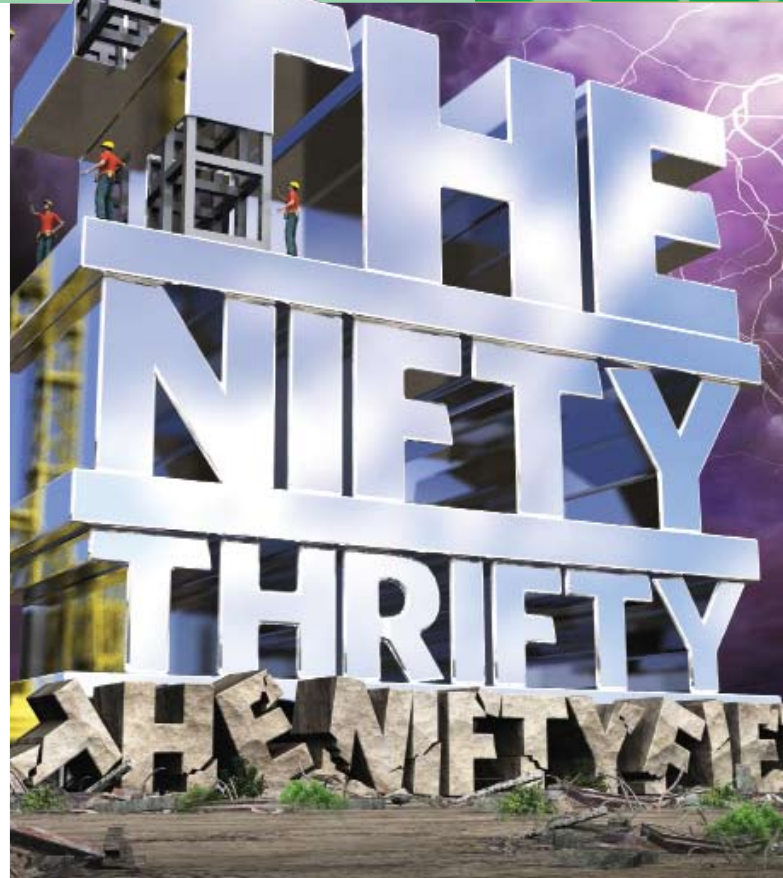




NIFTY THRIFTY UPDATE

Strategy can show its worth

The Nifty Thrifty has started shakily, but the algorithm has been deployed once again to ensure there is strength in numbers. **Richard Beddard** reports



Three months ago we started the *Money Observer* Nifty Thrifty, a portfolio of shares picked by an algorithm designed to sniff out big, strong UK companies that are cheap and highly profitable. Every three months, until March 2011, we'll add more shares until we have 30. Then we'll dispose of them on the anniversary of their inclusion and replace them with new shares 'recommended' by the computer.

This time, the computer says we should add WS Atkins, BHP Billiton, Halfords and British Sky Broadcasting, four companies that have little in common, even judged by the Nifty Thrifty criteria they meet.

With a market capitalisation of less than £700 million, WS Atkins (ATK.L) is one of the smallest companies eligible for the portfolio. This engineering consultancy joins Balfour Beatty and Carillion in the Nifty Thrifty. These companies are building infrastructure at a time of economic uncertainty and reduced government spending. Their

immediate prospects are modest, which probably explains why their shares are so cheap.

BHP Billiton's (BLT.L) shares are almost as cheap relative to earnings, but the mining company is one of the giants of the FTSE 100, with a market capitalisation of £41 billion.

Halfords' share price has risen impressively since the financial crisis

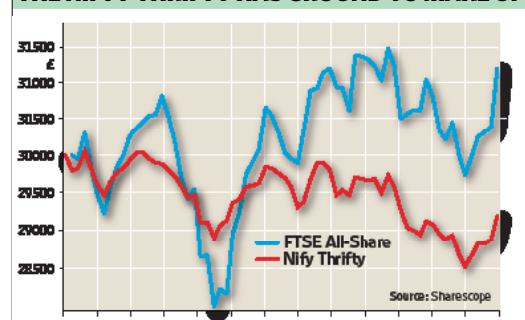
While **Halfords** and BSKyB aren't as cheap as our first two picks, these two household names compensate by being highly profitable. In its last financial year, the motor accessory and cycle shop made a 75 per cent return on capital, while BSKyB made 69 per cent.

