging market sector, with its stocks among the cheapest of any in emerging markets on average. Its stocks trade on an average P/E ratio of 6.5 times compared with 18.5 times for global equities, according to Bestinvest, with a much higher dividend yield as well. A new OPEC agreement that has helped to support the oil price is also a big prop, as Russia's economy is quite heavily dependent on oil production. Separately, new research from JPMorgan Cazenove's emerging markets strategy team finds that fund managers have increased exposure to Russia. Their data showed that net overweights in Russia increased from 15 to 21 (out of a sample of 55 funds). Russia remains the highest net overweight market in the emerging markets universe.

This is all fairly incidental to Raven Property Group and its warehouses, but it is perhaps reassuring that many other shrewd investors are quite happy to invest in Russia, where the political noise does not prevent some good profitable trading.

TECHNICAL MERIT

This 'technical merit' section is devoted to a brief overview of some of the corporate warrants that have been highlighted by our computer model as undervalued or overvalued. We should just stress that this valuation is not based upon a full analysis, but solely upon 'technical merit' - ie: premium, time to expiry, capital fulcrum point and gearing factor. Our undervalued selections have outperformed our overvalued selections in 284 out of 344 months to date, an 83% success rate.

Undervalued Warrants	Ticker	Shares	Warrants	Exercise	Expiry	Premium	Gearing	CFP
Fidelity Asian Values	FASS	406.5	28.5	392.75	30-Nov-19	3.63%	14.3	2.71%
Gresham House	GHEW	442	130	323.27	31-Dec-19	2.55%	3.4	2.37%
Ground Rents Income	GRIW	106	8	100	31-Aug-22	1.89%	13.3	0.48%
Myanmar Investments	MILW	US$1.225	US$0.40	US$0.90	31-Dec-21	6.12%	3.1	2.50%
Raven Russia	RUSW	46.2	21	25	25-Mar-19	-0.43%	2.2	-1.06%

Performance last month: average change -1.22% (1 rise out of 5 selections).

__Overvalued Warrants__

We consider the following warrants to be overvalued on technical grounds, so if you are interested in the following companies then we would suggest the shares rather than the warrants (capital fulcrum points in brackets): Geiger Counter (25.83%); Golden Prospect Precious Metals (29.18%).
Performance last month: average change -9.00% (1 rise out of 3 selections).

TECHNICAL MERIT FOR COVERED WARRANTS

Most call covered warrants fell in value last month, but the 'technically interesting' selections did just edge ahead of the 'technically unsuitable' covered warrant picks. The technically interesting selections have now outperformed the technically unsuitable warrants in 38 out of 49 months, a 78% success rate.

Technically Interesting Covered Warrants

EPIC	Underlying	Type	Strike	Expiry	Parity	Underlying	Bid	Ask	Mid	Delta %	Leverage	CFP
SC19	FTSE 100	Call	7,450	21/09/2018	1000	7547.81	0.2160	0.2180	0.217	51.96	17.98	7.16%
SL29	LLOYDS	Call	0.985	18/12/2020	0.9846396	0.614	0.0070	0.0270	0.017	14.77	3.40	22.38%
SD64	MAN GROUP	Call	1.5	21/12/2018	1	1.7975	0.3630	0.3720	0.3675	76.33	3.71	10.41%
SF87	RIO TINTO	Call	40	21/12/2018	10	40.89	0.4840	0.4930	0.4885	56.61	4.70	24.36%
SL53	SHELL (RDSB)	Call	25	21/12/2018	10	26.49	0.2450	0.2520	0.2485	60.50	6.36	8.78%

