JM FINN

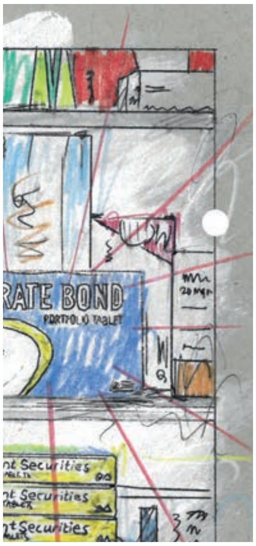
No.32 *Autumn 2020*

Prospects

The JM Finn Quarterly Periodical

No.32

Autumn 2020


Equity prospects
JM Finn's insights into companies 07, 11, 17, 21

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Welcome

Global markets have rallied significantly from their low points in March, led by the US and the technology sector in particular, with strong performance from healthcare and pharmaceutical stocks, whereas oil companies and financials remain weak. In the very short term, I think markets will be dictated by what is going on with regard to the virus, whether this comes back worse than before or not, but eventually we will be able to put this behind us; however, it could take time.

It is particularly pertinent to have well diversified portfolios across the UK and internationally with a reasonable amount of fixed interest stock and I do not think now is the time to change things radically in any shape or form, from an investment standpoint. If I were to voice one concern about markets, as we begin to go back to offices and the furlough schemes finish, it will be to watch how consumers hold up during the fourth quarter.

As our clients will be aware, we have been working from home since March with little to no disruption to our service. I hope that we will return to our desks in the not too distant future but I suspect this will be a gradual process and, hopefully, by the end of this year we will be able to invite clients to visit us in our offices.

Fundamentally, I suspect this will change working habits, particularly now businesses have proved that modern communications and IT infrastructure work. I think things will change across the spectrum for many white-collar businesses, whether it be people in the UK working more from offices outside London, or adapting to new technology to work remotely; I for one have undertaken a massive learning curve when it comes to remote working! In people businesses such as ours, it is important to meet your colleagues and for us to see our clients face to face. It is understandable that many do not want to come to London at the moment, but longer term I do think it is important for us to make contact and we look forward to doing so, whenever that may be.

As ever, I think we have pulled together an interesting selection of articles for this edition of Prospects. When I speak to clients, intergenerational wealth transfer is often a subject that is discussed, so it was interesting to note that September marks the 18th anniversary of the first Child Trust Funds and shines a light on the need to educate the young on investing. I would encourage readers to discuss their finances with their children or grandchildren and bring them along to meetings, when appropriate, to help them learn.

The other much-discussed subject at present, and covered by Atticus Kidd on page 18, is the recent review the Chancellor has announced for Capital Gains Tax. Whilst nothing is guaranteed, it seems likely CGT will rise, which could present investors with an opportunity to review their portfolios and take gains before any changes are implemented. It also goes to show the benefits of tax-free vehicles, such as ISAs and pensions.

As I mentioned in the last edition, we are very grateful to our clients for their understanding of the current situation and their continued long term loyalty; we hope that, as and when we can restart our events program, we will have a chance to thank you all in person.

James Edgedale
Chairman

Editorial

5G: Cellular network upgrades coming soon...

James Ayling, CFA
Research Analyst

Illustration by Adam Mallett

5G sounds impressive and the term is bandied throughout mainstream media as though it's a single technological solution that will solve all of our data transfer issues.

5G is heralded as the major prerequisite enabler for the 'Internet of Things' (IoT) revolution and the panacea for poor mobile reception, long webpage load times and even worse, online videos that take an age to buffer... or so we might be led to believe from the latest 5G enabled smartphone adverts.

With 5G enabled smartphones just reaching e-commerce shelves, we might be nearing the peak of the 5G hype cycle. So, with a tonic of scepticism, we endeavour to avoid the current 5G related fake news (which includes theories that 5G spreads Coronavirus...) and instead attempt to review the data transfer realities under the 5G decade.

It is best to begin by appreciating that 5G represents a technology standard: an umbrella term from which a range of new and existing technologies will be brought together to improve data transfer. Yet, similar to the 4G roll-out, 5G will be rolled out gradually over time with new technology releases occurring throughout the 2020s. So, in summary, 5G should be viewed as an evolution of wireless communication and not a sudden step-change.

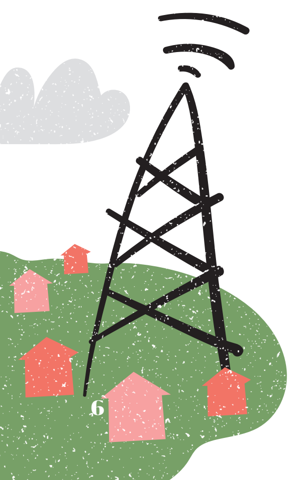
Looking back at history may provide us with a rough guide of what to expect from 5G. It was 1G that brought us voice communication. 2G enabled text message data to be transmitted. 3G ushered in the smartphone era and the web became mobile. 4G enabled faster web browsing allowing mobile devices to largely replicate the desktop PC. So, if history is any guide to the future we may expect 5G to increase data transfer speeds and unlock more data intensive processes.

Before assessing whether history gives us enough of a glimpse of our 5G future, it is worthwhile providing some context around the pros and cons of 5G by looking at a simplified explanation of how cellular networks work.

