THE STAR USER GUIDE

INTRODUCTION

THIS GUIDE CONTAINS THE FOLLOWING TOPICS

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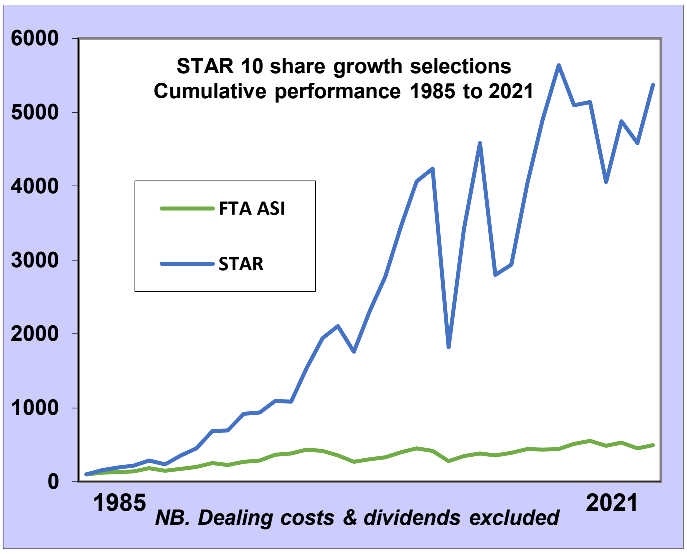
1 BACKGROUND – WHAT STAR IS

The Share Tracking and Rating (STAR) methods have been developed over more than 30 years to provide private investors with a range of structured templates that will enable anyone to set up and manage their own equity portfolios simply, cheaply and easily and without any prior knowledge of the investment world.

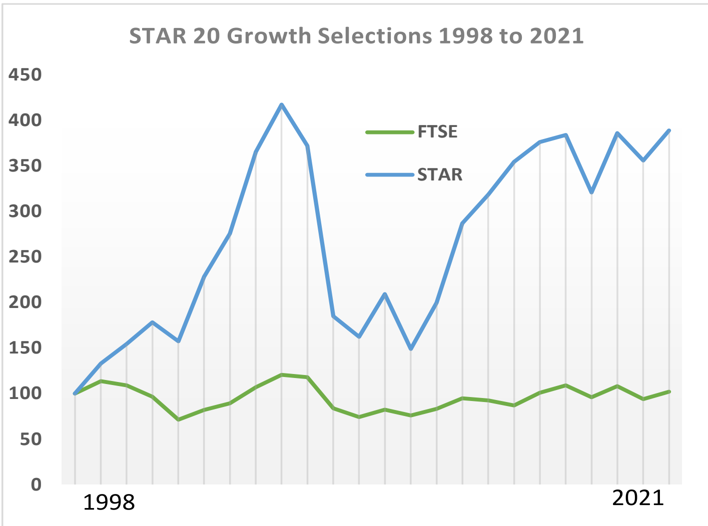
The STAR Newsletters provide regular monthly investment evaluations on over 450 of the largest UK quoted companies, 350 smaller AIM listed companies, more than 200 large global shares and over 300 shares listed on continental European bourses.

2 DOES STAR WORK?

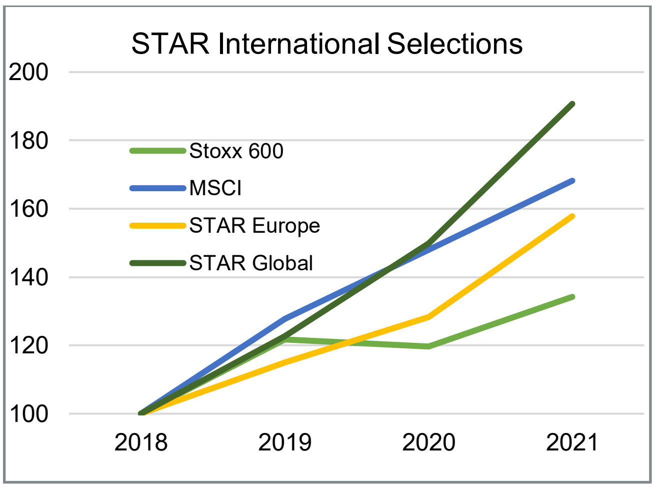
The monthly STAR updates were originally developed in the 1980s to construct and manage share portfolios from a database of shares listed on the LSE Main and Aim exchanges. The first performance records covered ten shares selected for growth and ten for income and growth. The price performance measurements of these portfolios stretch back as far as 1985 and compare the annual performance with the All-Share Index (ASI) up to September 2021. The chart below compares the average price gains and losses each year for **the top ten shares** selected for their growth potential.



