# Warrants Alert

November 2012

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**Reading about stormy conditions in October is nothing unusual, but at least this year there was no hurricane blowing through the markets. That's a relief, because there has been a lot of news for global equity markets to absorb. Banking regulation is back on the agenda, the third quarter earnings season has been in full swing, investors are keenly tracking the economic data from China, there has been an EU summit in Brussels, and there is the small matter of the US presidential election next week. It looks very close between the two candidates. Time magazine says "there's a slight lead for Mitt Romney in national polls and slight leads for Barack Obama in swing-state polls, and no good way of predicting next Tuesday's outcome beyond flipping a coin."**

**Generally we prefer to try other methods for forecasting warrant prices, and this month we revisit the CFP analysis we introduced in the last newsletter. We also write about a new form of quasi-warrant derivative from SG, and discuss a range of assets from a Spanish bank to a Vietnam investment fund.**

## MARKET STATISTICS

**Although there was quite a lot of market fluctuation in October, warrants markets have landed at the end of the month not too far from where they started. In the corporate warrants market the statistics are likely to change more next month as we remove some expiries from the database. For now there has been a small rise in the average CFP, but not too much to report. In the covered warrants market the total number of issues is set to breach the 500 mark as SG continues to issue new tranches.**

| **Corporate Warrants** | | **Covered Warrants** | |
|---|---|---|---|
| Average Warrant Price: | 27p | SG Issues: | 448 |
| Average Premium: | 25.26% | RBS Issues: | 37 |
| Average Final Exercise Date: | 26th April 2014 | Total Number Listed: | 485 |
| Average Gearing Factor: | 7.9 times | Calls/Puts: | 327/158 |
| Average Capital Fulcrum Point: | 18.66% | | |

October was a mixed month. The average corporate warrant dropped by 5.5%, but there was plenty of variation. Topping the table was **Qatar Investment Fund** warrants (QIFW), apparently up by 98%, but this was a quirk caused by a widening of the spread ahead of their expiry, as we go to press. The real gainers were from Asia as investors regained some appetite for emerging markets. **JPMorgan Asian** subscription shares (JAIS) rose by 56.8% over the month, followed by some of its stablemates.

The list of fallers is equally influenced by technical factors this month. The top two on the list - **Ludgate Environmental** warrants (LEFW) and **BlackRock Greater Europe** subscription shares (BRGS) were both losing remaining value prior to expiry, **HgCapital Trust** subscription shares (HGTS) were also affected by the passing of an intermediate exercise opportunity, and **Praetorian Resources** subscription shares (PRSS) have been going through a period of spread adjustment.

## CORPORATE WARRANTS - MAJOR PRICE CHANGES

### One Month

**Rises**

| | |
|---|---|
| Qatar Investment Fund | 98.0% |
| JPMorgan Asian | 56.8% |
| JPMorgan Chinese | 33.3% |
| Worldwide Healthcare | 19.1% |
| JPMorgan Indian | 15.2% |
| Polar Cap Glbl Healthcare | 9.1% |
| Aberdeen Asian Income | 7.6% |
| JPMorgan Emerging Mkts | 7.0% |
| Vietnam Holding | 4.5% |
| Henderson In'tl Income | 3.8% |
| Polar Capital Technology | 3.4% |
| Standard Life Equity Inc | 2.6% |
| Artemis Alpha | 2.3% |
| World Trust Fund | 2.2% |

**Falls**

| | |
|---|---|
| Ludgate Environmental | -92.5% |
| BlackRock Greater Europe | -77.3% |
| Fidelity Japanese Values | -45.7% |
| HgCapital Trust | -40.6% |
| Praetorian Resources | -38.5% |
| JPMorgan Private Equity | -33.1% |
| Invista European | -25.0% |
| Schroder AsiaPacific | -24.5% |
| Fidelity Asian Values | -21.1% |
| Eastern European Trust | -14.3% |
| Golden Prospect Prec Met | -11.5% |
| Baker Steel Resources | -8.0% |
| Infrastructure India | -6.5% |
| JPMorgan Brazil | -5.5% |
| Perpetual Inc & Gr Sub | -1.9% |

### Three Months

**Rises**

| | |
|---|---|
| Henderson In'tl Income | 51.9% |
| JPMorgan Indian | 50.0% |
| JPMorgan Asian | 45.0% |
| JPMorgan Emerging Mkts | 43.0% |
| Golden Prospect Prec Met | 39.4% |
| Worldwide Healthcare | 36.9% |
| Standard Life Equity Inc | 32.2% |
| Aberdeen New Thai | 31.5% |
| HgCapital Trust | 29.2% |
| JPMorgan Chinese | 23.1% |
| Schroder AsiaPacific | 20.2% |
| Aberdeen Asian Income | 19.4% |
| Perpetual Inc & Gr Sub | 14.0% |
| Raven Russia | 11.9% |

**Falls**

| | |
|---|---|
| Ludgate Environmental | -99.7% |
| Invista European | -74.3% |
| Praetorian Resources | -68.6% |
| Vietnam Holding | -65.0% |
| Fidelity Japanese Values | -60.0% |
| BlackRock Greater Europe | -58.3% |
| JPMorgan Japan Smaller | -39.0% |
| JPMorgan Brazil | -37.3% |
| JPMorgan Private Equity | -36.9% |
| Impax Asian Environmntl | -17.6% |
| Fidelity Asian Values | -16.7% |
| Marwyn Mgmt Partners | -16.7% |
| Infrastructure India | -12.1% |
| Eastern European Trust | -7.7% |
| Artemis Alpha | -6.4% |

### Twelve Months

**Rises**

| | |
|---|---|
| Aberdeen New Thai | 212.9% |
| Worldwide Healthcare | 188.6% |
| Aberdeen Asian Income | 77.2% |
| Henderson Opportunity | 72.2% |
| Polar Cap Glbl Healthcare | 52.9% |
| Perpetual Inc & Gr Sub | 51.4% |
| Raven Russia | 37.4% |
| Henderson In'tl Income | 32.3% |
| Standard Life Equity Inc | 24.0% |
| Artemis Alpha | 8.4% |

**Falls**

| | |
|---|---|
| Ludgate Environmental | -99.8% |
| BlackRock Greater Europe | -94.2% |
| Invista European | -93.2% |
| Fidelity Japanese Values | -88.1% |
| Impax Asian Environmntl | -77.0% |
| Marwyn Mgmt Partners | -75.0% |
| HgCapital Trust | -73.9% |
| BlackRock New Energy | -72.5% |
| JPMorgan Japan Smaller | -66.5% |
| JPMorgan Brazil | -65.6% |
| Fidelity Asian Values | -61.2% |
| JPMorgan Private Equity | -59.6% |
| Qatar Investment Fund | -59.6% |
| Infrastructure India | -54.7% |
| JPMorgan Asian | -49.1% |
| JPMorgan Chinese | -42.9% |
| Baker Steel Resources | -41.8% |
| Aberdeen LatAm Income | -36.4% |
| BCB Holdings | -32.5% |

**This is a quick follow-up on last month's analysis, just to see what has changed. We will be updating the figures each month to use as part of our overall work, and we expect to report on the findings occasionally.**