Mobile networks are split into geographically defined areas known as cells. Within each cell there is a tower which transmits and receives data from our mobiles and provides us with our network coverage. Data is sent over the cell using radio waves but, to reduce interference between cells, adjacent cells use slightly different frequencies. As mobile users move between cells the mobile network software seamlessly switches our mobile connection from one cell's tower to another cell's tower providing us with continuous mobile network coverage. With radio frequency affecting how much and how far data can be transmitted, and with radio waves affected by topography, building structures and population density, cell sizes have to vary.

> A good way to visualise the bandwidth differential from 4G to 5G is to imagine the water throughput of a garden hose (4G) vs. a fire hose (5G)

Today, a growing problem on 4G networks is congestion. You've probably experienced this if you've tried, unsuccessfully, to watch a YouTube video at London Bridge station despite apparently having 4G mobile reception. This is caused by too many mobile users attempting similar activities across a narrow radio frequency band such that everyone's bandwidth is thinned and the overall experience is poor. 5G seeks to use a larger bandwidth by incorporating millimetre wave technology; a higher frequency band of radio frequencies. A good way to visualise the bandwidth differential from 4G to 5G is to imagine the water throughput of a garden hose (4G) vs. a fire hose (5G). So, the roll out of 5G should ease network congestion as the larger bandwidth allows more data bytes to be sent concurrently.



This will allow cells to support more data intensive applications like augmented reality in addition to a significantly higher number of mobile devices. However, the major drawback of higher frequency millimetre waves is their relative fragility. Their shorter wavelengths suffer greater distortion by everyday objects and, relative to 4G, can't go around corners or through brick walls as well; and so these 5G cells will need to cover much smaller geographical areas. Hence don't be too shocked if 5G takes longer to roll out, coverage is somewhat unequal and, rural 5G benefits lag those of urban centres.

To mitigate these drawbacks, 5G networks will need to leverage other developing technologies to increase reliability and speed. For example, massive MIMO (multiple in multiple out) technology adds many antennas to mobile devices and cell towers to enable multiple pieces of data to be sent down separate routes. Another, beamforming technology, helps concentrate the flow of data similar to how a laser pen focuses light onto a point. Therefore smaller millimetre wave 5G cells will need to be supplemented by larger 5G cells operating at lower frequencies with these different technology combinations.

Due to greater 5G cell density and increasing technological complexity, a key growth opportunity for telecom operators may come from greater virtualisation: switching physical hardware into digital software applications akin to how apps on our mobiles replaced hardware gadgets (e.g. calculators, watches, cameras). Networks could then be upgraded frequently by software updates rather than hardware updates and network infrastructure could be shared reducing the telecom industry's required capital outlay.

Whilst 5G seems more evolutionary for consumers, where it may prove revolutionary is in unlocking the potential of future IoT applications where latency matters. Latency represents the time taken between a decision and subsequent action being made. In mobile gaming, latency can severely hinder the user experience if there is a delay between your click and an in-game action so this industry looks set to benefit from 5G. Yet more importantly, investors should be thinking ahead to the myriad of other IoT enabled industries where precision, and therefore latency, matters crucially for success and could have life or death consequences (e.g. remote surgery).

Understanding Finance

BREAKING EVEN WITH INFLATION

John Royden, CFA
Head of Research

You probably sort of know how index linked gilts, or "linkers," work. The redemption value is linked to the change in the retail price index, or RPI, that takes place over the life of the gilt.

Investing in linkers is not as easy as it sounds. The price of linkers reflects what the market thinks about inflation over the life of the bond. So if the market is expecting to see high inflation then the prices of linkers will reflect this. If you also expect high inflation then don't rush to buy linkers and expect to make excessive returns. You will have paid a price that has high inflation baked into it. Keeping it simple, you will only make excessive returns over the conventional gilt equivalent return if inflation turns out to be higher than the market was expecting. The rate of inflation that is baked into the prices of linkers is a maths problem for a large spreadsheet if done precisely and is called the breakeven rate.

If you look at the yield on a ten year conventional gilt, you can work out what rate of inflation you need to get the equivalent ten year index linked gilt to produce the same final gross redemption yield when the bonds mature. It is not quite as easy as it sounds because you have to remember that the semi-annual coupons are index linked. Added to which, if you have worked out the inflation implied by the 2022 linker then you have to use that inflation as the first two years of inflation when working out the inflation implied by the 2024 linker. That is our process at JM Finn.

