Our writers give their tips

Invest in Canada and US small caps, and snap up a cosmetics company and a Hungarian telecoms outfit

Buy into US small caps

In 2023, US smaller companies delivered only two-thirds of the 27% return their larger counterparts managed, *says Stephen Connolly*. This year, up until the US election, their relative performance was even worse, at just over half. But since then, in response to Trump's victory and his "America First" agenda, small caps have rebounded rapidly.

Trump might be light on detail, but his messaging points to a warm environment for America's smaller, domestically exposed businesses and entrepreneurs – bringing back manufacturing to the US, imposing high tariffs, boosting enterprise with tax breaks, and binning burdensome regulation and red tape. All this suggests that US small caps could well outperform in 2025. Switching about 5% of your portfolio's equity exposure to them could, at a stroke, reduce your overall risk thanks to increased diversification while giving you more growth.

The Russell 2000 is the 40-year-old index that tracks the ups and downs of the smallest 2,000 US companies – 7% by value of the market. The average size of these companies is just $4bn, versus $950bn for the largest. And while a third of the big stocks' index is weighted to technology, including giants near all-time-highs such as Apple, Nvidia, Amazon and Tesla, the small-cap arena is more balanced. Tech exposure drops to just 10%, for example, in favour of less racy sectors like industrials and materials that potentially offer more value.

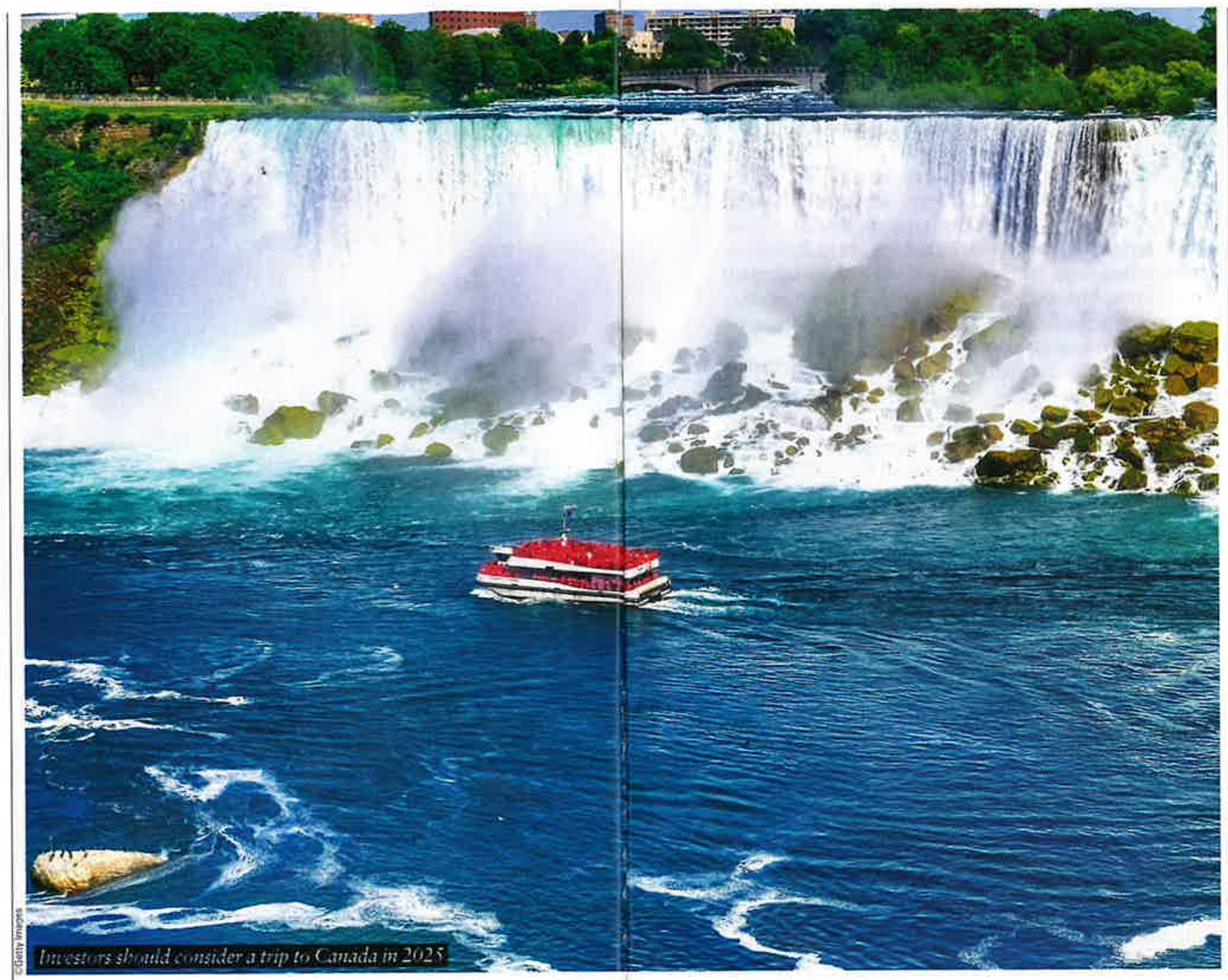
The simplest way to get exposure is via State Street's **SPDR Russell 2000 US Small Cap (LSE: R2SC)**, a UK-listed exchange-traded fund. The total annual charges are only 0.3% and you can put it in an Isa or a Sipp, too.