Starting with the relatively cheap warrants, this CFP range approach highlighted ten warrants last month – **Aberdeen Asian Income, BlackRock Greater Europe, Eastern European Trust, Henderson International Income, JPMorgan Asian, JPMorgan Indian, Perpetual Income & Growth, Polar Capital Global Healthcare, Raven Russia,** and **Worldwide Healthcare Trust.** The list has changed significantly now. Valuations appear to have shifted around quite a lot over the course of the month, and now this model indicates only five warrants that rank as cheap against their 12-month data. The first is **Henderson International Income** subscription shares (HINS), still on a CFP of 2.84% against a 12-month range between 2.84% and 7.89%, and an average of 4.44%. Next on the list is **JPMorgan Asian** subscription shares (JAIS), in spite of their sharp price rise over the month. Their CFP of 7.93% remains below its 12-month average of 9.38%, and towards the lower end of the range between 6.26% and 13.91%. Third, we turn again to **Perpetual Income & Growth** subscription shares (PLIS). These may look perpetually cheap against other warrants, but there are degrees of cheapness, and we were surprised to see the subscription shares slip by 1.9% this month to 53p. Their CFP of -5.35% is at a new low for the last year, and below the 12-month average of -2.20%. We rate them a BUY, partly because we like the technical position of the subscription shares, which we think skews the odds in your favour, and partly as well because we consider the trust's manager Mark Barnett a safe pair of hands. The trust is ranked third out of 20 peer group trusts in the UK income & growth sector by NAV performance over the last five years. You may know that Mark Barnett works alongside the well-known fund manager Neil Woodford at Invesco Perpetual in Henley, and we were interested to read an article about Mark in this week's issue of the trade newspaper Investment Adviser. Mark explains a little about the way in which the office works, saying that Invesco creates an environment that allows fund managers to express their views in their portfolios with a high degree of autonomy to implement their strategy – which is a combination of both the manager's own work and the collaborative effort of colleagues. "We do discuss thoughts and ideas and views together to arrive at sometimes an agreed view and sometimes we don't agree. The setup means that even if we talk about a stock and agree to differ I can still go away and put it to work in my portfolio. I have autonomy within my own fund. We're trying to combine the best of individual responsibility on the portfolio with a collective thought process at a team level, and it's worked."

The fourth warrant on the list may be a surprise, and indicates the need to use this form of analysis in conjunction with other methods. **Praetorian Resources** subscription shares (PRSS), for which we have only four months' data, is at its lowest CFP so far, although it remains high at 22.87%. Finally, the fifth entry is another new one, **Standard Life Equity Income** subscription shares (SLES). These subscription shares rose by 2.6% last month to 29.75p, but they might have risen further in reaction to a 2.15% rise in the ordinary shares. As a result their CFP has dropped back to 3.86%, and this compares favourably to its 12-month average of 4.89%. The 12-month range is between 3.57% and 6.31% - actually quite narrow, meaning we might not read too much into this conclusion.

The system flagged only three relatively expensive warrants last month, **Aberdeen New Thai, Impax Asian Environmental,** and **Praetorian Resources.** We have already seen that one of these has jumped to the relatively cheap list, but what is interesting is how the system now flags six warrants as being of concern. The first is still **Aberdeen New Thai** subscription shares (ANWS) at 181.5p and now on a CFP of 5.91%. This does not look high in absolute terms, but the CFP is at its highest level for a year, and well in excess of its 0.91% average. Next is **Ground Rents Income,** for which we have only three months of data. We would be inclined to dismiss this finding: while the CFP is technically at a high, it is only 0.58%. Third, **Impax Asian Environmental** subscription shares (IAES) have stayed on the list, and their CFP has risen from 16.75% to a new 12-month high of 17.04%. Fourth is **JPMorgan Japan Smaller**

**Companies** subscription shares (JPSS), where the CFP of 21.27% is near the top of its very narrow 12-month range between 16.53% and 21.68%. Given the stability of this rating though, and the 25 times gearing as well, we don't think this is a strong indication these warrants are overvalued. We find the case much more convincing for **Polar Capital Technology** subscription shares (PCTS), where we think there is a true misalignment. The trust's ordinary shares fell by 7% last month as shares in its largest holding, Apple (12.1% of assets at the end of September) fell back. Yet the subscription shares edged up by 3.4% to 10.215p and their CFP jumped to 23.05%, quite clearly at the top end of its 12-month range between 10.66% and 23.05%, and well above the 12-month average of 16.91%. We think the subscription shares are technically OVERVALUED at this level, and rate them a SELL. The last entry on the list is an interesting one, **Worldwide Healthcare** subscription shares (WWHS), which jumped by 19.1% last month in spite of a 2.1% fall in the ordinary shares. They did look cheap beforehand, but even so, the CFP has risen to 5.91%, its highest level for a year. With gearing of 3.9 times we don't think there is any need to change our positive view for the moment, but we will watch for any further increase in the valuation from this point.

## CORPORATE WARRANTS NEWS

We have not been surprised to see **Aberdeen Asian Income** warrants (AAIW) rallying from what we regarded as an oddly depressed position against the ordinary shares. Up by 7.6% over the month to 81.5p, we still consider the warrants undervalued on a CFP of -10.56%. There could be some 'noise' to come from the trust's imminent issue of 'C' shares, but it is never quite clear to us whether these issues serve to mop up demand, or to create much more attention on the trust and its merits. Probably a little of each, without much net impact.

On 22nd October, **Aberdeen New Thai** announced its results for the six months to 31st August. Of course we already know the trust did well, with its net assets up by 11.1% against its benchmark, up by 6.2%. The outlook statement is of more interest, we think, and it sounds rather mixed. The managers say "the weak global macroeconomic backdrop will certainly have an impact on Thailand. Any volatility in capital flows could tighten credit and depress economic activity. The Bank of Thailand has halved its export growth target, taking into account the rapid change in the terms of trade. As a result, full-year growth has been pared to 5.5%." This does still compare very favourably to more mature economies in the West, and the report also says that compared to its regional peers, Thailand "is still among the most preferred destinations for foreign investment. The political situation has stabilised and public approval ratings for prime minister Yingluck Shinawatra have improved. The relative calm eases the policy implementation process and is conducive to business operations. Government reserves remain robust at more than 5 trillion baht, enough to finance much needed public works projects, while debt-to-GDP remains low." Furthermore, the managers argue that a burgeoning middle class underscores the country's appeal as a consumer market. This is an important theme in the portfolio, which has a consumer bias. The report concludes "overall, it is encouraging to note that listed companies have been conservative and corporate debt levels are generally low. Corporate governance has improved significantly, while earnings have outperformed the wider region. Looking at companies in the portfolio, valuations are reasonable and the dividend yield remains attractive. In particular, the balance sheets of the bank holdings are robust with negligible exposure to offshore instruments. The directors remain assured by the quality of the company's portfolio, which comprises steady and defensive businesses that have proven their mettle amid volatile times."

For holders of the subscription shares (ANWS), the relevant timespan is fairly short, as they expire at the end of January. Following some that were exercised, there are now 2,106,829 subscription shares in issue, each with the right to subscribe for one ordinary share at 200p on the final business day in any calendar month up to and including 31st January 2013. The trust has reiterated that following this final date, a trustee will be appointed to exercise any outstanding (unexercised) subscription shares within two weeks and to distribute the net proceeds to holders by the end of March.

For now, we are strong holders. The trust's ordinary shares are trading on a discount to net asset value of 12.9% in spite of their excellent performance. It has been helped this week by a strong showing from PTT Exploration and Production, the trust's second-largest holding at the end of September, at 6.1% of assets. The company is raising capital to buy Cove Energy plc and it is attracting buyers itself. Over the last two trading sessions its shares are up by 6.4%. We like the trust, and the subscription shares are well in-the-money with 178.625p of intrinsic value. We expect their price to track the shares almost penny-for-penny between now and expiry, with the gearing of 2.1 times providing additional movement in percentage terms.