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COLOPLAST

John Royden, CFA
Head of Research

PRICE
1042.00kr

52 WEEK HIGH-LOW
1148.50kr—756.40kr

NET YIELD
1.72%

HIST/PROS PER
57.00—48.74

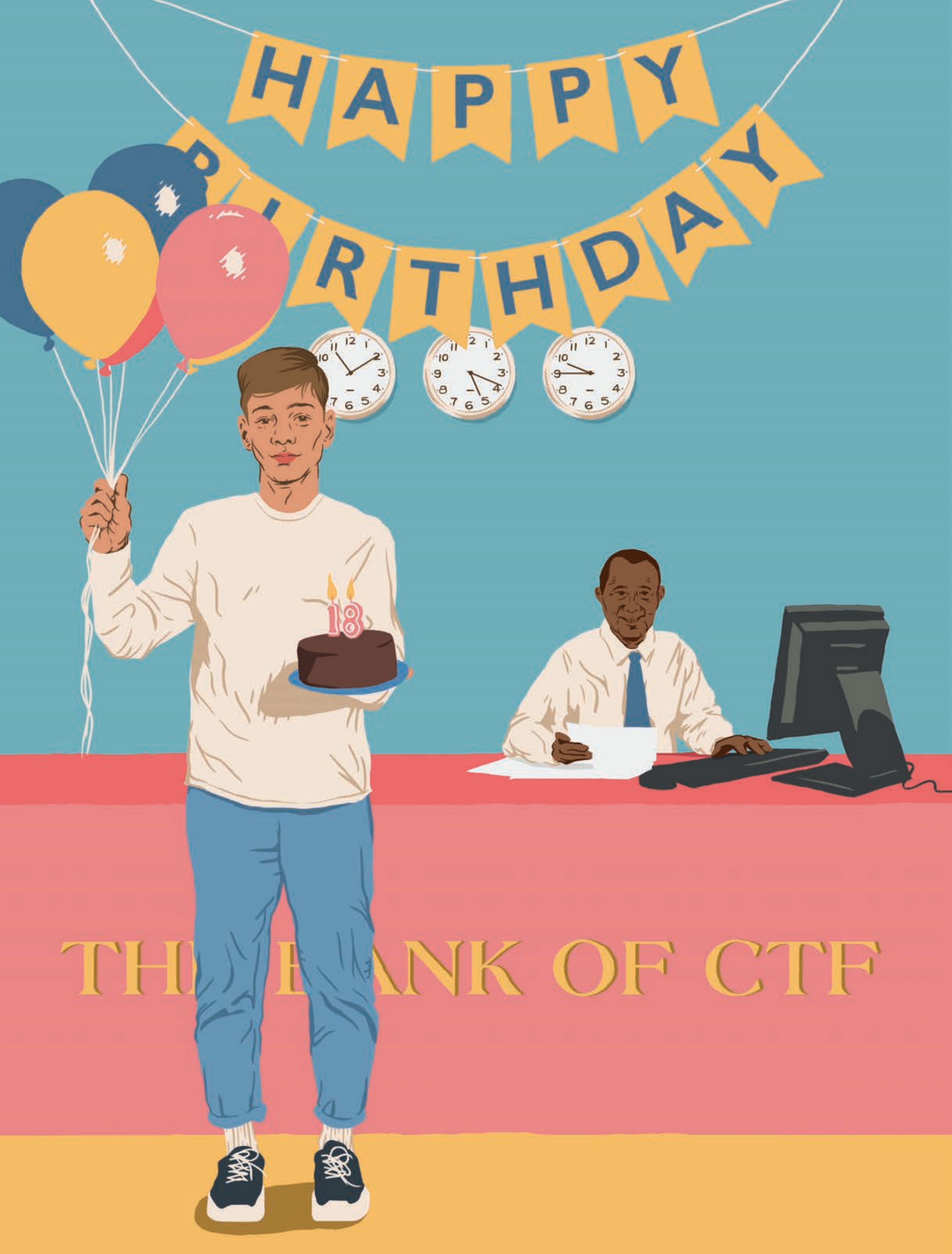
EQUITY MARKET CAP (M)
213,062kr

Coloplast's products are not quite dinner party conversation, as they help us when our plumbing stops working properly. They make stoma bags, which is what you get given if some of your intestines are surgically removed or temporarily out of order. Continence care is a large part of their sales as well as making the parts that surgeons use to fix the problem.

What is much more elegant and easy to talk about is their profit margins, which have been wonderfully constant up until now. Although this does not guarantee future success, the fact is that Coloplast are price setters. That's what a constant profit margin as a percentage of sales implies. Would you quibble about the price of your stoma bag or would you try switching to test a new and cheaper product when your existing one works well? Probably not.

7% annual sales growth over the past decade is not to be sniffed at either. Success here is driven by the close relationship that Coloplast develop with the medical fraternity. Head to Copenhagen if you want to trade the shares, although you might wait until the capital markets day in September to get a better grip on the company's future strategy in light of the dampening effect that Covid-19 has had on elective surgery.

Please read the important notice on page 1.


HAPPY BIRTHDAY
18
THE BANK OF CTF

Guest Editorial

Empowering the young to protect our future

By Gavin Oldham OBE
Founder & chair of The Share Foundation

Illustration by Adi Kuznicki

On 1 September, the first of six million young people throughout the United Kingdom gets access to their Child Trust Funds on reaching their 18th birthday. For the next 8 ½ years, this radical opportunity to empower a generation of disadvantaged young adults will be with us. Gavin Oldham OBE, founder & chair of The Share Foundation looks at the societal challenge of intergenerational wealth transfer.

If it works, Gordon Brown and Ruth Kelly will have shown the world how to solve one of the greatest economic dilemmas: how to retain the vibrant wealth creation attributes of capitalism, whilst at the same time allowing each new generation the chance to benefit.

The sheer scale of the 'intergenerational re-balancing' Child Trust Fund scheme, a world-leading initiative in individually-owned, asset-based welfare, is huge. Individual accounts are securely in place for all children born between 1 September 2002 and 2 January 2011 in the United Kingdom, now valued at a total of c. £9 billion. It presents a huge opportunity, but also a huge challenge.

The challenge lies in the fact that about two million of these accounts are either 'Addressee Gone Away' or unclaimed with a total of c. £3 billion, and that the greatest rate of these un-linked accounts applies to the most disadvantaged young people.