Performance last month: 0/7 risers, average change -23.37%

Technically Unsuitable Covered Warrants

EPIC	Underlying	Type	Strike	Expiry	Parity	Underlying	Bid	Ask	Mid	Delta %	Leverage	CFP
SD22	EASYJET	Call	24.366	21/12/2018	0.9746589	17.29	0.1550	0.1600	0.1575	8.89	9.84	107.38%
SC21	FTSE 100	Call	8,300	21/09/2018	1000	7547.81	0.0070	0.0170	0.012	4.57	20.28	51.30%
LC52	HSBC	Call	10	21/12/2018	1	7.045	0.0410	0.0460	0.0435	6.83	10.47	109.31%
SD47	HSBC	Call	8	21/12/2018	1	7.045	0.2440	0.2510	0.2475	29.07	8.17	40.15%
SF83	MAN GROUP	Call	2.5	21/12/2018	1	1.7975	0.0310	0.0360	0.0335	14.27	7.17	105.98%
SD66	PRUDENTIAL	Call	19.848	21/12/2018	9.9245732	17.59	0.0860	0.0900	0.088	34.68	6.81	42.73%
LC56	RIO TINTO	Call	50	21/12/2018	10	40.89	0.1530	0.1580	0.1555	25.85	6.69	64.40%
SD86	SHELL (RDSB)	Call	40	21/12/2018	10	26.49	0.0050	0.0250	0.015	5.49	5.81	137.68%
SL01	TESCO	Call	4	21/12/2018	1	2.5815	0.0120	0.0320	0.022	7.48	6.03	152.24%
SL05	WHITBREAD	Call	60	21/12/2018	10	39.6	0.0180	0.0380	0.028	6.66	6.91	140.07%

Performance last month: 1/10 risers, average change -24.84%

LEVERAGE EXCHANGE TRADED PRODUCTS

Although the results do not vary hugely in each issue, we still think it is a useful exercise to check on the weekly trading data for ETFs on the London Stock Exchange to see which leveraged ETFs are most actively traded. This can provide a feel for which are most popular, most mainstream, and perhaps provide a handy shortlist if you are thinking of making a first foray into this sector.

Top of the list as usual is the **SUK2** 2x short product on the **FTSE 100 Index,** but note the name is now the **SUK2 L&G FTSE 100 Super Short Strategy,** as it is under the umbrella now of Legal & General Investment Management, arguably making it even more mainstream than before. This branding may help to reassure some sceptical investors that this is a completely legitimate product that can easily form a part of sensibly-constructed investment portfolios. For now – and we get the impression the acquisition of these ETFs was just the start – L&G has six leveraged ETFs, the **DEL2 L&G DAX Daily 2x Long UCITS ETF (€); DL2P L&G DAX Daily 2x Long UCITS ETF (£); LUK2 L&G FTSE 100 Leveraged**

(Daily 2x) UCITS ETF (£); DES2 L&G DAX Daily 2x Short UCITS ETF (€); DS2P L&G DAX Daily 2x Short UCITS ETF (£); and the **SUK2 L&G FTSE 100 Super Short Strategy (Daily 2x) UCITS ETF (£).**

The SUK2 leveraged ETF was traded 440 times during the week ending 23rd June, and is always a popular choice for hedging against UK holdings, or speculating on a fall in the domestic market. The costs of dealing are crucial here, and they are very low. Let's take a look at just how small a move in the market is required for you to move into profit on a SUK2 trade. As we write, the market price for these leveraged ETFs is 778.1p-778.4p, and there is no stamp duty payable on these products. If we assume your investment size is £5000 and your broker charges £10 per trade, how many points must the FTSE 100 Index fall for you to cover your dealing costs? Let's consider a purchase of 641 units at 778.4p, plus the £10 dealing charge, which takes us to an overall cost, all in, of £4999.54. To come out with a profit requires the bid price to move up to 778.4p plus our in-and-out cost of £20, which means it must move up to 781.5p on the bid (selling) price. That requires a movement of 0.437% in the leveraged ETF, and because that amplifies daily movements in the FTSE 100 Index two times, that means a movement in the FTSE 100 Index of 0.2185%. With the index currently at 7607, that in turn implies a movement of 16.6 points, which is not a big move. That's how big an index movement in your favour (a fall in the index) is required before you move into profit. If we re-work the figures for an investment of £10,000, that required index movement falls to just 9.3 points, so the point here is that this product can provide a very efficient way of dealing, with minimal costs, allowing you to take a simply leveraged position on the FTSE 100 Index, in sterling, on the London Stock Exchange, with a minimum of fuss. It is worth remembering too that leveraged ETFs can be put into SIPPs and ISAs, unlike warrants and covered warrants, so that is again a potentially big plus, especially if you want to trade actively, thereby crystallizing profis and losses and creating tax paperwork if held outside a wrapper.