We find it slightly puzzling – and a little disappointing – that the value of **Baker Steel Resources** ordinary shares and warrants (BSRW) have dropped in the month when the trust's largest holding successfully floated on the Toronto Stock Exchange. We reported last month on the imminent IPO for Ivanplats, which was subsequently completed successfully, if at the lower end of the pricing range. The shares listed at C$4.75 per share and initially rose in value to more than C$5.00 before falling back to C$4.64 at the time of writing. Baker Steel Resources Trust has indicated that it will apply a 10% discount to the value for valuation purposes, as it is 'locked in' under the terms of the IPO agreement. On this basis the net asset value – which we can expect to be announced next week – has probably not moved too much higher than the end-September value of 102.2p (fully diluted). The stockbrokers JPMorgan Cazenove currently estimate the live NAV to be 103.1p, implying a discount of 15.8% for the ordinary shares. That is only slightly wider than the sector average of 13.4%, so we are not certain there is much immediate upside unless the price of Ivanplats rallies again. For now we feel we must temper our expectations, and on a CFP of 102.07% the warrants look OVERVALUED at 11.5p. With slight reluctance, we rate them a SELL.

**BlackRock Greater Europe** subscription shares (BRGS) expire just as we go to press, more or less at the money. We will be interested to see what proportion of them is exercised. The trust has also published a shareholder circular asking for ordinary and subscription shareholder approval at general meetings following the AGM due to be held on 29th November, to redesignate the outstanding subscription shares (if any) as deferred shares following the expected lapse of the subscription share rights, the subsequent repurchase and cancellation of the deferred shares immediately following such redesignation, and an amendment to the Articles of Association to remove all references to subscription shares. This palaver is necessary because the tax authorities recently indicated to another trust – Ecofin Water & Power Opportunities – that it considers subscription shares part of the ordinary share capital for tax purposes, and for investment trusts to keep their favourable status, these must be listed on a regulated market if they are not cancelled. Unfortunately we feel this additional complication makes it less likely that trusts will consider subscription shares in the future. This is one more reason for them not to bother.

The penultimate exercise opportunity for **HgCapital** subscription shares (HGTS) has also passed now. Unfortunately, our suspicion that they would "fall in price around the end of October, or early in November" has been proved correct. They have slid by 40.6% over the last month, in anticipation of the passing of the 950p exercise opportunity. The one remaining exercise period now is at 1025p, and runs until 31st May 2013. At 27.625p the subscription shares offer high gearing of 36.1 times for a CFP of 9.99%, which we regard as REASONABLE. We would probably not be buyers on a CFP in excess of 10%, but at this level, with the CFP just sneaking under the threshold, we would not dissuade investors from buying. While the shares at 997.5p are currently modestly below that final exercise price, we have a high degree of confidence in the trust's management and their proven ability to wrest some additional value from the assets.

The trust released its latest update, an interim management statement, on 10th October. Its net asset value at the end of September was up by 2.6% over the quarter to 1167.4p, and the trust reported on good trading from its portfolio companies. The managers are on the board of all investee companies, enabling them to keep completely up to date with trading and other events. That was reasonable news, and Reuters has subsequently reported as well that HgCapital has mandated Goldman Sachs to look for a buyer for Schleich, a toy manufacturer that is currently the trust's 15th largest holding. Hg acquired Schleich in December 2006, and the report suggests an auction will commence at the start of 2013. The brokers Liberum Capital comment "the potential sale is not a surprise given that the manager commented that the company was experiencing a difficult environment and it is part of the company's legacy consumer and leisure portfolio. We would expect any disposal to come at an uplift to its current carrying value."

**JPMorgan Asian Investment Trust,** which has been conducting a review into its management arrangements, announced a raft of proposals on 17th October. The news, first of all, is that the board has decided to stick with JPMorgan under the management of Jeffrey Roskell, but it has taken the opportunity to trim both the fee and the notice period for termination. At the same time, and perhaps in recognition that some shareholders would prefer not to take a gamble on the performance improving, the board has used its discretion to propose a tender offer for up to 24.99% of the ordinary shares at NAV less costs. Looking forward, the board aims to use buyback powers with the objective of stabilising the discount to NAV at between 8% and 10%, and it can propose further tenders for up to 5% of the trust's capital on a semi-annual basis if the average daily discount exceeds 9%. Finally, to provide legitimacy to the new arrangements, a continuation vote is proposed for the AGM in January.

That's quite a lot to digest. The immediate response has been a slight rise in the ordinary shares to 196.75p, at which level the shares are on a 10% discount to net asset value. It seems clear to us that the tender offer will be taken up in full, but this will not necessarily have much impact on the market price of the shares. Up by a dramatic 56.8% over the month to 14.5p (dealing spread 13p-16p), JPMorgan Asian subscription shares (JAIS) are just out-of-the-money, but with plenty of time to run until 31st March 2014. Gearing is 13.6 times for a CFP of 7.93%, which we consider REASONABLE VALUE. Our view is that JPMorgan will be very keen to do whatever it can to move this trust up the performance tables. Effort does not guarantee success, but at least we think the trust will have the right structure and the right incentives to succeed from this point.

On 29th October, the stockbroker Cantor Fitzgerald rated **JPMorgan Brazil** ordinary shares as a 'sell', saying that a re-rating had "more than run its course." The shares look expensive to us on a discount of just 3.5%, and in spite of a fall of 5.5% over the month to 6.5p, we continue to rate the subscription shares (JPBS) as OVERVALUED as well, on a CFP of 45.46%.

We noted last month the strange and inexorable march downwards of the mid-price of the **Praetorian Resources** subscription shares (PRSS). You may remember that the dealing spread has narrowed each month from 1p-50p in August, to 1p-40p in September, and 1p-25p last month. Guess what? It has narrowed to 1p-15p now. If the trend continues and the price falls to 1p-5p next month, we might have to re-consider the subscription shares as part of our investable universe. Not yet, though.

We are generally very wary of paid-for research, which always tends to be positive, but it can have some value when it makes relative judgements. For this reason we were interested to see a sector report on Russian property, released in September by the firm Edison Investment Research. The report says that Russian real estate values have rebounded strongly from the lows in 2009, supported by positive fundamentals, but that quoted real estate valuations are still a fraction of their peaks. Edison suggest that with the Russian economy forecast to grow steadily, supported by strong commodity prices, they anticipate continued market recovery, which should improve yields and valuations in the sector further.

They say "we believe the most attractive segments of the sector in Russia, especially Moscow, are retail and warehouses, based on the supply and demand dynamics, occupancy levels and improving rental rates." **Raven Russia** is their preferred pick in the sector, ahead of others they mentioned. The note concludes "Raven Russia has been rewarded for leading the way in its segmentally-focused strategy, cash returns to investors and corporate governance efforts. It thus provides the model for others to emulate if they want to reach the same level of valuation. We still see some upside for Raven." We think holders of the warrants (RUSW) should be quite content to KEEP HOLDING at 42.25p.

Sometimes you can only base judgements on your own experience, and on this basis we have not been too impressed with **Vietnam Holding,** which decided earlier this year to list some short-dated warrants (VHNW). They expire on 13th December, and currently look as though they will be worthless. The shares at just under US$1.00 are well below the US$1.196 exercise price, and we think this shows the limitation of this form of 'bullet' warrant issue. We much prefer warrant issues with longer maturities, and we can only hope that Vietnam Holding might try again with a more generously dated series of warrants.