Since 1998 the annual lists of **twenty growth shares** had, by September 2021, grown in value, before deducting costs, more than three times faster than the FTSE All Share Index.



In similar fashion the **STAR Global and Continental European portfolio selections** have outperformed the comparator indices since they were initiated in 2018 as shown in the chart below.



However, do please remember that past performance on any investment management programme or selection process such as STAR is no guarantee to future success.

One of the main advantages of the methods used for selecting growth shares is that on average since 2010 less than 20% of the growth share portfolio holdings have been switched during the course of the year, thus reducing dealing costs to a minimum.

3 WHAT THE STAR NEWSLETTERS CONTAIN

More specifically the STAR monthly bulletins contain the following sections:

- **Editorial comment**
- **Evaluation and comment on the current year's UK & Overseas share portfolios**
- **Market barometer that indicates changes in aggregated UK corporate earnings estimates**
- **Detailed STAR profile on one or more selected companies that have been double screened**
- **Latest 10 and 20 share purchase lists for the UK main and AIM equity portfolios**
- **Latest 10 and 20 share purchase lists for continental European and global equity portfolios**
- **Danger list for UK-listed main market shares whose future earnings have fallen by 20% or more**
- **Separate list detailing the latest STAR rating values of all the main market shares in the current database**

4 DECIDING WHICH TEMPLATE MEETS YOUR NEEDS

The STAR templates have been created with the alternative objectives of generating either capital growth, income or a combination of the two from a database comprising key information on the largest companies listed on the LSE main market. There is also the higher risk AIM template that is designed to achieve capital gains from the STAR AIM database of approximately 350 shares. Since late 2017 a global portfolio sourced from a database of MSCI-indexed shares and a continental European portfolio derived from leading European listed equities have broadened the options for private investors seeking portfolios that possess wider geographical coverage.

You may use STAR either by following the templates closely or by selecting individual shares from any of the latest "purchase" lists in order to add to an existing portfolio.

Before putting STAR to work it will clearly be important to decide your priority in terms of your own objectives and also your preference in terms of attitude to risk. All shares are risky to the extent that their price, and hence value, may fall or rise depending on market conditions or changes to the perceived outlook for the underlying business or relevant sector.

5 HOW TO USE STAR

The STAR newsletter monthly updates may be used in any of the following ways:

- **To set up and manage share portfolios from scratch using cash**
- **To manage part or all of an existing portfolio**
- **To select shares for self-managed portfolios in ISA and SIPP wrappers**

The notes which follow show how STAR can be used to set up and manage share portfolios of 10 and 20 shares using cash and the modifications required for use with existing portfolios.

In essence the options are:

- Follow the ready-made templates for 10 and 20 shares by investing equally in each of the shares in the relevant list and hold for at least one year or until one of the shares appears on the latest danger list that is provided as the final table at the end of each monthly newsletter, or

- Select any share appearing on the monthly list for further research using your own criteria, or
- Build up a UK share portfolio using the monthly STAR corporate profiles that employ more detailed secondary screening methods as explained in section 8 of the STAR Guide to Equity Investment.

6 GENERAL GUIDELINES FOR USING STAR

6.1 Deciding on the Number of Shares to Buy

Evaluation of portfolio selections since 1985 indicates that it is sensible to spread the initial investment funds equally between at least 10 shares in order to reduce risk. Fewer than 10 shares increases the adverse impact of a single poor performing share even though the long term gains from selections of as few as six shares have often exceeded those from 10 shares. With more than 20 shares management of private portfolios can become expensive and time consuming. For this reason, each STAR newsletter provides lists of the latest month's top twenty 20 shares for each of the templates.

On the basis of an initial selection of 10 shares, I suggest that equal amounts be invested in each of the shares marked as **BUY10** in the latest Ranking list - selecting from either the Growth, Income & Growth, or AIM selection lists for UK-listed shares and similarly for growth shares listed on European and global bourses. The procedure is the same for the construction of an initial 20 share portfolio in which case you would buy all the shares marked as **BUY10** as well as those marked **BUY20.**

6.2 Spreading the Risk

In order to prevent share portfolios becoming too exposed to problems in any one sector of the market the rating system for main market listed shares allows for no more than two shares in any single sector in ten share portfolios and no more than four in twenty share selections. The rating guidelines (**BUY10** and **BUY20**) allow for this in each monthly list but it is obviously up to you to check that sector over-weighting does not become excessive - especially as investment values change through the year. The same sector limits are applied to the higher risk AIM selection list and the international portfolios.