Finding value in overlooked businesses in Europe

My 2024 tips – Polish miner KGHM and the iShares MSCI Emerging Markets ETF – delivered returns slightly above 10%, *says Frédéric Guirinec*. But their performance pales against the blistering gains from crypto and US stocks. This year has been difficult for western Europe. France is flirting with a financial crisis, German industrial production is in free fall and Britain is turning socialist. Despite this gloom, we can still find some undervalued companies or businesses with strong prospects.

"France is flirting with financial crisis, German industry is in free fall, and Britain is turning socialist"

France's CAC 40 index returned a 0% yield this year and French companies are overlooked by international investors. Take private-equity firm **Wendel (Paris: MF)**: it trades at a 50% discount to net asset value (NAV). You get the illiquid assets almost for free once you deduct the value of the listed assets. Could this be a free lunch? Meanwhile, **OSE Immunotherapeutics (Paris: OSE)** has registered strong growth: it produces Tedopi for lung cancer, while the development of lusvertikimab for the treatment of ulcerative colitis is on track. Central Europe is also a solid bet. **AmRest (Warsaw: EAT)** operates more than 1,600 restaurants under brands including Starbucks, KFC, Pizza Hut and Burger King. Central Europe makes up 60% of its revenues, it generates strong cash flow and trades at discount to peers, so it is an attractive long-term hold. Hungarian telecoms firm **4iG (Budapest: 4iG)** is developing fast with government support.



Investors should consider a trip to Canada in 2025

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Games Workshop is still on a hero's quest

My pick for 2025 has risen strongly in recent months, *says Cris Sholto Heaton*, but it can go further, not least because it is a rare global growth story in a market that is desperate for them. **Games Workshop (LSE: GAW)** should be familiar to many readers since it has been widely covered and will join the FTSE 100 index this month. The company makes table-top battle games in two settings – science fiction (*Warhammer 40,000*) and swords and sorcery (*Warhammer Fantasy Battle*) – with a devoted set of fans around the world.

This has been an excellent business with high margins, good cashflow and a solid balance sheet, but it would have to sell far more plastic figurines to justify its forecast price/earnings ratio of 29 for 2025. The long-term upside lies in how well Games Workshop can extend its intellectual property (IP) through other channels such as film and television adaptations. It has just finalised a deal for *Warhammer 40,000* with Amazon Studios, although there is no detail on how soon the first productions will be completed. What is underappreciated is how shrewdly Games Workshop has been evolving its IP. As far as I can see, *Warhammer 40,000* has gone through three distinct phases.