We would have liked to follow its progress over a longer period. The stockmarket in Vietnam certainly has the capacity for growth, and it has exhibited some tremendous performance during certain periods in the past. This trust has its fans too. We noticed a research note from the stockbroker Fairfax on 16th October that was positive about the trust. The broker noted first of all that Vietnam is being successful now in getting inflation under control, with price rises forecast to come in at around 6%-7% this year, against 18% at the end of 2011. GDP growth has also been resilient, and sustainable growth of between 5% and 6% is forecast for 2012, after a rise of 5.9% in 2011. Furthermore, Fairfax say the stockmarket is looking attractive with average trailing P/Es of 9.8x, comparing positively with the other East Asian economies where the range is from 11.4x in China to 19.0x in both India and Indonesia. The average dividend yield of 4.8% is equally attractive against an unweighted average of 2.7% across the other markets in the region. By way of comparison, the VNH portfolio has a trailing P/E of only 7x (forward P/E 6.4x) and a dividend yield of 6.7%. Further, Fairfax reckon the currency risk is muted, the demographics are supportive, and the level of foreign direct investment is steady. When Fairfax met the management team from Vietnam Holding recently they were bullish on the outlook for Vietnam, despite some near term volatilities. They have been implementing a number of changes intended to catch the cycle uptrend, including a rebalancing of the portfolio. The biggest shifts have seen an increase in exposure to the food & beverage and healthcare sectors by 4.9% and 4.8% respectfully, and a balancing reduction in the weighting of agri-chemical stocks by 8%. There has also been a downshift in underlying company size. The manager takes a value investment approach, aiming to identify long term growth mega-trends, and the focus is on thematic asset allocation. As such, VNH continues to favour agri-businesses, but there has also been a shift towards those sectors facing domestic consumers, such as pharmaceuticals and food producers mentioned above. Generally speaking, the rebalancing has resulted in a more diversified portfolio that is now more inclined towards growth.

The trust's portfolio is invested predominantly in equities (96.2%) and is relatively high conviction with 28 positions. Fairfax note that in NAV total return terms, VNH is up 8% over the last year, but the share price has improved by 50% as the discount has narrowed considerably from around 42% to around 19%. The broker concludes "we believe that equity investment in Vietnam is an exciting prospect, and with existing foreign ownership restrictions, VNH is an excellent way in which to play it."

On 31st October, Oriel Securities also issued a research note on the trust, which is a client of the broker. This follows a meeting with Vu Quang Thinh, the manager. Oriel has a positive stance on the trust "as an attractive means of gaining well managed exposure to a relatively new equity market in an economy undergoing profound long term change." Like Fairfax, Oriel report on the positive demographics, the cheap valuations, and the rebalancing of the portfolio. Agribusiness now represents around 36% of net assets and another third of the portfolio is in domestic consumer stocks, leaving a relatively low exposure to financials. So far this year, agribusiness positions have been built in Hung Vuong Aqua, a 'state of the art' seafood producer trading on a forecast current year p/e of 4.7x and Dabaco, an animal feed company estimated to be trading on 2.9x current year earnings. In the domestic consumer sector positions have been acquired in Hoa Binh Construction which is a play on urbanisation and Japan Vietnam Medical

Instrument which is providing much needed healthcare equipment and mobile services for the country's growing healthcare demands. These new positions have been funded by reducing holdings in names such as Vinamilk, now the second largest holding at 10% of NAV having previously represented over 20%. Oriel conclude "the Vietnamese equity market has given investors a roller coaster ride over the last few years and VNH has managed to keep pace with and, more recently, outperform the main indices. The 21% discount is in line with the peer group and much narrower than the 40% discount it traded on a year ago when we initiated research coverage and when the shares traded at US$0.76. Since that time we have seen inflation come down dramatically and whilst many hurdles remain, we share the current optimism of VNH's management and maintain our positive stance."

## TECHNICAL MERIT

**This 'technical merit' section is devoted to a brief overview of some of the corporate warrants which 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 230 out of 276 months to date, an 83% success rate.**

| Undervalued Warrants | Shares | Warrants | Exercise | Expiry | Prem | Gearing | CFP |
|---|---|---|---|---|---|---|---|
| Aberdeen Asian Income | 207.75p | 81.5p | 120p | 15-Apr-13 | -3.01% | 2.5 | -10.56% |
| Aberdeen New Thai | 378.625p | 181.5p | 200p | 31-Jan-13 | 0.76% | 2.1 | 5.91% |
| Artemis Alpha Trust | 293.25p | 54.75p | 345p | 31-Dec-17 | 36.32% | 5.4 | 7.40% |
| Ground Rents Income | 104p | 9.5p | 100p | 31-Aug-22 | 5.29% | 10.9 | 0.58% |
| Henderson Int'l Income | 105.25p | 10.25p | 100p | 31-Aug-14 | 4.75% | 10.3 | 2.84% |
| HgCapital Trust | 997.5p | 27.625p | 1025p | 31-May-13 | 5.53% | 36.1 | 9.99% |
| JPMorgan Asian | 196.75p | 14.5p | 203p | 31-Mar-14 | 10.55% | 13.6 | 7.93% |
| JPMorgan Emerging | 552.25p | 76.125p | 543p | 31-Jul-14 | 12.11% | 7.3 | 7.81% |
| JPMorgan Indian | 364.15p | 87p | 291p | 02-Jan-14 | 3.80% | 4.2 | 4.25% |
| Perpetual Income & Growth | 282.2p | 53p | 218.9p | 31-Aug-13 | -3.64% | 5.3 | -5.35% |
| Polar Capital Glbl Healthcare | 118.75p | 19.5p | 100p | 31-Jan-14 | 0.63% | 6.1 | 0.60% |
| Raven Russia | 65.95p | 42.25p | 25p | 25-Mar-19 | 1.97% | 1.6 | 0.84% |
| Standard Life Equity Income | 303p | 29.75p | 320p | 31-Dec-16 | 15.43% | 10.2 | 3.86% |
| Worldwide Healthcare | 847.25p | 215p | 699p | 31-Jul-14 | 7.88% | 3.9 | 5.91% |

*Performance last month: average change +9.53% (11 rises out of 13 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):** Baker Steel Resources (102.07%); BCB Holdings 2013 (n/a); BCB Holdings 2014 (n/a); Golden Prospect Precious Metals (22.70%); Infrastructure India (856.60%); Invista European (186.02%); JPMorgan Brazil (45.46%); Marwyn Management Partners (167.17%); Phoenix Group (1136.50%); Praetorian Resources (22.87%); Premier Gold (n/a).

*Performance last month: average change -8.35% (0 rises out of 11 selections).*

## WARRANTS ALERT TRADING PORTFOLIO III

**The Trading Portfolio has consolidated its position in overall profit, rising by 6.04% or £621.05 over the month to reach a total of £10,905.26. As was the case last month, the prime mover on the plus side was again Worldwide Healthcare subscription shares, up by 19% this month, and by 46% over the last two months.**

| Warrant | Ticker | Number | Bought | Current | Profit | % |
|---|---|---|---|---|---|---|
| | | | | | | |
| Aberdeen Asian Income | AAIW | 3900 | £1,993.80 | £3,081.00 | £1,087.21 | 54.53% |
| FTSE 100 6500 18-Dec-15 Calls | LC11 | 2000 | £1,079.50 | £966.40 | -£113.10 | -10.48% |
| Polar Cap Healthcare | PCGS | 9500 | £1,205.94 | £1,710.00 | £504.06 | 41.80% |
| Raven Russia | RUSW | 5600 | £1,914.40 | £2,296.00 | £381.60 | 19.93% |
| Worldwide Healthcare | WWHS | 1200 | £1,314.98 | £2,544.00 | £1,229.02 | 93.46% |
| | | | | | | |
| Cash | | | | £276.71 | | |
| Interest | | | | £31.15 | | |
| | | | | | | |
| **TOTAL** | | | | **£10,905.26** | | |

For **Aberdeen Asian Income** warrants the stop-loss can be edged up again from 63p to 69p, and we hope we might be able to hold this for a few months longer, conscious though we are of the April 2013 expiry date. The new holding in the **LC11 FTSE 100 6500 18-Dec-15 calls** has not started particularly well, de-rating slightly. Its stop-loss is 40p, and we think this may need to be watched. For **Polar Capital Global Healthcare** subscription shares the stop-loss can stay at 14p, and for **Raven Russia** warrants the stop-loss can also stay at 34p. For **Worldwide Healthcare Trust** the stop-loss can be raised substantially again, from 140p to 165p.