If you're thinking of hedging against a market fall, some recent opinions publicised by large hedge fund managers might provide encouragement. Bloomberg has reported that Greg Coffey, a former star manager at Moore Capital Management who started trading at his own firm this year, is comparing the turmoil in May to the end of dotcom bubble in 2000. Horseman Capital Management's Russell Clark, one of the most bearish hedge fund managers in Europe, has also invoked memories of the financial crisis of 2008 in a letter to clients. Bloomberg say these two managers are among the best-known in Europe (although not to us, we must admit), and they join a growing chorus of investors predicting an end to the decade-old rally in asset prices, as central banks move to normalise policies and the rise of populism threatens trade across the globe. The article says billionaire George Soros in May warned of a looming financial crisis and an existential threat to the European Union. Crispin Odey has for years expected a market crash and lost money betting on it. "The ghosts of 2000 are upon us," Coffey wrote in a May investors letter for his Kirkoswald Capital Partners. "Make no mistake, this is the current investment environment we are in, and will be through 2018." Clark, whose firm oversees US$1.2bn, wrote that the current market patterns remind him of 2008. Margins and valuations are high, while commodities and interest rates are rising. Momentum strategies and exchange traded funds are herding ever more money into assets that worked up to now, such as technology, even as the fundamentals begin to deteriorate.

Of course there will always be opinions in both directions – that's the nature of markets – and Philippe Ferreira, a Paris-based senior cross-asset strategist at Lyxor Asset Management, is quoted in the article saying "since the global financial crisis, the number of doomsayers has risen exponentially, but aside from political risks, the global economy is doing well." That is the perspective we obtain ourselves from our frequent meetings with investment trust managers for our sister Investment Trust Newsletter, but that's not to say we might not experience a bumpy ride along the way.

After the SUK2 product, the next most actively traded leveraged ETF over the week was its sister product, the **LUK2 L&G FTSE 100 Leveraged Daily 2x**, traded 195 times. This was followed by the **XT2D X S&P 500 2x Inverse Swap,** traded 127 times, and the **XS2D X S&P 500 2x Leveraged Swap,** traded 64 times.

Turning to the ETC's, those classified as exchange-traded commodities, there was a lot of interest in these with 836 trades during the week in the **3OIL Boost WTI Oil 3x Leverage Daily ETP** and 259 trades in the **3OIS Boost WTI Oil 3x Short Daily ETP.** Staying in the energy sector there were also 333 trades in the **3NGS Boost Natural Gas 3x Short Daily ETP.** The oil market was enlivened last week by a new OPEC output deal in Vienna, and there was news as well of a break in output at the Syncrude oil sands facility in Canada that has tightened supplies in North America.

WTI Crude Oil price, one year to 27th June 2018; source macrotrends.net

Away from energy, we were interested to see there were 467 trades during the week ending 23rd June in the **PUS5 ETFS 5x Short USD Long GBP** product. The sterling/dollar exchange rate currently stands at US$1.3250, well down from its level of US$1.43 in April and not far off its recent low of US$1.317 on 20th June. Sterling has been persistently weak as the Brexit drama has continued, with new problems seemingly arising on a weekly basis. The uncertainty is wearing, and some companies have been making fresh noises about withdrawing investment from the UK. BMW and Airbus have been in the news. More broadly, Reuters reported on a survey conducted by law firm Baker & McKenzie showing that Britain's exit from the European Union (EU) has led nearly half of big companies from the rest of the bloc to cut investment in the country. The survey found that three-quarters of bosses wanted Brussels to make concessions to Britain to secure a better trading relationship after it leaves the EU in early 2019. There was also a majority view that business leaders had not been properly consulted, or their views taken into account, by the EU negotiating team as it tries to hammer out a post-Brexit trade deal. Two-thirds of respondents said they wanted a free-trade deal while 45% were in favour of a customs union, Baker & McKenzie said. There is a great deal of unease about what the near-term future might hold, and the market consensus seems to be that this should keep a lid on sterling, as it is difficult to build a strong case for backing the pound ahead of so many potential pitfalls. Against that background it is slightly surprising to see so many trades in the long sterling PUS5 product. Equally, though, some analysts feel this might not be the time to be backing further momentum movement to short sterling – we read that Commerzbank believes now is the time to exit GBP/USD shorts, and Lloyds also says that recent price action could be suggestive of a base forming. Many trades in the currency markets are very short-term in nature, and probably that's where the action is likely to be now, as we cannot see a clear reason for a major shift in one direction or the other.