As a stock picker used to deciding the stocks I include in a portfolio myself, I admit feeling wary about the latest additions. **BSkyB's (BSY.L)** price is propped up by bid speculation after Rupert Murdoch's News Corporation, already BSKyB's biggest shareholder, offered 700p per share for the 60 per cent of the company it doesn't own. The broadcaster's directors are holding out for a higher offer, but News Corp says they're not going to get one.

As we've added the shares at 712p, and BSKyB is reportedly demanding 800p, there doesn't seem to be a huge amount of profit in it, even if it gets its way. And since News Corp owns enough of BSKyB to block competing offers, it doesn't have to sweat too much.

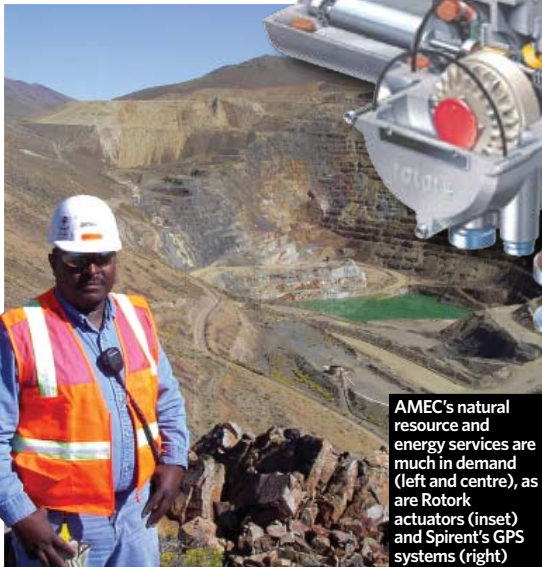
Halfords' (HFD.L) share price has risen even more impressively since the financial crisis, to well above pre-crisis levels. Its popularity seems justified. It has cut costs and increased sales through the recession by selling more bikes and camping equipment, as customers

THE NIFTY THRIFTY HAS GROUND TO MAKE UP



Notes: Transactions include fees and tax. Dividends and sale proceeds are credited to the cash balance (currently £12,129), which earns no interest. £30,000 invested in the Nifty Thrifty on 1 June 2010 was worth £29,126 on 1 September 2010. £30,000 invested in a FTSE All-Share exchange traded fund with dividends reinvested over the same period was worth £31,616. Source: Sharescope

NIFTY THRIFTY UPDATE



AMEC's natural resource and energy services are much in demand (left and centre), as are Rotork actuators (inset) and Spirent's GPS systems (right)



employed cheaper transport and enjoyed camping holidays in the UK.

The company has now diversified into car servicing through its acquisition of Nationwide Autocentre, a chain of garages that should profit from the trend for people to keep their cars for longer.

The Nifty Thrifty has started inauspiciously

So far, so good, but the contrarian in me wonders how long Halfords will delight investors and whether we're too late to benefit. I feel

the same about BHP Billiton, which has profited from a boom in commodity prices over the past decade.

Fortunately, it doesn't matter what I think. The algorithm rules, and of the companies with a market value of more than £500 million and above-average financial strength according to the F-Score statistic, these four are the

highest ranked by the Magic Formula, a statistic that combines profitability (return on capital) and value (earnings yield). I'll explain those measures in detail in the next two quarterly updates.

This quarter we've only added four companies, compared with 14 in June, because we had fewer to choose from.

The financial years of about half of all listed companies coincide with the calendar year, so there is a rush of reports in the first six months of the year while the second half is quieter.