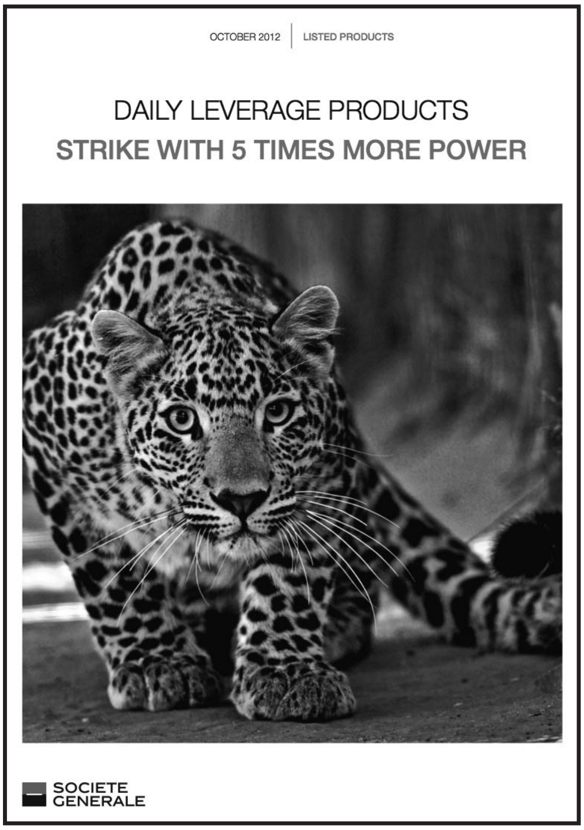
Last month we liked two warrants but had the cash to buy only one. As it has turned out so far, we chose the wrong one, but this does serve to highlight a common issue for all investors. It is all very well having lots of great buying ideas, but the cash has to come from somewhere. Right now, we don't want to sell any of our existing holdings, and so we are content to sit tight. There is no reason at all why we should trade all the time. Commissions and trading costs can eat into your returns significantly, and some of the world's greatest investors operate with a long-term view and a low portfolio turnover.

## DAILY LEVERAGE PRODUCTS

**SG is continuing its sterling efforts to promote geared, or leveraged, opportunities for investors, and has just developed its offering further. An introduction might be handy to a new style of products it has introduced, called 'daily leverage products.' It has started with just two, based on the FTSE 100 Total Return Index, but we imagine the bank will expand the range if these are well received.**

**As the name suggests, these are a form of securitised derivative, similar to covered warrants, but specifically intended for short-term trading. Using figures from Bloomberg, SG say that over the last five years (ending September 24th), the FTSE 100 Total Return Index has moved by an average of 1.06% per day, and their daily leverage products are designed to multiply this daily performance by five times. They are really designed for intra-day trading. You can hold on to them for longer, but overnight holdings start to attract charges that may make them unattractive.**

Effectively, what SG is doing here is tweaking the terms of its products to make them simpler and to appeal to a specific audience. On an intra-day basis the new **UKL5 Daily Long X5 FTSE 100 Total Return Index** and the **UKS5 Daily Short X5 FTSE 100 Total Return Index** are really trackers for indices that are calculated on a 5x geared basis. You can follow these on Bloomberg if you wish. On the day of writing, for example, the FTSE 100 Index is currently down by 0.70%, so the long index is down by 3.5% and the short index is up by 3.5%. The SG products, which are listed on the London Stock Exchange and can be traded through your stockbroker in the normal way, have moved by a similar amount, so this seems quite straightforward. The underlying indices are re-set each morning, and the daily percentage change then starts again. As a result, over periods of more than one day, profits or losses are compounded, and the performance of the underlying index, and therefore the daily leverage product, will deviate from five times the actual performance of the FTSE 100 Total Return Index.




There are two other complicating features too. The first of these is called an 'Air Bag'. Both the long and short leveraged indices include an Air Bag mechanism, which is designed to slow the rate of loss on the Index in extreme market conditions. The Air Bag comes into effect if the underlying index loses 75% of its value in one trading day. If this does occur, the Air Bag triggers an intra-day re-set of the underlying index. The reset takes place over a one minute period. Following the reset, the performance of the underlying index is based on the level that the FTSE 100 TR was trading at when the Air Bag was triggered. This is designed to reduce the impact of any subsequent fall. To illustrate how this works, let's assume that you bought a daily long 5 on Tuesday morning and the FTSE 100 TR had closed on the Monday at a level of 4,000. If on Tuesday, by 11:00 am, the FTSE 100 TR had dropped 15% this would translate into a 75% loss on the FTSE 100 DL5 Index, leaving it at a level of 2,500. At this point the index is reset and the performance of the index is now based on the new level of 2,500. Therefore, if the FTSE 100 TR was to fall another 5% from 3,400 when the markets closed, the loss to the FTSE 100 DL5 would be 25% of 2,500, meaning it would close at a level of 1,875. Without the Air Bag, the additional 5% fall in the FTSE 100 TR would have left the FTSE 100 DL5 and the Daily Long 5 worthless. This is because the total loss on the FTSE 100 TR of 20% would equate to a 100% loss on the FTSE 100 DL5.

The second additional feature is called 'Gap Premium', and comes into play if you hold these products overnight. SG say the Gap Premium is "essentially like a form of insurance that is embedded in the price of the product to limit your risk from extreme market movements overnight. Without the Gap Premium, if the FTSE 100 TR was to open more than 20% against you, you could lose more than your initial investment as the product would lose more than 100% of its value. However, because of the hedging paid for by the Gap Premium, the worst that can happen is that your daily leverage product is worth nothing. You cannot lose more than you invest." The Gap Premium is a cost that is calculated daily and deducted from the product at market close. If you trade out before the end of the day no Gap Premium is paid. The amount of the Gap Premium, based on volatility, is displayed on the product pages on SG's website, and is currently 0.0089% per night. For longer-term holders there is also a commission charge of 0.50% per year, charged daily and taken from the value of the product at a pro-rated rate of 0.0013% per day. These charges don't sound too onerous, but really these products are intended for day trading, and we think they are best used in that way if the idea appeals to you.

## NEW COVERED WARRANT ISSUES

SG has also been busy with a couple of tranches of new covered warrants. On 15th October it issued 35 new covered warrants on **Apple, CAC 40 Index, Dow Jones Industrials, Facebook, FTSE 100 Index, FTSE 250 Index, Google, Nasdaq 100 Index, Nikkei 225 Index, S&P 500 Index, Brent Crude Oil December 2013 Future, Gold,** and **Silver.** The majority of these warrants run until various dates next year, although a pair of the warrants on Apple run all the way to December 2014. On 19th October, SG added one more warrant on the **S&P 500 Index.**

On 1st November SG is issuing 24 more covered warrants, again on a mix of assets, and also 16 turbos on market indices. The new covered warrants are on the **FTSE 100 Index, FTSE 250 Index,** some currencies, and there is also one on **Banco Popular Espanol.** We do not yet have the details, so we cannot judge whether the issue is worth considering or not, but it's an interesting notion to take a position on a Spanish bank now. Certainly there has been a decent recovery from the British banking sector, and the sovereign debt position in Europe seems much more stable. That said, there are clearly very serious problems for Spain to work through. Banco Popular is the fifth largest banking group in Spain in terms of assets (EU161.1bn including Banco Pastor) and client deposits. It is a fairly traditional bank as far as we can tell, dominated by its retail and commercial banking activities. Retail banking represents 82% of the pre-provisioning profit, with corporates, SMEs and independent professionals accounting for 77%. The bank has more than 2,500 branches in Spain and nearly 250 abroad, as well as more than 18,000 employees. The bank says it has more than seven million customers.