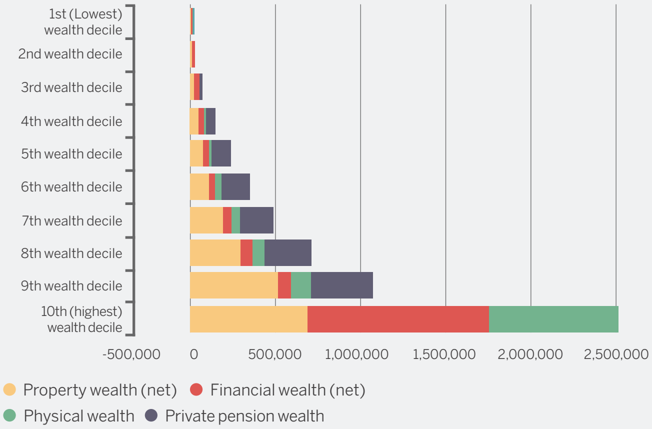
Giving young people some money with which to start life is, however, only half the story. The other half is to build that vital sense of ownership - and responsibility - which comes with learning financial awareness.

> Sharefound's aim is to enable young people to leave care at 18 years old with both the material resources and the knowledge to achieve their potential. Since established in February 2005, they have been working with the Government's two investment initiatives for young people: the Child Trust Fund and the Junior ISA.

There is a big problem with economic demographics: wealth is hugely concentrated in the old but, because birth rate is inversely proportional to wealth, there are not many young in their families to benefit from their inheritance.

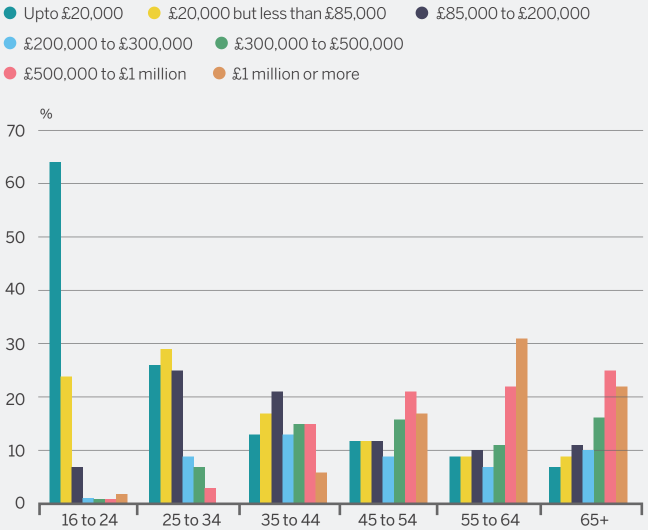
Financial wealth (net) is a relatively small component of total wealth throughout the distribution, but becomes relativley more important in higher deciles

Mean total wealth by component and wealth decile, Great Britain, April 2016 to March 2018



In general, older headed households have higher wealth but there are still significant proportions of older headed households with low wealth

Percentage of households in a given wealth band by age household reference person (HRP), Great Britain, April 2016 to March 2018



Source: Figures 5 & 9. Office for National Statistics - Wealth and Assets Survey

The Share Foundation's recovery campaign for CTFs is an effective search facility, developed in liaison with HMRC to build a simple application process via **https://findCTF.sharefound.org**

So when wealthy old people die, governments stand ready to seize a large proportion of it as Inheritance Tax: but they do not currently distribute those receipts to disadvantaged young people, but instead burn it off as current public expenditure – an entirely unproductive process for future generations.

There have been a number of studies, which spell out this problem in detail. For wealth concentration by age cohort, the ONS study of Total Wealth in Great Britain and, in particular, its figures 5 and 9 highlight the point. And for a more digestible read focused on the United States, the article 'The Staggering Millennial Wealth Deficit' by Christopher Ingraham of The Washington Post on 3 December 2019, shows the dramatic contrast between the baby boomers, Generation X, and the millennials.

There is no question here - not only is wealth concentrated in the old, but also young adults can't get started in the same way as baby boomers did, 30-40 years ago. The reason for this is also demographic: wealthy people simply do not have as many babies as poorer people, so natural inheritance within their families can't do the job of empowering the next generation. A comparison of birth rate with GDP in different countries shows clearly that young people of the future will be predominantly, and disproportionately, born into poverty.

We must therefore do intergenerational re-balancing if we want a vibrant capitalist economy in the future - the only other solution is socialist deployment of wealth by governments through public expenditure, as the ruling class see fit. That is why the Child Trust Fund is so important, and I hope that it will not be long before the UK Government re-introduces a similar scheme (on a more progressive basis). However, there is one additional ingredient I would like to see in it - Incentivised Learning.

The reason that micro-finance works so well is that it's based on loans, not grants: so beneficiaries build a sense of accountability and responsibility. This is the difference between 'give people fish and you'll feed them for a week – teach them how to fish, and you'll feed them for a lifetime'. Incentivised Learning does the same – I would like to see a new Child Trust Fund (or whatever HM Treasury chooses to call it) started with £1,000, with an additional £1,000 at age 7, then - critically - with £3,000 more to be earned between ages 15 and 17 as a result of progressing through a programme of life skills and financial awareness.

The Share Foundation already does this for young people in care, who can earn an additional £1,500 in their Child Trust Funds by taking our six-step 'Stepladder Plus' programme. The contrast in progress between the incentivised and standard versions is dramatic. Incentivisation builds a real sense of ownership and accountability.

We should all should sit up and take notice of the need to develop a new, young generation with financial awareness and assets. The young are the future for our country and the world - we must endow them and empower them so that they can deliver fair and just opportunities for all in the future.