If we ignore when companies report

their results, we could end up using figures that are almost a year old. In that time a company's fortunes can change dramatically, so I've chosen to rank only those companies reporting in the latest quarter. To make sure we get the highest-ranking shares, I've allocated berths in the portfolio roughly in proportion to the number of companies reporting. That means 14 companies in June, four in September, four in December and eight in March.

After one year, the portfolio will be full. Let's hope its performance has improved by then because the Nifty Thrifty has started inauspiciously. It's down nearly 3 per cent, and it could have been worse had more than half of its value not been languishing in cash. The shares in the Nifty Thrifty are down more than 5 per cent, although we have received modest dividends of nearly £79 in total from Babcock, De La Rue, MITIE and Rotork.

De La Rue is one reason why the

portfolio has fallen so sharply. In a rather un-nifty manoeuvre, the banknote printer suspended operations at a paper factory, when it discovered employees has falsified paper test certificates. Writing off paper stocks and putting things right will cost at least £35 million, a significant chunk of profits. Meanwhile,

SHARES QUALIFYING FOR THE NIFTY THRIFTY PORTFOLIO						
Rank	Name	Sector	Cap (£m)	ROC (%)	EY (%)	F-Score
1	Atkins (WS)	Support services	689	48	35	5
2	BHP Billiton	Mining	41,995	31	29	8
3	Halfords	General retailers	1,053	75	9	7
4	British Sky Broadcasting	Media	12,480	69	10	8
5	Sports Direct International	General retailers	617	66	10	6

Notes: ROC = return on capital. EY = earnings yield. Exclusions: companies reporting before 31 May 2010, companies below £500 million market capitalisation, companies with F-Scores of four or below. Companies are ranked using Joel Greenblatt's Magic Formula (see June 2010 edition). Only the top 25 per cent are included in the table.
Source: www.sharelockholmes.com, 1 September 2010

chief executive has resigned. It's no wonder investors are spooked, and the shares have lost 23 per cent since I added them to the Nifty Thrifty.

Unfortunately, De La Rue is not the worst offender. Yell shares are down 52 per cent since June. The company is a difficult one to value, which probably explains why its share price is all over the place. Once directories such as Yellow Pages were the obvious place to go to find local businesses, but today advertising is migrating online. Meanwhile, Yell is saddled with heavy debts and losing its long-standing chief executive and its finance director, two men who had started to slow the rate of decline.

We'll be holding Yell and De La Rue until June, as instructed. Hopefully they'll make amends and join Rotork, Spirent and AMEC, all of which are up sharply.

The portfolio can be tracked on www.moneyobserver.com/portfolio/nifty-thrifty-portfolio

NIFTY THRIFTY PORTFOLIO					
Name	Shares	Price (£)	Cost (£)	Value (£)	Return %
AMEC	124	9.39	995	1,164	17
Atkins (WS)	143	6.88	999	984	-2
Babcock International	172	5.21	1,000	895	-10
Balfour Beatty	384	2.45	998	939	-6
BHP Billiton	51	19.03	986	971	-2
British Sky Broadcasting	138	7.12	998	983	-2
Carillion	308	3.10	998	955	-4
Cobham	426	2.15	1,000	917	-8
De La Rue	109	7.03	999	766	-23
Halfords	197	4.98	996	981	-2
London & Stamford Property	804	1.14	1,000	917	-8
MITIE	431	2.02	999	870	-13
Next	47	20.28	996	953	-4
Regus	1,118	0.71	999	789	-21
Rotork	73	16.14	993	1,178	19
Spirent Communications	909	1.30	999	1,185	19
Ultra Electronics	62	17.26	998	1,070	7
Yell	3,064	0.16	1,000	481	-52
Total current holdings			17,950	16,998	-5
Cash				12,129	
Total portfolio			30,000	29,126	-3

Cost includes £10 broker fee and 0.5 per cent stamp duty for each transaction. The value is calculated at closing mid-price on the day of valuation. Cash earns no interest. Dividends and sale proceeds are credited to the cash balance.
Source: Sharescope, 1 September 2010