Last week the bank presented its results for the first nine months of the year, which it said were "as planned." Pre-provision profit was up 31% to EU1.6bn, and the bank reported strong growth in customer deposits in the third quarter. It is setting aside EU9.3bn this year though in provisions, which Banco Popular reckons will enable it to "face extreme and very severe scenarios." It also has shareholder support for a EU2.5bn rights issue, which it expects to be completed in early December. The rights issue is part of a new business plan that the bank revealed at the start of October, one which it believes will enable it to consolidate its position going forward. The bank believes the macroeconomic position in Spain to be very challenging, particularly in the real estate sector, and it is under no illusion that policy measures will provide a cure in the near-term.

The background here is that Banco Popular failed a stress test, hence the need for extra provisions and capital, but assuming the rights issue goes through successfully, it should be able to avoid a claim on the international bank rescue fund offered by other Eurozone countries. The bank may well price the rights issue at a deep discount to ensure it gets the cash, and in the meantime it is saving money by scrapping its dividend. The news has been grim for some time, which is why the bank's share price, which trades under the ticker POP.MC on the Madrid Stock Exchange, has slid from EU1.90 in September to EU1.20 now.

It is hard to overstate the importance of the rights issue. The ratings agency Fitch said on October 4th that "Popular's decision to raise the bulk of the capital through a EUR2.5bn rights issue will improve its capital significantly before a June 2013 deadline. This represents more tangible new capital for the bank than other measures it might have considered. The bank expects the rest of the capital will come from EUR300m of asset sales and EUR400m in retained profits. The poor macro-economic and banking environment means Popular will find a large rights issue and asset sales challenging. However, Popular said on an analysts call on 1st October that it has already identified 12 investment banks that might underwrite the offering, and expects to complete it by year-end." The agency continued "Popular has two advantages over former savings banks: it is already listed, and has a well-developed SME franchise. Most other banks with capital shortfalls, such as Liberbank, Banco Grupo Caja 3 and Banco Mare Nostrum, are not listed - so cannot raise capital through a public rights issue. Our recent report, 'Spanish Bank Ratings', splits the country's banks into four groups. Popular is in group three - it is a bank that we expected to have a shortfall, but that can meet the demand on its own. Banco Popular has a strong SME business, with over a 10% market share in this segment. The SME business has supported sound pre-provision earnings over the years, which should help the bank sell its case to investors." Fitch concluded "the success of measures being taken in Spain to strengthen capitalisation, clean up loan books and improve funding profiles - and by the EU authorities to alleviate the broader eurozone crisis - are ultimately the critical issues that will determine the extent to which Spanish bank ratings, including Banco Popular's, can improve over the medium term."

The downward trend in Banco Popular's shares has perhaps been no great surprise. A survey of 24 analysts on the Reuters website finds that 23 have negative views, as has been the case for the last three months. Those views have been correct, of course, so Banco Popular must hope that a successful rights issue can mark some kind of watershed and basis for recovery. We'll see.

| Code | Underlying | Currency | Type | Expiry | Parity | Strike | Sedol | ISIN |
|---|---|---|---|---|---|---|---|---|
| SW01 | Apple | GBP | CALL | 21/06/2013 | 100 | $800 | B7T34T5 | CWN8139V2692 |
| SW02 | Apple | GBP | PUT | 21/06/2013 | 100 | $600 | B8DDDN5 | CWN8139V2775 |
| SW03 | Apple | GBP | CALL | 19/12/2014 | 100 | $900 | B84KWK5 | CWN8139V2858 |
| SW04 | Apple | GBP | CALL | 19/12/2014 | 100 | $1,100 | B88MPC0 | CWN8139V2932 |
| SW05 | CAC 40 | GBP | CALL | 21/06/2013 | 1,000 | € 4,000 | B4K6JY2 | CWN8139V3013 |
| SW06 | CAC 40 | GBP | PUT | 21/06/2013 | 1,000 | € 3,000 | B7YMSX9 | CWN8139V3195 |
| SW07 | CAC 40 | GBP | CALL | 20/12/2013 | 1,000 | € 4,200 | B87SV43 | CWN8139V3278 |
| SW08 | DOW JONES | GBP | CALL | 21/06/2013 | 1,000 | $15,000 | B7QN1M0 | CWN8139V3351 |
| SW09 | DOW JONES | GBP | PUT | 21/06/2013 | 1,000 | $12,500 | B88WPK8 | CWN8139V3435 |

| Code | Underlying | Currency | Type | Expiry | Parity | Strike | Sedol | ISIN |
|---|---|---|---|---|---|---|---|---|
| SW10 | DOW JONES | GBP | CALL | 20/12/2013 | 1,000 | $15,500 | B7LX716 | CWN8139V3500 |
| SW11 | DOW JONES | GBP | PUT | 20/12/2013 | 1,000 | $12,000 | B883LW5 | CWN8139V3682 |
| SW12 | Facebook | GBP | PUT | 21/06/2013 | 10 | $15 | B8D68Z1 | CWN8139V3765 |
| SW13 | FTSE 100 | GBP | PUT | 21/06/2013 | 1,000 | £5,700 | B7Z7PM1 | CWN8139V3849 |
| SW14 | FTSE 100 | GBP | PUT | 21/06/2013 | 1,000 | £5,900 | B8HRCY7 | CWN8139V3922 |
| SW15 | FTSE 100 | GBP | PUT | 20/12/2013 | 1,000 | £5,750 | B87N955 | CWN8139V4003 |
| SW16 | FTSE 250 | GBP | CALL | 21/06/2013 | 1,000 | £13,000 | B8C11V4 | CWN8139V4185 |
| SW17 | FTSE 250 | GBP | CALL | 20/12/2013 | 1,000 | £13,000 | B8CK6K5 | CWN8139V4268 |
| SW18 | FTSE 250 | GBP | PUT | 20/12/2013 | 1,000 | £11,000 | B8N93H7 | CWN8139V4342 |
| SW19 | GOOGLE | GBP | CALL | 20/12/2013 | 100 | $900 | B7XKZV1 | CWN8139V4425 |
| SW20 | NASDAQ 100 | GBP | PUT | 21/06/2013 | 1,000 | $2,500 | B7Z8TD3 | CWN8139V4599 |
| SW21 | NASDAQ 100 | GBP | CALL | 20/12/2013 | 1,000 | $3,000 | B75F8X7 | CWN8139V4672 |
| SW22 | NIKKEI 225 | GBP | CALL | 20/12/2013 | 10 | ¥10,000 | B7F4B35 | CWN8139V4755 |
| SW23 | NIKKEI 225 | GBP | CALL | 20/12/2013 | 10 | ¥12,000 | B7KJT08 | CWN8139V4839 |
| SW24 | NIKKEI 225 | GBP | PUT | 20/12/2013 | 10 | ¥7,500 | B8KC528 | CWN8139V4912 |
| SW25 | S&P 500 | GBP | PUT | 21/06/2013 | 100 | $1,350 | B80LQH7 | CWN8139V5091 |
| SW26 | S&P 500 | GBP | CALL | 20/12/2013 | 100 | $1,600 | B83C5N6 | CWN8139V5174 |
| SW27 | S&P 500 | GBP | CALL | 20/12/2013 | 100 | $1,800 | B7ZT4H5 | CWN8139V5257 |
| SW28 | BRENT DEC 13 | GBP | CALL | 11/11/2013 | 10 | $110 | B43T5J5 | CWN8139V5331 |
| SW29 | BRENT DEC 13 | GBP | PUT | 11/11/2013 | 10 | $100 | B84HMV7 | CWN8139V5414 |
| SW30 | GOLD | GBP | CALL | 27/12/2012 | 100 | $1,900 | B8K9PQ3 | CWN8139V5588 |
| SW31 | GOLD | GBP | CALL | 26/06/2013 | 100 | $1,900 | B7MPQ25 | CWN8139V5661 |
| SW32 | GOLD | GBP | PUT | 26/06/2013 | 100 | $1,700 | B825633 | CWN8139V5745 |
| SW33 | GOLD | GBP | CALL | 27/12/2013 | 100 | $2,000 | B8MJ4X1 | CWN8139V5828 |
| SW34 | SILVER | GBP | CALL | 26/06/2013 | 10 | $35 | B7MHYM7 | CWN8139V5901 |
| SW35 | SILVER | GBP | CALL | 27/12/2013 | 10 | $40 | B7T0KG5 | CWN8139V6081 |
| SX96 | S&P 500 | GBP | PUT | 21/12/2012 | 100 | $1,400 | B8DXGR0 | CWN8139V6321 |