6.3 The STAR ratings used in the primary screening process

The STAR rating numbers that are used to create each month's ranking lists are based on the following metrics:

- Consensus forecast earnings growth
- Return on capital employed (ROCE)
- Past sales growth
- Operating margins.

Additional metrics include gearing levels and the dividend yield (for income selections).

Each of these metrics is accorded a value ranging between 1 and 10 for the first two mentioned above and from 1 to 6 for the latter two so that the maximum "score" is currently 32 for any individual share. The basic STAR scoring procedures are continually evaluated and variations on the basic theme are back-tested from time to time to assess whether changes should be made to improve the overall performance of the methodology in securing long-term returns.

6.4 The Gearing Filters

Gearing ratios indicate the extent to which a company uses borrowed money. When interest rates are low and money is cheap a relatively high gearing ratio may help the company to generate fast profits growth. However, when interest rates rise, high gearing can be dangerous and investors may wish to exclude shares with high gearing ratios. The gearing data are one of the metrics used in the STAR Series 3 selection process and shares with very high gearing ratios of over 250% are normally excluded from the latest purchase lists – although in some cases (banking and mining) high borrowing levels are part of the basic business.

6.5 Dividend Yield

The dividend yield shows the gross dividend yield that is estimated to be received by shareholders at the current market price of the shares in two years' time. The STAR Income list uses the same basic selection criteria as the capital growth list but excludes all shares with a dividend yield below the median for the total universe of companies monitored.

6.6 Putting STAR into action using the primary screening process

An example may help. Let us assume that you have £20,000 to invest and you wish to spread this sum equally between twenty shares featured in the growth share list for the current month. The examples which follow are taken from the STAR ranking list published in the newsletter of January 2021. The list of the top twenty shares shown in the table below has been selected after first rating all the 450 plus shares as explained in section 6.3 above and then eliminating shares whose forecast earnings have reduced by more than 20% over the past two months. Adjustments are also made to ensure that the weighting limits are also respected (see section 6.2 above). Shares rated "**BUY 10**" are the first ten that meet the basic criteria provided that there are no more than two in any single industry sector. The next ten shares in the ranking list which meet the criteria are given a "**BUY 20**" rating subject to there being no more than four shares in any single sector in the top twenty list.

Please note that the rating numbers were reduced by a factor of 10 during 2021 while keeping all values in balance so that the maximum "Score" for an individual share, which was 320 in January, was lowered to 32 and so on down the list.

Example – STAR Main Market Growth Selections – 1st January 2021

Sector	Code	Company	Price	Gearing	Yield	Rating	Action
Leisure Goods	GAW	Games Workshop Group	11460	0	2.0	274	Buy 10
Financial Services	LIO	Liontrust	1330	0	3.7	266	Buy 10
Mining	POLY	Polymetal International	1842	78	7.4	266	Buy 10
Travel & Leisure	DOM	Domino's Pizza Group PLC	326		3.2	248	Buy 10
Industrial Transportation	AVAP	Avation PLC	126	469	11.2	246	Buy 10
Financial Services	CLIG	City of London Investment	450	0	7.6	246	Buy 10
Real Estate Investment	LMP	Londonmetric Property	234	60	3.8	246	Buy 10
Media	GOCO	GoCo Group PLC	131		0.9	236	Buy 10
Pharmaceuticals & Biotech	DPH	Dechra Pharmaceuticals	3548	20	1.1	232	Buy 10
Industrial Metals & Mining	EVR	Evraz PLC	492	205	7.6	230	Buy 10
Travel & Leisure	888	888 Holdings PLC	296	0	2.8	229	Buy 20
Support Services	SNN	Sanne Group PLC	632	68	2.4	226	Buy 20
Mining	KAZ	KAZ Minerals PLC	666	130	1.1	224	Buy 20
Electronic & Electrical	LUCE	Luceco PLC	260	58	2.2	224	Buy 20
Mining	CEY	Centamin PLC	134	0	4.6	222	Buy 20
Mining	HOC	Hochschild Mining PLC	224	5	1.4	222	Buy 20
Software & Computers	AVST	Avast PLC	533	78	2.1	218	Buy 20
Support Services	DPLM	Diploma PLC	2220	0	1.6	216	Buy 20
Electricity	GLO	ContourGlobal PLC	217	927	6.1	214	Buy 20
Software & Computers	TRB	Tribal Group PLC	89	0	1.7	212	Buy 20