Gavin Oldham OBE, founder & chair of The Share Foundation was also founder and Chairman of The Share Centre. He is also founder and Managing Director of Share Radio, an online broadcaster whose purpose is to help people to become more confident with money and in business. Gavin is an elected member of the Church of England's General Synod (Oxford Diocese), and was a Church Commissioner (and member of its Assets Committee) for 18 of the past 20 years. He was a board member of pfeg, the personal finance education group, until it merged with Young Enterprise in 2014.

gavin.oldham@sharefound.org

EDWARDS LIFESCIENCES

Michael Bray, CFA
Research Analyst

PRICE
$85.91

52 WEEK HIGH-LOW
$87.97—$51.51

NET YIELD
0.00

HIST/PROS PER
51—44.85

EQUITY MARKET CAP (M)
$51,616

Edwards Lifesciences' roots date to 1958, when Miles Edwards set out to build the first artificial heart. Edwards was a 60-year old recently retired engineer who had a fascination with healing the heart, developed whilst he was in his teens after suffering two bouts of rheumatic fever; a condition which can cause heart valve scarring and eventually lead to heart failure. After some initial work, the concept of an artificial heart was deemed too complex for the time, but what it did lead Edwards to develop was the world's first artificial mitral heart valve.

Today, with sales of $4.3bn, Edwards Lifesciences is the leader in tissue replacement heart valves and repair products and advanced hemodynamic monitoring (the physics of blood flows in blood vessels). In recent years, its transcatheter aortic valve replacement (TAVR) products have been a game changer. Rather than patients enduring the grisliness of traditional open heart surgery where their chest is broken open, causing much blood loss and many hours of surgery, they can instead have a TAVR inserted via the femoral artery in their leg... impressive stuff!

Yet, as with many businesses, the near-term outlook for Edwards' remains uncertain given the backdrop of Covid-19, which has caused many procedural delays.

Please read the important notice on page 1.

Company Meetings

A spotlight on three of the key companies we've met during the past quarter.

We met or spoke with the companies below and you can learn more on any of these by contacting the person at JM Finn with whom you usually deal.

James Ayling, CFA
Research Analyst

Michael Bray, CFA
Research Analyst

Maude Holloway
Assistant Research Analyst

COMMUNICATION SERVICES
Pearson

CONSUMER DISCRETIONARY
Whitbread, Mercado Libre

CONSUMER STAPLES
Fevertree Drinks,
Reckitt Benckiser Group

ENERGY
Royal Dutch Shell,
John Wood Group

FINANCIALS
Barclays, Burford Capital Limited, HSBC Holdings,
Lloyds Banking Group, Prudential

HEALTH CARE
AstraZeneca, Coloplast , Edwards Life Sciences , Intuitive Surgical,
Novartis, Novo Nordisk,
Roche Holding, Smith & Nephew

INDUSTRIALS
BAE Systems, Grafton Group,
Intertek Group,
Otis Worldwide Corporation,
Spirax-Sarco Engineering

INFORMATION TECHNOLOGY
Microsoft Corporation,
NVIDIA Corporation,
salesforce.com, Visa

MATERIALS
BHP Group, Croda International,
Hill & Smith Holdings,
Johnson Matthey, Rio Tinto

REAL ESTATE
British Land Company,
Derwent London, Grainger,
Weyerhaeuser Company

UTILITIES
ContourGlobal, National Grid,
Pennon Group, Severn Trent,
SSE, Telecom Plus,
United Utilities Group

1.

Hill & Smith Holdings

Price **£12.24**
52 week high-low **£15.34 – £8.44**
Net Yield **0.88%**
Hist/Pros PER **20 – 21.45**
Equity Market Cap (M) **£962**

Materials
Derek Muir (CEO) and Hannah Nichols (CFO)

Hill & Smith is an industrial engineering firm whose revenue and earnings derive from three core segments; roads and security infrastructure, utilities infrastructure and galvanising services. Geographically, the company operates across seven countries although revenue and profitability heavily derive from operations in the UK and US.

The company has achieved growth over a number of years through a combination of organic and acquisitive growth. Yet, unlike some other businesses the group operates with a decentralised management structure that gives the underlying subsidiaries more independence; Hill & Smith believe this drives a more entrepreneurial culture.

Recently management outlined how this culture is fostering an exciting product development avenue for their composite materials group. Worsening storms across the US are highlighting deficiencies of wooden electricity poles and damaged poles in California are contributing to wildfire issues. Hill & Smith's composite group are developing a high strength and fire resistant composite utility pole for US utilities to evaluate. Whilst the initial cost outlay for these composite poles will be higher, the lifetime cost and safety benefits could create a new market opportunity.

Like many firms, Hill & Smith has been negatively impacted by the Covid-19 pandemic but results have been buoyed by the ongoing growth and resilience of their US business. If governments begin shifting away from their fiscal austerity mind-set of the post 2008-09 decade then the ageing US infrastructure backdrop could provide a prolonged growth tailwind across Hill & Smith's infrastructure and galvanising divisions. However, a question for investors to consider is the extent to which Hill & Smith controls its own destiny or relies upon fleeting government budget priorities.

2.

Intuitive Surgical

Price **$741.57**
52 week high-low **$778.83 – $360.50**
Net Yield **0.00%**
Hist/Pros PER **62 – 79.99**
Equity Market Cap (M) **$82,476**

Healthcare
Phillip Kim (Investor Relations)

Intuitive Surgical is a truly innovative medical technology company: it is the only commercial player in the fast growing soft-tissue robotic assisted surgical market. Its surgical robot - da Vinci - is controlled by a surgeon on a nearby console and allows minimally invasive surgeries to be conducted through a few small incisions, typically 5mm–10mm in diameter. The superior precision and control results in improved surgical outcomes for patients (less scarring, faster recovery, lower remittance etc.) and also lowers total healthcare costs for hospitals.