## EXPLAINING COVERED WARRANTS

**Reviewing the data on covered warrants trading in the year to date, we note that in the first nine months of the year there were 8134 trades on the London Stock Exchange, worth a total of £30.27m. Those figures may seem rather abstract, but we think they become more interesting when they are used to calculate the average trade size. It works out at £3721. Covered warrants are a private investors' market. They were designed specifically to allow smaller investors to participate in derivative markets in a transparent and risk-controlled manner, and you do not need to invest a large sum to join in.**

The minimum deal size when trading in covered warrants is just one warrant; more realistically, in view of stockbrokers' commissions, a couple of hundred pounds is probably a reasonable starting point, particularly if you are just wanting to test the water.

When choosing which covered warrants to trade it can also be helpful to see which issues other people are trading. Last month the warrant attracting the largest value of trade was the **SV79 RBS 1.00 20-Dec-13 call,** and the warrant attracting the largest number of transactions was the **SB28 Silver 35.00 21-Dec-12 call.** Looking at the top ten by value though, it is telling that five of them are based on the **FTSE 100 Index,** which is no great surprise. It is consistently the most popular underlying instrument, and with good reason, we think. For a start, the index is highly visible, and very easy to track even if your daily life does not allow you to check the index level on a computer or mobile electronic device. The FTSE 100 Index is in every newspaper, on radio news bulletins, and on television news. This constant coverage means that most reasonably active investors have – unwittingly perhaps – built up a fund of knowledge about the index and how it moves. Besides knowing where the index is now, it is useful to have an idea of its recent history, its high point, the rough parameters of its likely daily movements, and of course what some of the prime influences are on its movement.

Added to those reasons, the covered warrants market serves the index particularly well. There are more warrants available on the FTSE 100 Index than on any other asset, with a good choice of maturity dates and strike prices. You can readily choose to trade calls or puts. The dealing spreads are competitive. Furthermore, because volatility is a part of the pricing formula, and market indices usually exhibit lower volatility than individual equities, covered warrants on market indices are usually cheaper. The combination of these factors makes the index a great place to start, in our view, perhaps with warrants with a few months to run, and where the strike price is not too far away from the current market level. With the index currently standing at 5782, one of the warrants on that top ten list seems to fit the bill quite well. The **SX30 FTSE 100 5750 21-Jun-13 calls** at £0.295 offer effective gearing of 9.5 times and have exhibited a good degree of movement since they were listed in mid-July. The price has been as low as £0.265 and as high as £0.455.

On the put side, the **SW14 FTSE 100 5900 21-Jun-13 puts** at £0.47 look reasonable to us. They offer effective gearing of 7.2 times and are currently in-the-money with some intrinsic value. These are relatively new, having launched on 15th October, and in their short life to date the price has ranged between £0.41 and £0.48.

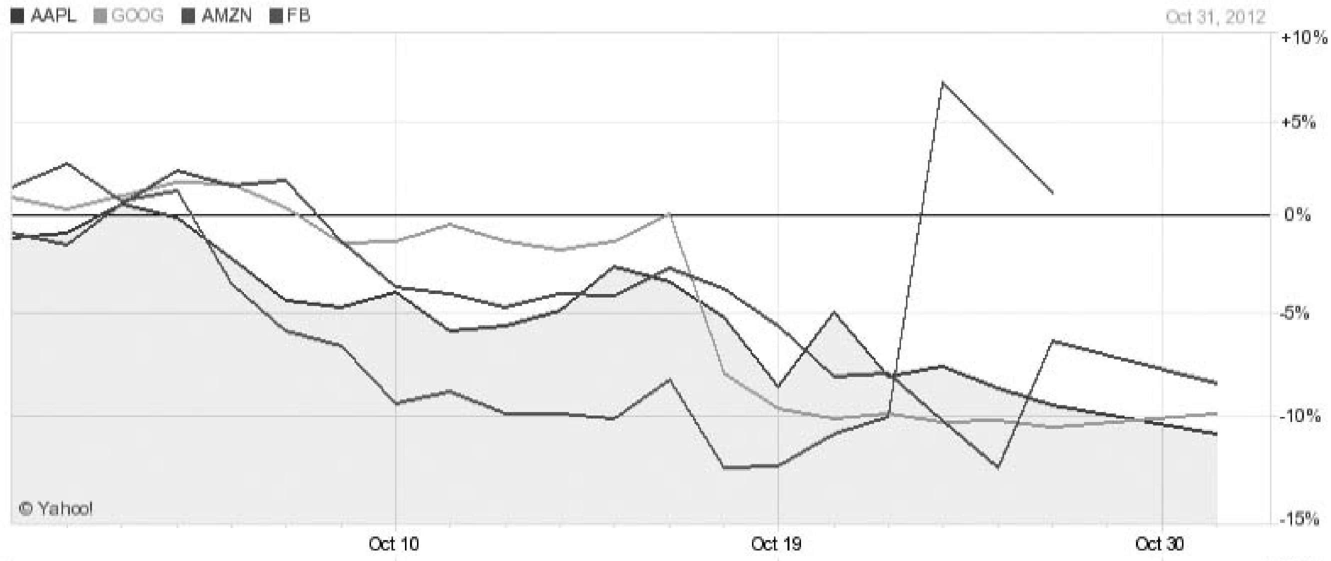
Just in case you were wondering, the remaining three warrants in the top ten by value in September were a call warrant on **gold** and two call warrants on the largest stock in the world, **Apple.** Again, there is no shortage of regular and accessible news on these two assets, making it comparatively easy for you to form a view and take a position.

## COVERED WARRANTS IDEAS

Last month we introduced the new range of long-term call covered warrants from SG. We have added these to our main model so that we can track their performance. Over the last month the ones to have were the **LC25 RBS 3.50 18-Dec-15 calls,** up by 17.4% in response to an 8.6% rise in the underlying shares. At £0.769 the warrants offer gearing of 3.7 times for a CFP of 18.70%, which looks quite FULLY VALUED to us. There are cheaper alternatives in the sector, such as the **LC15 HSBC 6.75 18-Dec-15 calls,** up by 9.8% over the month to £1.056. They offer gearing of 5.8 times for a CFP of 9.31%. Covered warrants on **Barclays, Eurostoxx Banks Index, Lloyds Banking Group,** and **Standard Chartered** were all up. The British banking sector was helped by a new FSA ruling indicating the banks will not have to hold extra capital against new loans made under the 'funding for lending' scheme. The regulator also eased its core capital requirements, leading to hopes that the worst of the regulatory squeeze on the sector may have passed.