In terms of interest rate differentials, we don't see much support for sterling here either. News reports about the new member of the Bank of England's monetary policy committee (MPC) that is responsible for setting interest rates, suggest that Professor Jonathan Haskel may be less inclined to support near-term interest rate rises in the face of

weak wage growth. “The immediate takeaway is that the MPC is replacing a hawk with a dove,” JPMorgan economist Allan Monks said. Hawks, in this sense, are focused on keeping inflation low and conditions tight, inclined towards higher interest rates; whereas doves take a more balanced view and want to allow room for economic expansion, preferring lower interest rates.

GBP/USD exchange rate, one year to 27th June 2018; source xe.com

The smaller market for exchange-traded notes (ETNs) often has less trade, but in this case there was some active two-way trading in the **3ITS Boost FTSE MIB 3x Short Daily,** traded 263 times, and the **3ITL Boost FTSE MIB 3x Leverage Daily,** traded 165 times. This Italian index had a big fall in late May on political developments, and has since been trying to stabilise and find a new level, currently at 21,612. It might not succeed if the political support for the far-right League party continues to climb, and for what it is worth we found a less-than-bullish forecast on the Trading Economics website. It says “the Italy Stock Market (FTSE MIB) is expected to trade at 21478.05 points by the end of this quarter, according to Trading Economics global macro models and analysts expectations. Looking forward, we estimate it to trade at 19241.12 in 12 months time.”

FTSE MIB Index, one year to 27th June 2018; source TradingEconomics.com

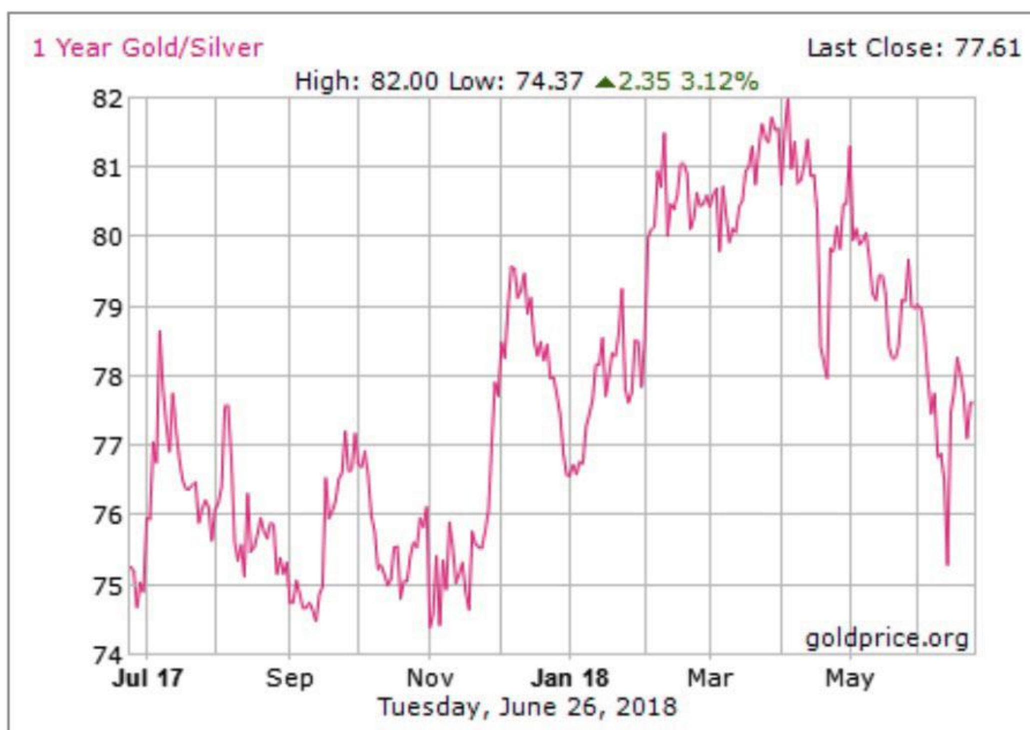
There has also been good two-way trade in another index pair, the **QQQ3 Boost Nasdaq 100 3x Leverage Daily ETP,** traded 157 times during the week; and the **QQQS Boost Nasdaq 100 3x Short Daily ETP,** traded 153 times. The Nasdaq was one of the best performing world indices during the first half of the month, bolstered by continuing demand for the major technology giants, until reports of potential US trade restrictions on Chinese investment in technology companies reined in investors' enthusiasm. Following on from a 25% tariff on a range of Chinese high-tech goods, President Trump is reportedly set to announce further trade restrictions, this time on the ability of Chinese companies to buy US companies involved in technology considered to be significant. Trade wars are known to destroy value – the free trade model is widely accepted as the optimal outcome – so whilst some fund managers are sanguine about the impact, emphasising its limited nature, there is a broader negative effect on sentiment and how investors feel about the economic outlook. Markets took fright last Monday, driving the price of the **VILX Boost S&P 500 VIX Short-Term Futures 2.25x** ETNs up by 31% on the day as the VIX Index rose from its previously low levels.