On conservative assumptions, Intuitive estimate da Vinci has achieved 24% penetration of applicable surgical markets, leaving plenty of room for the business to grow in the long-run. Short-term, however, the Covid-19 pandemic presents a material headwind. It has caused delays to elective surgeries – 50% of the procedures conducted on da Vincis – and perhaps more importantly, has cast uncertainty over the future capital expenditure (capex) decision of hospitals. With 30% of sales coming from da Vinci systems, any change to hospital capex could have a big impact.

So far, system sales have held up better than expected. Intuitive confirmed that support had come from large US orders agreed pre-Covid and from an existing quota with China, which remains only half fulfilled. In the coming quarters, aside from China, demand is highly uncertain. With 70% of the business in the US and the CARES Act only partially covering Covid-19 costs, US hospitals are likely to cut capex. Intuitive have been upfront about this risk to investors, but have also stated they have minimal visibility on the size and timing of these cuts. For investors, the conundrum is whether the valuation of shares (69x December's estimated earnings) fairly accounts for both the substantial long-term opportunity and highly uncertain near-term outlook.

3.

Pennon

Price **£10.03**
52 week high-low **£12.11 – £7.16**
Net Yield **4.23%**
Hist/Pros PER **21 – 28.20**
Equity Market Cap (M) **£4,363**

Utilities
Susan Davy (CEO) and Paul Boote (Finance Director)

Pennon is the holding company for the regulated water company South West Water. In July they finalised the sale of Viridor, their waste management and energy recovery business operating across the UK, and announced proceeds of £3.7bn. We spoke with the newly appointed CEO and the Finance Director to discuss how they intend to use these proceeds across four targeted areas.

Firstly, following the sale of Viridor, they plan to realign the capital structure for the Group to ensure that borrowing is at an appropriate level going forward. They intend to pay down £900m of debt to remain within the regulator's guided range and maintain balance sheet strength despite the current uncertain environment. Secondly, they have made a contribution to their defined benefit pension scheme. They recently closed the scheme to future accruals. However, at the last review in 2019, the pension deficit stood at £45m and they have since paid in £36m to reflect the fact that Viridor was a participating employer and has now left the scheme.

Following their successful acquisition and consolidation of Bournemouth Water, they intend to look for similar growth opportunities within the UK water sector, ensuring any acquisitions are value accretive to shareholders. Finally, they intend to return any remaining cash to shareholders, the extent of which will depend on the scope of any growth opportunities that have arisen over the year.

Having consolidated the business to focus solely on UK water, investors will hope that the half year results in November provide a clearer plan for any acquisitive growth and on the promise of returning cash to shareholders.

Please read the important notice on page 1.

Economic Focus

What are the Challenges to Recovery?

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Adam Mallett

Markets have been undimmed by the recent rise in positive Covid-19 cases – particularly in America.

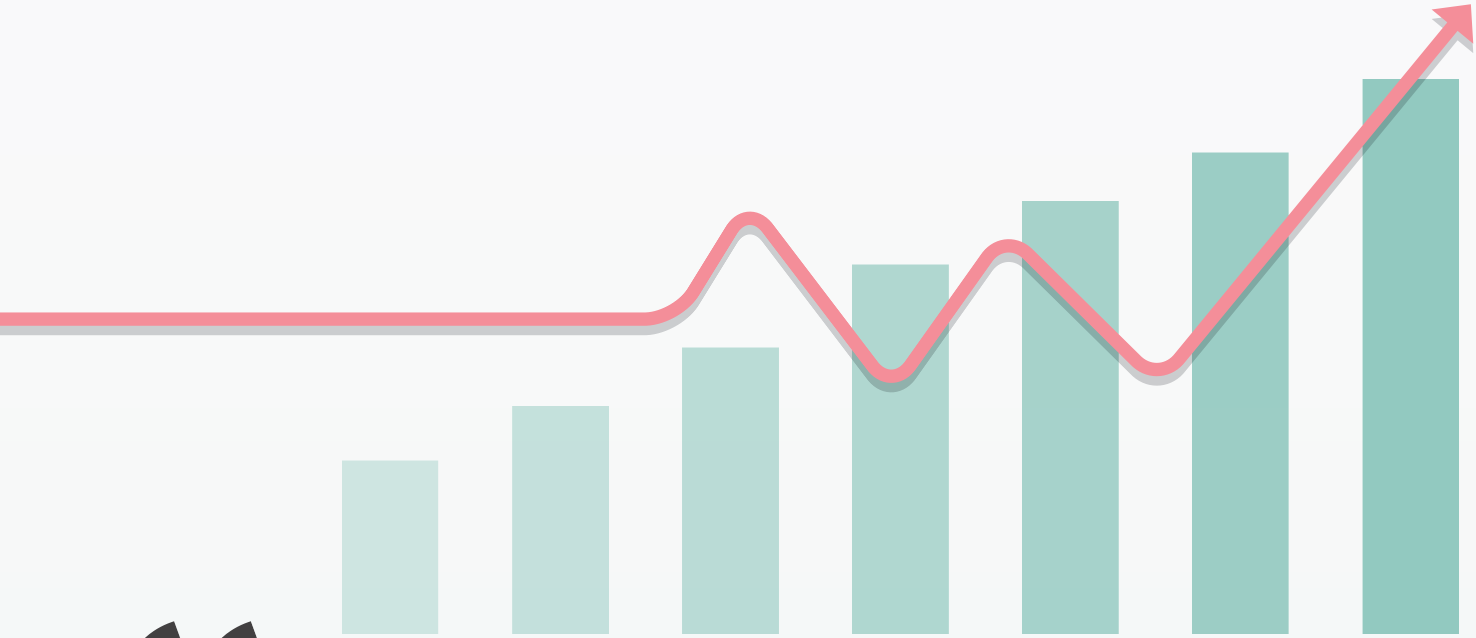
There the end of August saw new high ground being achieved in both the technology heavy NASDAQ index and in the more broadly based S&P 500. And this despite some truly shocking experiences, economically speaking, from many of the world's largest economies in the second quarter of the year, the UK being particularly badly hit.