6.7 Subsequent Management – sales, purchases and annual re-balancing

Sales and purchases

In the early years of STAR, back in the 1990s, I flagged the lowest rated 10% of shares covered by the monthly ranking lists as sales. The reasoning behind this approach was that these poor performers, which were exhibiting either negative or extremely low rates of growth in earnings over the next two years should be exchanged for shares near the top of the list in terms of future growth and current value.

Over subsequent years I discovered that these methods were a bit too extreme and that a more nuanced take on flagging sales was generally less expensive and more profitable. In recent years, as the STAR screens have progressed and become much more widely focused, in terms of the number of valuation metrics employed, the sales signals have been reduced to include only those companies whose consensus earnings forecasts have been reduced by more than 20% or where a profits warning has resulted in a similar reduction in forecast earnings over the next two trading periods.

If any share appears on the danger list the first step is to review very carefully the reasons for this warning signal. It may be because it has fallen in value because investors think it is over-valued or it may, of course, be because the outlook for future profits has fallen and it is now viewed as expensive. The former is covered by the STAR Danger List that flags any share whose forward (2 years ahead) earnings estimates have been reduced by 20% or more over the past two monthly periods.

End year re-balancing

In order that portfolios do not become too unbalanced, it is usually a good idea to adjust existing holdings after completion of the first full calendar year following initial investment. Depending upon taxation liabilities and personal preferences this may involve, at the most extreme, the replacement of all shares not currently rated as purchases with those that are featured on the latest relevant selection list. This course of action is the one that is used in tracking the long-term performance of the STAR portfolios and is most suitable for users who wish to follow the mechanical STAR approach without considering any other factors.

Less dramatic, and probably more suitable for more active investors, is the sale in early January, subject to taxation considerations, of all shares appearing on the Danger List or appearing on the latest ranking list with a STAR rating value below the median (currently 16). The proceeds of the shares sold at the time of re-balancing would be aggregated and then re-invested in the same number of shares, not already held, derived from the latest Top Twenty list.

7 USING STAR FOR EXISTING SHARE PORTFOLIOS INCLUDING ISAs AND SIPPs

Investment Objectives

Before putting STAR to work on existing portfolios it is advisable to review the overall objectives of your equity investments. At this point it may also be helpful to seek investment advice from a qualified accountant or other investment advisor. More specifically it will be essential to decide on the number of holdings you want to have in your portfolio and their average value and the weighting between sectors as explained in the preceding notes.

Investment action

Once you have decided on the strategy to be adopted you may use the latest issue of the STAR newsletter to sell any shares that appear on the danger list, which is the final table in the monthly newsletter. Sale proceeds would then be re-invested equally between those shares currently rated as either **BUY10** or **BUY20** depending on the final composition of the portfolio desired.

Deciding on Your Portfolio Size

In adjusting existing portfolios to the STAR system, you must first decide on the total number of holdings you want to have in your portfolio and their average initial value, as explained in the section above.

Setting up the Portfolio

Subject to potential tax liabilities and transaction costs of share sales, you should consider disposing of any existing shares that are currently on the danger list. The total proceeds from any sales should be reinvested equally between as many shares on the current buy list as are necessary to make up a balanced portfolio. The procedure is then as explained in the previous section dealing with cash investments.

Subsequent management

After you have re-organised your existing portfolio, the subsequent management procedures will be exactly the same as those outlined in the previous sections.

8 ADAPTING STAR FOR YOUR OWN INVESTMENT METHODS

Using the STAR secondary screened company profiles to select individual shares

The monthly STAR templates rank all the shares in the markets covered according to the factors described in this guide. In essence, this is a mechanical method that follows the objectives that have become known as Growth at a Reasonable Price (GARP) subject to the additional screens mentioned. It is clearly possible for interested users to adapt these selection lists according to their particular requirements thus generating portfolios comprising any chosen number of shares and, if necessary, ignoring the sector weighting limits. This is one of the reasons that, over the past five years, we have added the more detailed STAR company profiles that rate specific shares according to the growth and value metrics that are shown in the table below. We have termed this process the STAR Secondary Screening. The example below relates to an evaluation of AIM-listed Ergomed which was published in the June 2020 issue of STAR.