CBOE VIX Index, one year to 27th June 2018; source CBOE

TRADING IDEAS

Let's revisit the **gold-silver ratio,** which we have featured a few times in past newsletters. We have been expecting it to fall from what looked like an elevated level in historic terms. You may remember the multiple – which measures how many ounces of silver are required to buy one ounce of gold - was around 82x at the start of April, but it has since fallen back to 77.61x. This is not very different from when we first mooted this trading idea in February, but it might still be interesting to see what has happened to the pairs trade since then.

We suggested combining a long silver position with a short gold position, which would in principle isolate their relative value as the driver of returns. Both gold and silver prices are lower since then, but that should not matter in itself, as the loss on one side of the equation should be balanced by a gain on the other side. The **3LSI Boost Silver 3x Leverage Daily ETP** has dropped from £2.5395 to £2.1275, a fall of 16.2%, but we would hope to be more than compensated for that fall by a rise in the **3SGO Boost Gold 3x Daily Short ETP.** It has risen from £66.78 to £86.08, a rise of 28.9%, providing a modest profit on the trade overall. We calculate that if you had put an equal amount of capital into each, you would be up by 6.3% now – a small gain, but a gain nonetheless, and one that we think might well rise over coming months.



Gold/Silver Ratio, one year to 27th June 2018; source goldprice.org

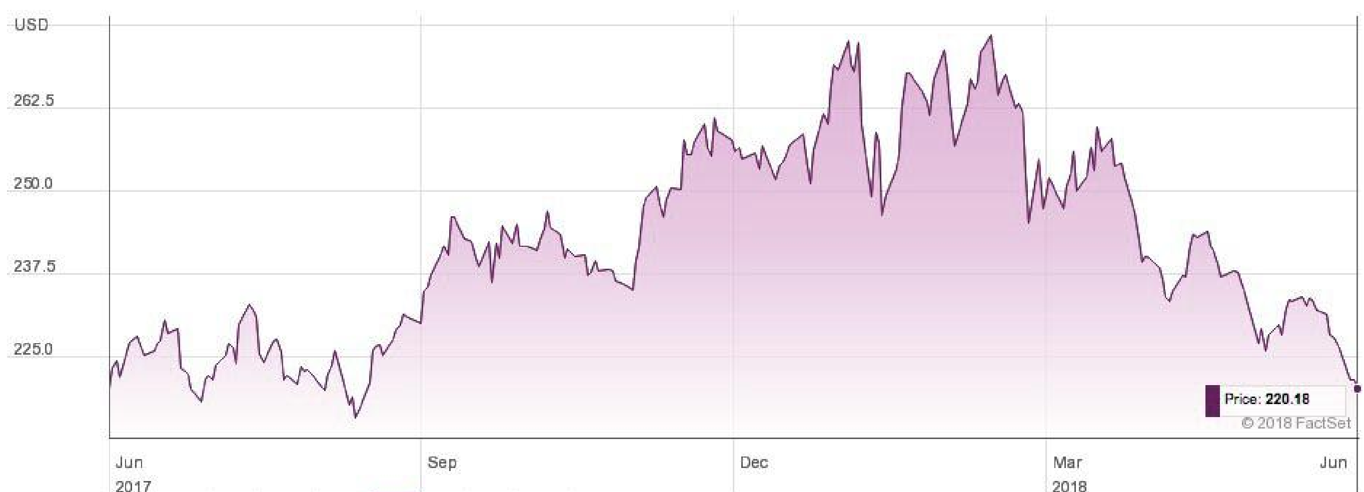
Much more disappointing to date has been the **3HCL Boost Copper 3x Leverage Daily ETP** that we recommended in January at US$27.275. It has since sunk to US$19.585 as the copper price has failed to make any headway. The price of copper did briefly dip below US$3.00/lb this week before recovering to just above this level. The main reason for the recent weakness appears to be the threat of a growing trade war between the US and China, that could ultimately reduce demand from China. Many analysts see this as a potential buying opportunity though, and expect technical support levels to hold.