Expectations are for a strong bounce back during the quarter to the end of September which, given the fact that nation wide lock downs seem to be a thing of the past – at least for the time being, does not seem unreasonable. That is not to say we will have succeeded in replacing the output lost as the pandemic took hold, but at least the year as a whole should show a global recession of less eye-watering magnitude. Certainly, forward looking indicators have improved markedly recently, while hard data concerning economic progress has also been encouraging.

The recovery comes with some considerable cost, though. Global indebtedness has soared as governments pump money into failing economies and companies endeavour to borrow their way out of the difficult trading conditions wrought by the pandemic. Central banks will continue to be supportive as we feel our way towards a new future, changed forever by coronavirus, but what are the risks that might upset the best laid plans of those trying to keep us all on an even keel?

First and foremost must be the possibility of a second wave of the virus. This already appears to be happening in some measure in a number of countries, including those that had been considered to have got the pandemic under control – like South Korea and Germany. As the winter takes hold, we can expect the situation to worsen as there will be less opportunity to congregate outdoors, traditional flu and colds will take hold and more people will be at school or in the workplace, with all the attendant risks that will bring.

But that does not automatically mean a return to the stifling conditions imposed by lock downs. The evidence so far has been that, while cases are rising, hospital admissions and deaths are not. This can be attributed to a variety of reasons. More people are now being tested, so we are more aware of the number of cases of infection than we were at the peak of the pandemic. Also, it is likely that the measures already introduced, like social distancing, face masks and more hand washing, are reducing the effectiveness of the virus when it is transmitted.



Expectations are for a strong bounce back during the quarter to the end of September.

Then there is the undoubted fact that we have become better at dealing with the more serious cases of the virus in hospitals, with more effective treatments now available and a greater understanding of what to do. Moreover, there is evidence that transmission is now more concentrated on younger members of society who are better able to survive the consequences, while the elderly and vulnerable are remaining more cautious. Finally, there is the possibility, not yet proven, that some form of herd immunity is becoming established and/or that the virus is mutating into a less virulent form.

Of course, future events could undermine these arguments, though so far there seems reason to believe that some at least will hold true. But there are other risks created by the economic upheaval that has occurred. Most important amongst these is the possible loss of confidence amongst consumers. So far retail sales seem to have bounced back in a vigourous and encouraging fashion, but this might reflect little more than pent up demand following months of enforced isolation for many of us. As the consequences of the recession begin to bite in the form of higher unemployment and less spending power, consumers could well adopt a more cautious stance overall.

Higher taxes, which do seem inevitable given the cost to governments, could place a further burden on spending, so the pattern of retail sales will need to be watched closely. Other threats include banks drawing in their horns, as fears of non-performing loans increase, and central banks becoming less accommodating, though this seems an unlikely prospect, given the scale of the problem. Could there be a change of approach if the incumbent of the White House changes next year? We'll have to wait and see.

So, markets do seem to have some substance behind the recovery that has taken place so far, though future progress will depend on the economic ship not foundering on any of these rocks the challenges could place in its path. One thing is certain, though. There will be winners and losers as we emerge from the chaos engendered by the pandemic, in terms of nations, industries and companies. We will all need to keep on our toes in the months and years ahead.

JM Finn News

JM Finn finds new Bristol home

With a presence in Bristol for over 20 years, in the same office we are delighted to announce that we have moved to a new location.

Now in the beautiful Queen Square in the heart of the city and only a short walk from the station, our 16 staff who look after around £850 million of funds, moved in, albeit on a staggered basis, at the beginning of August.

The new office location offers a significant improvement in terms of client meeting rooms and we hope, as and when clients wish to resume meetings with their investment managers, they will come and visit.

New faces

As we look to grow without compromising the high quality of service that we have become known for, we are always looking to recruit new talent across the firm.

This year, despite the challenges we are all facing, is no exception and we are excited to welcome four new investment managers to the team. All four are experienced managers and whilst they are starting their JM Finn careers working remotely, we look forward to integrating their expertise into our investment management proposition.

The four new joiners are:

- Clare Gore Langton, Investment Director
- Stephen Wright, Senior Investment Manager
- Stephen Thornton, Senior Investment Manager
- Mark Rowe-Ham, Investment Manager

More awards

During this difficult year, we have been proud to have picked up a number of awards and accolades, which recognise the services we offer to our clients.

Having been shortlisted in the annual Private Asset Manager awards for the Client Service Quality award, we followed this up with four wins:

- **Legal 100** – Wealth Management Firm of the Year 2020
- **Finance Monthly** – Wealth Management Advisory Firm of the Year 2020
- **Global 100 2020** – Winner, Wealth Management Firm of the Year
- **CFI.co Wealth Management Awards** – Best Wealth Management Advisory Firm UK

Additionally, we have been shortlisted in the CityWealth brand management and reputation awards 2020 for Brand of the Year and in the Good Money Guide Awards. To vote for JM Finn in the latter, please visit www.goodmoneyguide.com/awards/wealth-management.

