Lord, make me pure - but not just yet

Diary of a Private Investor   Update #5   12 July 2018

June was a great month for sunshine but a bad month for my portfolio. Its value fell by more than 4%, wiping out most of May's 5.2% gain. The prices of my top four stocks all fell, while the opposite happened to Tesla, in which I have a significant short position. Its share price rose by more than 20% in the month, contributing a negative 1.1% to June's overall negative 4.3%.

The good news is that I was spared an even worse outcome by acting on readers' advice, as I'll explain.

Following last month's revelation that some of my share purchases are funded by borrowings, I was roundly criticised by readers of the diary on www.askaboutmoney.com . They castigated me for taking excessive risks. I heeded their advice and sold enough shares, spread across the portfolio, to reduce the gearing level by more than 10%. The sales were completed over a few days immediately following the publication of the diary update on 11 June. I decided not to deleverage completely however, as I expect to earn an average return of at least 6% per annum on shares, compared with borrowing costs of only 3% per annum.

I recognise that the expected additional return from investing in shares is not a free lunch. Far from it. The market value of the shares could fall significantly – and suddenly. A sharp fall in share prices could result in borrowings being called in at short notice, and at exactly the wrong time, when values are depressed. I'm satisfied that I can manage the risks - provided the leverage is low enough.

I was fortunate in the timing of the share sales. All but one of the shares were sold at prices higher than those ruling at the end of May, and substantially higher than those ruling at the end of June. The loss in the month would have been much greater if I hadn't deleveraged or had waited until later in the month to do so. Thank you, readers, for the advice.

I made a firm resolution to be good in future, not to allow borrowing levels to increase again, and to continue selling shares as market conditions allowed, using the proceeds to repay borrowings. Sadly, my good intentions did not last long. An invitation from an old flame seduced me into putting my good intentions on hold – for the time being at least.

The old flame, risen from the ashes as it were, was Phoenix Group Holdings, a UK life assurance group headed by Clive Bannister, son of the late great Sir Roger Bannister, the first sub-four-minute miler.

I bought my first shares in Phoenix Group Holdings in May 2014. The main attraction was the dividend yield of 7.9%. After doing some advance homework, I concluded that the dividend could be maintained indefinitely, so the long-term return should be considerably above my minimum target return of 6% per annum. That was enough for me.

Thus far, my faith has been rewarded. The dividend was maintained at its 2014 level in 2015; then it increased by 2.6% in 2016, by 10.5% in 2017, and is expected to increase a further 4.3% in 2018.

Capital values haven't followed a similarly smooth trajectory. Within a month of my initial purchase, the share price fell 7%. Most would see this as bad news, but it meant that the dividend yield on new purchases was an even more attractive 8.5%. I took the opportunity of the lower price to double my holding. Since then, I have exploited temporary price weaknesses to continue adding more Phoenix Group shares to my portfolio, to the point where it is now my second biggest holding (after Renishaw, which I've written about elsewhere).

Allowing for rights issues (of which more anon), the Phoenix Group share price is now more than 30% above where it was when I made my first investment in the company in May 2014. Sterling has weakened considerably against the Euro in the meantime, which limits the gains, but I hedged my currency exposure to Phoenix Group and other UK-focused shares from mid-2015, so was spared the worst effects of sterling's devaluation following the Brexit referendum in 2016.

Just over a month ago, at the end of May, Phoenix Group announced a rights issue to help pay for the cost of buying Standard Life Assurance Company, which it agreed to purchase in February last. Existing shareholders were given the option of buying another 7 shares for every 15 already held, at the knock-down price of £5.18 a share, compared with £7.72 share when the rights issue was announced. The theoretical ex-rights share price was thus 691p.

I felt the shares were good value, even though the prospective dividend yield was now less than 7%, compared with almost 8% when I bought my first shares in the company in 2014. I couldn't resist the temptation to take up as much of the rights issue as possible, even though it meant straying from the path of righteousness I had vowed to follow only a short time previously. I used some of the liquidity in my portfolio, and increased my borrowing again, to buy as many of the rights issue shares as I could afford.

I now feel like the financial equivalent of St. Augustine, aspiring to the purity of a debt-free portfolio – but not just yet.