Whilst copper and other metals prices currently seem subdued because of these trade concerns, Aneeka Gupta of WisdomTree, the ETF provider, points out that the tariffs imposed to date might not be as important as the headlines suggest. She says "so far, the extent on interruption seems contained since the steel and aluminium tariffs account for less than 2% of US imports and an even smaller portion is affected since countries including Australia remain exempted. Added to that, US$50bn of Chinese imports equate to less than 2% of US imports. From a historical standpoint, the current trade wars are of a much lower magnitude in comparison to the 1929 or 1971 tariff hikes that reached 20% and 10% respectively. Although the metal tariffs cover a narrow range of imports so far, the real threat for financial markets is that a tit-for-tat spiral could widen the scope and magnitude of products and imperil global growth." Aneeka believes the fundamentals remain intact for most metals. And given their procyclical nature, she says "industrial metals stand to benefit as we enter the late phase of the expansion cycle."

Turning to the supply and demand dynamics, Aneeka explains "copper is expected to post a moderate supply surplus of 43,000 tons in 2018 for the first time in nine years according to the International Copper Study Group (ICSG). We believe the ICSG has discounted the likelihood of any supply disruptions this year." There are concerns over labour agreements, and last week as well the Tamil-Nadu state government in India ordered the closure of Vedanta's 400kt Sterlite copper smelter, owing to environmental concerns. Aneeka says this jeopardises 1.7% of global copper supply, which could alone swing the market back in a deficit in 2018. On the demand side, ICSG expects demand to grow by 3%, driven by infrastructure development in China and India. While recent activity data in China has been mixed, China's official Purchasing Managers Index rose to an eight-month high of 51.9 in May, signalling continued expansion.

Copper price, one year to 27th June 2018; source TradingEconomics.com

One covered warrant we have not looked at for some time is the **SF76 Goldman Sachs 250 21-Dec-18 calls,** currently trading at £0.048-£0.068. Immediately you will see that looks like a low price, with a wide dealing spread, and the delta is only 31% to boot, so why might these obviously speculative warrants be interesting? Well, with the Goldman Sachs share price at US$220.94, down from US$273 as recently as mid-March, it wouldn't take too much of a rally to take these warrants back into-the-money and potentially to a much higher price. We think they are worth watching on this basis. According to CNN Money, the 27 analysts offering 12-month price forecasts for Goldman Sachs Group have a median target of US$280, and the bank is due to report its next quarterly results on July 17th, so we can get a more detailed picture of its current position then. With a beta of 1.3x against the market, Goldman is sometimes seen as something of a warrant itself on the US market, and its recent decline should be seen in that context, with prospects perhaps dimming a little for 2019 and 2020, and US investors concerned about the impact of President Trump's trade policies on the stockmarket. We would have to say the recent trend looks fairly awful, but things can change quickly and it is as well to be prepared. Something could easily cause sentiment to swing back to the positive, such as renewed buybacks. Should the shares of this investment bank recover their poise, these warrants could be in a good position to benefit – back in March they were trading as high as £0.315.



Goldman Sachs share price, one year to 27th June 2018; source Hargreaves Lansdown

Your next newsletter is published on 4th August 2018.