On the way down, **William Morrison Supermarkets** shares dropped by 5.3% over the month to £2.70, on the back of disappointing sales figures. The company said it has been outpaced by competitors with internet sales operations and with more smaller convenience stores. Morrison's share of the UK grocery market has dropped from 11.8% to 11.4% as a result. Whilst the company plans to address these issues with an online wine offer and 20 'M local' outlets by the end of the year, it admits it is playing 'catch up' with competitors. The **LC33 Wm Morrison 3.75 18-Dec-15 calls** were down by 19.4% over the month to £0.2411, at which level gearing is 11.2 times for a CFP of 14.44%.

It has been difficult to avoid the US technology sector over the last month. **Apple** has introduced a new, smaller, iPad to compete with cheaper offerings from **Amazon** and **Google** amongst others, but has also suffered management and production problems; the latest results from **Google** resulted in a short sharp shock for the shares; and **Facebook** shares have been extremely volatile as investors fret over whether its business model can prove sustainable and adaptable. To help us follow these four stocks, all of which have covered warrants available, we have created a chart that plots the four share prices together. We felt this might help us to spot trends, and we have already learned a few things. Over the last three months, for example, the best performer of these four is not Apple, as you might think, but Google. The most volatile of the four is Facebook. Over the last month, as this chart shows, the sector trend has definitely been downwards, but Facebook is a maverick performer, more subject to company-specific factors than to the prevailing market movement, and is actually up on balance over the month.

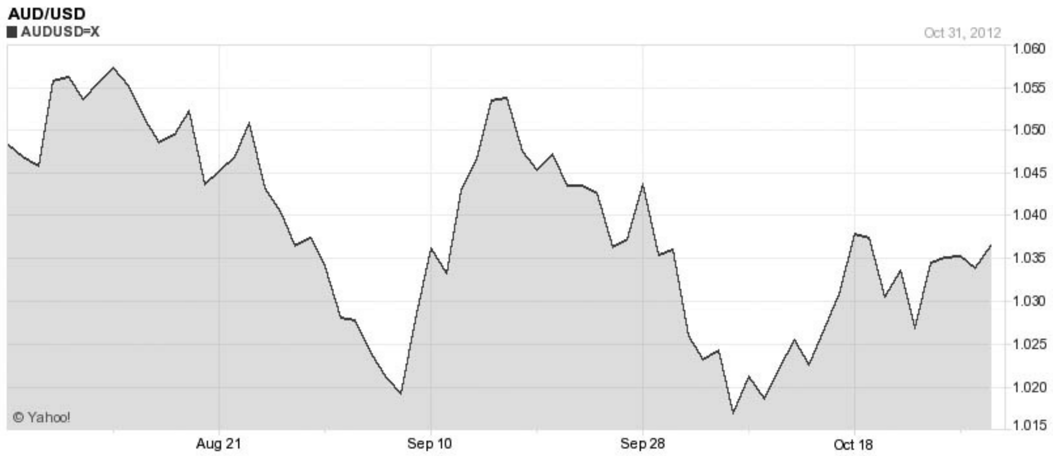



Two implications leap out at us. The first relates to **Google,** and suggests that perhaps it might pay to look past its results hiccough. It has generally been a decent performer, so perhaps its recent setback might prove an opportunity. The second is that if you are looking at out-of-the-money warrants on these stocks, **Facebook** could be the one that actually stands the greatest chance of delivering a really large movement.

Let's consider these two possibilities, starting with Google. It hit the news headlines on 18th October after its third quarter results were released a few hours early by mistake and the disappointing figures, showing a 20% drop in profits from the same period last year, caused the shares to dive by 9%. The real problem with releasing the figures early was that this happened during trading hours, and it meant there was no time for an analysts conference call to explain the figures, or for a more studied evaluation. On reflection, the figures really weren't so bad, with non-recurring issues such as forex movements and restructuring costs accounting for part of the shortfall. Google shares have since recovered their poise, but they have not recovered to the pre-shock level. The market isn't that forgiving, and special factors or not, the company's revenue growth still failed to match expectations. Google shares are trading now at US$677 and in our view the **SD15 Google 700 21-Jun-13 calls** look well placed if you believe a recovery is likely. They are only just out-of-the-money, offering effective gearing of 4.2 times and with a delta of 0.31. If the shares could find some good news to take them back up to the US$750 mark by the year-end, the SG warrants calculator suggests the SD15 covered warrants could deliver a 38% rise. That may be too optimistic, but if US economic confidence were to rally for the key holiday season, we think Google could definitely join in any rally.

Turning to Facebook, its shares have traced out a gut-wrenching pattern since IPO, but its third quarter results served to impress the market. They beat market expectations and soothed fears that Facebook could have difficulty maintaining its advertising revenues. In fact, its advertising revenue was up 14% for the quarter, and Facebook shares jumped by a remarkable 18.7% over just one week, triggering a 60%-plus rise in the **SV96 Facebook 40.00 21-Jun-13 calls.** With Facebook shares currently at US$21.20 though, a strike price of US$40 is quite a stretch, and for risk-averse investors these warrants will most likely be well beyond the bounds of acceptability with a delta of just 0.09. Perhaps it is worth re-framing the question though, from the likelihood of Facebook reaching US$40 per share by June to the likelihood of Facebook reaching, say, US$27 by December. That seems more feasible, and might be greeted by a chunky rise in the warrant price. After the results, Reuters reported that several brokers upgraded their rating on Facebook shares. Barclays Capital raised its target to US$26 from US$23, Jefferies & Co to US$32 from US$30 and Macquarie Equities Research to US$24 from US$21. Citi Investment Research upgraded the stock to "buy" from "neutral". One final point we will note is that an important lock-in period has just passed for Facebook shares, meaning that some 'old' holders have been able to sell. Arguably, that may have held the price down, so this adds a little extra fuel to the bullish argument.

Currency warrants are always interesting, we think, both because of their restless movement and also because there are always two different assets at play. If you are examining the GBP/USD exchange rate, for example, you might expect this rate to rise because of a stronger pound or because of a weaker dollar. Sometimes it is possible to combine the two - this is ideal - as happened with the **GBP/JPY** exchange rate last week. Sterling was stronger on the back of third quarter GDP figures that showed a welcome return to growth, while the yen was weak ahead of new price data expected to show continuing deflation in Japan. The result was a decent gain for the **SP51 GBP/JPY 120 21-Dec-12 calls.** Now we are interested in the **AUD/USD** exchange rate, which has had two attempts at dipping below parity in the last three months, as you can see from the chart.




Recently the exchange rate has rallied back up to US$1.037, helped by some good Chinese data and CPI data in Australia, but we can see good arguments for it dipping again. This is a contrarian view, we have to admit. ANZ analyst Andrew Salter has just turned bullish on the near-term prospects for the Aussie dollar, and most technical analysts seem to be expecting the current trend to continue. We are not so sure though, particularly for as long as the exchange rate stays below US$1.04, seen as a key resistance level. First of all, a post-election rally in the US dollar is a decent possibility, we think, as long as there is a clear outcome to the election that removes uncertainty. And on the other side of the equation, there has been sporadic weakness in metals prices that might serve again to undermine the commodity-heavy Australian dollar, and the Reserve Bank of Australia seems intent on cutting interest rates when it meets next week.

Another run at parity seems a reasonable scenario, in which case the **FX06 AUD/USD 0.95 28-Dec-12 puts** could be of speculative interest. Currently very low-priced at US$0.0075, these warrants were as high as US$0.45 in May. The odds are against a successful outcome, we would have to say, but the payoff could be large if it happens. As such, a very small investment could be interesting here, especially as it may act as hedge for existing commodity or equity holdings.

**Your next newsletter is published on Saturday, 1st December.**