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NEWS

PENNY'S GROWTH PICKS FOR A PROSPEROUS 2011

A sigh of relief greeted the close of 2010. Despite many economic headwinds, the UK stock market delivered a double-digit return.

In fact, the UK's FTSE All Share has seen a close to 40% increase in corporate profits, and even after the recovery rally of 2009/10, the equity market looks cheap.

The prospective price/earnings (P/E) valuation for 2011 looks to be between 10.5 and 11.5 times earnings, which compares favourably to a long-term average of 13.

The UK All Companies fund sector has seen a huge spread of returns among equity funds over the past two years. Returns have ranged from 20.3% at the lower end to 176% at the top. The winners have been stock picking funds with titles that reflect a focus on microeconomic factors rather than macroeconomic ones.

This year looks set to continue the theme, with highly concentrated and flexible mandates likely to be among the winning funds for 2011.

Large and mega caps for value

2009 was a value year where refinancing and recovery stocks, many of them smaller companies, drove performance; 2010 was more about growth stocks. This year looks to be similar to last, with perhaps a wild card of increased M&A activity thrown in.

Among very large companies, the so called mega caps, there is a great deal of internationally exposed businesses with very attractive yields. These include Royal Dutch Shell, British American Tobacco, GlaxoSmithKline and Vodafone. All of these companies yield over 5%, and by growing their dividends became attractive to private individuals and income funds alike.

Two smaller large caps that we believe might be bid candidates in 2011 are Smith & Nephew and BG.

Small and cheap for growth

The L&G UK Alpha Trust fund's recent performance has been driven by smaller growth stocks, but often the key has been to buy these companies cheaply.

The three best performers have been Immunodiagnostic systems, Hutchison China Meditech and Supergroup.

These three businesses have delivered exceptional sales growth, but the share price performance has also been driven by the cheap prices paid.

I continue to hold Supergroup and Hutchison China Meditech and expect positive but more modest returns from these two stocks.

Emerging market infrastructure

The growth of China and India looks set to continue in 2011. Hutchison China Meditech is benefiting from the building of surgeries in China, whereas OPG is delivering power stations for the Indian Power market.

OPG currently generates around 100 megawatts (MW) of power in southern India, but this is only part of the investment proposition. OPG has another 370MW capacity financed and in development, and an additional 700MW in advanced planning stages.

Building these assets will take time and there are considerable risks to development. With excellent project economics and a valuation that arguably factors in little more than current operational capacity, we believe OPG has the scope to be another portfolio winner.

Other holdings in this area are CSF, which builds and operates data centres in South East Asia and is benefiting from the growth in internet related services, and SKIL Ports, which is involved in building ports and logistics in India.

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4G, data centres and the internet

A decade on, much of the visionary promise of the internet boom is starting to become a reality. Mobile internet is being driven by the Apple iPhone and products using the Android operating system.

Such smartphones, along with existing websites, are driving demand for more infrastructure. Globally, $120 billion is likely to be spent on new 4G base stations, and more data centres are needed to host websites and backup emails.

One company that we think looks well placed to take advantage of this is Iomart, which owns and operates data centres throughout the UK. The company has seen increasing demand from existing clients, and has been winning new clients for growth services such as 'cloud' computing and web hosting.

Emerging commodity producers

Commodity prices are booming on the back of demand from emerging economies. Shares in mining companies have soared and there is much speculative interest in oil and mining exploration companies.

We like companies that are able to build upon existing defined reserves and production (and hence cashflow) and which are not yet highly valued.

Australasian firm Allied Gold looks set to expand its gold output from 80,000 ounces to 200,000 ounces as its new Solomon Islands mine begins operating in the first half of this year. This change of scale means the company should attract increased investor attention, which should in turn lead to an improved valuation.

Meanwhile, Firestone Diamonds began diamond production at its Botswana mine in 2010 and looks set to commence production at its much bigger Liqhobong mine in Lesotho in 2011.

The respective values of diamonds in these two reserves are $146 million and $2.7 billion. There are, of course, significant operational costs involved in extracting diamonds, but we believe the stock market valuation of the company at £80 million could potentially increase as clearly there is the possibility of ramping up production.

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Richard Penny

Richard Penny is the manager of the L&G UK Alpha trust, a concentrated stock picking fund looking for deep value and strong growth investments. The fund is the number one performing fund in the UK All Companies sector since its launch in May 2005.

Apple: Fulfilling the mobile promise