Analysis of the share price performance of companies that have been put through the secondary screening and evaluation process indicates that those shares with a STAR points rating of 60 and above have delivered returns that have been on average substantially greater than the market. The example of Ergomed illustrates the secondary screening evaluation metrics currently employed. Analysis of the price performance of shares that have been screened in more detail is updated in each monthly issue of STAR.

Ergomed – STAR Profile Table June 2020 – Price 440p

Ergomed plc	Points	Max Points
Growth Metrics:		
Sales Growth - over past 5 Years	10	10
Operating Margins %	6	10
Estimated EPS Growth – next 2 years %	10	10
Efficiency - ROCE %	4	10
Management - incentives & competence	4	5
Business Model	2	10
Sector outlook - "Canary Signals"	8	10
Sub-total growth metrics	44	65
Value Metrics:		
Business Valuation - PER Measure	6	10
Financial Strength - Gearing %	4	5
Financial Strength - Interest cover	5	5
Dividend Yield %	0	5
Overall Value rating	8	10
Sub-total value metrics	23	35
Total Profile Rating	67	100

9 GLOSSARY – A FEW BASIC TERMS EXPLAINED

Unfortunately, the investment industry enjoys using a number of basic terms that often confuse rather than enlighten investors. A few of these are noted below taking the view that successful equity investment necessitates identifying financially sound businesses with potential for continued profitable growth:

Loans: Investment in a loan confers no ownership rights to the underlying business but priority in access to assets on dissolution

Shares: A share in a business is exactly that – a share (probably a very small percentage) of the total equity ownership of the business

Gearing: The amount of borrowing the business has taken on as a percentage of the assets of the business. The borrowing includes short- and longer-term lines of credit, bank overdrafts and loans as well dated loans (eg to be repaid at specific dates such as 5, 10 years) and loans that are held by outside investors.

EBITDA: Earnings Before deduction of Interest costs, Taxes, Depreciation charges and Amortisation. This is a basic measure of the ongoing profitability of the underlying business

Earnings: The amount that is available in each relevant accounting period (usually a year) for the owners of the business. For UK listed companies this is usually expressed in pence per share.

PER: The Price Earnings Ratio measures the multiple that the current share price of a quoted company bears to the earnings (after deduction of all operating costs, corporate taxes and deductions that the business has made to allow for depreciation of physical assets and amortisation charges usually made against intangible assets). It may be more useful to think of the PER as an earnings yield (the inverse of the PER) which is the final measure of earnings, usually expressed as pence per share in the UK, as a percentage of the current share price.

Interest Cover: This measures the number of times the annual interest costs are covered by annual earnings before deducting taxes and interest costs. ***Cover below 2 times is often dangerous territory.***

Dividends: The amount that the business pays out to its owners from the earnings available in the relevant accounting period. As with interest cover it is usually prudent for businesses, that need to invest for the future, to pay out no more than 50% of earnings by way of dividends. ***Dividend cover of between 2 and 3 times is a good general guideline.***

Key Measures for a Sound Business:

Sales: Ideally the business should have a proven record of steady and regular annual growth in the basic measure of annual sales.

Operating Margins: These measure the difference between sales and direct operating expenses. They shoe the gross margin between sold outputs and purchased inputs and exclude overhead costs. They are a measure of the pricing power of the business so that ***a strong business may exhibit an element of monopoly power through high operating margins.***

Return on Capital Employed (ROCE): This is another vital measure that looks at the return to the whole business and is derived by showing the business's Earnings before deduction of interest and taxes as a percentage of total assets less current liabilities. ***The ROCE should be significantly higher than the average cost of capital otherwise the business will be on a downward path to financial ruin.***

10 GENERAL NOTES AND WARNING

Before using the STAR newsletters you should carefully consider the likely dealing and transaction costs as well as all taxation implications and, if in any doubt, you should seek professional financial advice. The information contained within the STAR newsletters is provided strictly on the basis that subscribers make their own investment decisions. Users of the STAR newsletters must accept that the value of their investments can go down as well as up and past performance is no guarantee of future income, earnings or capital growth.

The STAR newsletter is a publication that features certain securities and comments on them, based on a number of factors. These factors may vary and are subject to change from time to time without notice.

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If you need investment or taxation advice you should consult a duly authorised financial adviser.

John Mulligan – Editor
October 2021