The first, starting in the 1980s, had a strongly satirical tone. This gave way to a nihilistic style, dubbed "grimdark". Both had limited broad appeal. More recently, Games Workshop seems to have been bringing in new storylines to leaven the mix, adding characters that are just a little more heroic and offer a touch more optimism. That has far greater potential to reach a wide audience, which can both increase licensing income (just 6% of revenues currently) and maybe even convert a (small) proportion of viewers into buyers of the games.

Don't ignore Canada

Canada's stockmarket is 80% of the size of the UK yet widely ignored, *says Max King*. Most "North American" funds are synonymous with the US, yet Canada is home to many successful and interesting companies. It has just one trust, the £850m **Canadian General Investments (LSE: CGI)**. Its shares trade at a discount to net asset value (NAV) of more than 40%, yet they have compounded by 13.9% a year over the past five years and the NAV by 15.9% a year. One-year returns are 25.3% and 33.5% respectively, yet the Canadian market trades on only 15.6 times forward earnings, a 30% discount to the US, and yields 2.7%, twice as much.

CGI has to pay capital-gains tax (CGT) on realised profits, but if the gains are distributed, this tax franks the dividend, leaving shareholders with no income tax to pay. This encourages CGI to run its profits rather than see the trust whittled away by distributions. As a result, CGI's largest holding is Nvidia (7.6% of the portfolio), bought in 2016 at just $1.35 a share, one-hundredth of its current level. Since then, profits of $150m have been realised.

CGI can invest 25% of its portfolio in the US, so Apple and Mastercard are also in the top ten holdings. Other large ones include the Canadian e-commerce company Shopify, and pan-North American transport firms TFI and Canadian Pacific Railway. Materials and energy make up 25% of the portfolio (5% less than the overall market) and these include the gold royalty group Franco-Nevada and uranium miners Cameco and NexGen. Financials constitute 32% of the index but just 13% of the portfolio, while technology exposure is 24% against 8% for the index. There is every prospect that the Canadian market will continue to perform, that CGI will continue its long-term outperformance and that the discount will narrow. The dividend yield is 2.5% and the payout has risen every year for a decade.

Snap up these defence giants

Aerospace and defence equities outperformed in 2024, and this trend looks set to continue in 2025, *says Rupert Hargreaves*. European aerospace and defence equities, in particular, appear well placed to benefit from a step change in government spending over the coming years. Countries in the EU increased defence spending by 10% to a record €279bn last year, the highest level in more than two decades and the ninth year of consecutive growth.

According to the European Defence Agency, that number is set to hit €326bn in 2024, extending the explosive run of growth for another year. On top of this, the region is also racing to set up a €500bn joint defence fund that can be used to support collective defence projects, such as common air defences. With money flooding into the sector, there's further growth on the cards for Europe's defence giants.

When it comes to defence spending, countries often prioritise their own home-grown companies, or in Europe's case, those domiciled in Europe. Moreover, spending plans tend to run over many years and, in some cases, decades. That means companies have a great deal of visibility over future revenue streams.

The MSCI Europe Aerospace and Defense index returned around 30% in 2024 as investors factored in this future growth. Still, even after this jump, the index's forward price/earnings (p/e) ratio stands at only 21.8, compared with 25.6 for the global average (the MSCI World Aerospace and Defense index). This valuation also overlooks future earnings growth potential as spending ramps up over the next few years.

"The MSCI Europe Aerospace and Defense index rose by 30% in 2024, but remains good value"

There are several ways to play the trend. The continent's biggest defence contractors, **Rheinmetall (Frankfurt: RHM)**, **Safran** (Paris: SAF), **Airbus (Paris: AIR)**, **Rolls-Royce** (LSE: RR) and **BAE Systems** (LSE: BAE) all offer something different in terms of subsector exposure (such as tanks in the case of Rheinmetall, jet engines for Rolls-Royce and ships for BAE) and are likely to benefit from the overall rise in spending. Smaller players, such as **Cohort** (LSE: CHRT) and **Babcock** (LSE: BAB), might offer more scope for growth, although their smaller scale means they could struggle to win bigger contracts. Finally, there are ETFs tracking the sector, such as the **HANetf Future of Defence Ucits ETF (LSE: NATO)** and the **VanEck Defense Ucits ETF (LSE: DFNS)**.

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