MERCADOLIBRE

John Royden, CFA
Head of Research

PRICE
$1209.26

52 WEEK HIGH-LOW
$1270.00—$422.22

NET YIELD
0.00%

HIST/PROS PER
-342—1,943.76

EQUITY MARKET CAP (M)
$51,693

We have all heard of eBay and PayPal. eBay used to own PayPal before spinning it off as its own entity in 2015. The South American equivalent of eBay-before-it-spun-off-PayPal is MercadoLibre.

To me the two companies look similar. MercadoLibre runs on-line auctions as well as fixed priced sales and MercadoLibre runs its own payments system called MercadoPago. In contrast to eBay, you can ask their MercadoEnvios division to run your fulfilment as well. And if you really fancy yourself as an on-line trader then MercadoShops helps you build your own online shop.

Whilst MercadoLibre has enjoyed sales growth of close to 30% per annum, you could be forgiven for thinking that it is being run as a not-for-profit organisation. True to a point, until you realise that MercadoLibre is in land grab mode and that when they start turning their income margin back up to the 35% level of the past, the share price looks more than fair unless international competition wins their market over. Their shares are traded on NASDAQ in America so they are closer to home than you might imagine.

Please read the important notice on page 1.

Wealth planning in focus

CAPITAL GAINS TAX REVIEW

Atticus Kidd
Wealth Planning Assistant

Capital Gains Tax (CGT) is a wide ranging and complex tax that in broad terms is levied on the increased value of certain possessions over the time that they have been held by their owner and is charged on disposal of the asset. Atticus Kidd reviews the tax that many predict will change in the near future.

First and foremost it is worth noting that there are various reliefs and exemptions available for CGT so, if you are uncertain whether the disposal of a certain asset will give rise to a CGT liability it is recommended that you speak to a tax specialist about your scenario. Typical assets impacted by CGT are second homes, rental property and investments (unless held in an ISA or pension).

CGT currently stands at 10% (18% for residential property) for basic rate taxpayers and 20% (28% for residential property) for higher or additional rate taxpayers. However, there are a variety of reliefs and exemptions based on the nature of the scenario, most notably each individual is entitled to a CGT allowance of £12,300 in the 2020/21 tax year within which no tax is due.

CGT has recently been brought into focus as the Chancellor has ordered that the tax be reviewed by the Office of Tax Simplification (OTS). The intent of the review is to identify opportunities relating to administrative and technical issues as well as areas where the present rules can distort behaviour and do not meet their policy intent. It is certainly clear that CGT could benefit from some simplification however, many see this review as more of an opportunity to help bolster the government's coffers following the recent spending associated with the global pandemic.

Not surprisingly, those most impacted by the potential changes to CGT are the wealthy. In the 2018/19 tax year CGT raised a record £9.5bn in tax receipts with just 1% of taxpayers accounting for 40% of the tax take. Additionally, higher rate income tax payers are twice as likely to incur CGT as all taxpayers generally.

Of course the implications of this review will depend on the nature of any prospective changes. Rishi Sunak stated in his

> **In the 2018/19 tax year CGT raised a record £9.5bn (a 6% rise from the previous tax year) in tax receipts.**

letter that he would be interested in any proposals on the regime of allowances, exemptions, reliefs and treatment of losses within CGT, and the interactions of how gains are taxed compared to other types of income.

Based on Rishi's statement, one of the potential changes that may occur is the aligning of CGT rates with those of income tax. This has previously been proposed by Labour and would of course have larger implications for higher and additional rate tax payers as standard CGT rates would increase by 10% (from 10% to 20%) for basic rate tax payers but, 20% to 25% (from 20% to 40% or 45%) for higher and additional rate tax payers respectively. This measure may be of particular interest to raise funds as, of the £62.8bn of total gains made by individuals in the 2018/19 tax year the £9.5bn tax take represents an average tax rate of only 15%.

> *Private residence relief is the current exemption from CGT on all or part of an individual's main home.*

Another area that could be changed is the allowances, reliefs and exemptions currently applicable to CGT. This could vary from a reduction or removal of the existing £12,300 CGT allowance to a changing of the main residence relief. The Labour manifesto previously targeted the CGT allowance and proposed to reduce this to £1,000 at the last election. Most of those who realise gains are shielded from a tax liability by the CGT allowance and so any change would likely see a large increase in the amount of tax receipts received. Private residence relief is the current exemption from CGT on all or part of an individual's main home. This is currently a generous exemption and would generate a significant amount of revenue if removed although, this route does seem counterintuitive to the government's intent to keep the property market moving. There are a number of other exemptions that exist that would be somewhat easier to target such as those on gambling winnings, wine, cars and the exemption at death rule that removes capital gains from assets on death of the owner which, although they may incur inheritance tax, may also wrongly incentivise individuals to hold assets for life rather than gift throughout their lifetime.

Similar to the exemption at death rule is what is referred to as the uplift. This is where someone inheriting an asset is assumed to have acquired it as at the date of death rather than the initial acquisition cost. The OTS already mentioned this in their review of inheritance tax so are likely to flag this up again. The issue attached to the current rule is that an individual can sell a recently acquired asset and incur no CGT liability, this is particularly problematic where this overlaps with exemptions on the asset from inheritance tax. This again encourages individuals to hold assets until death rather than encourage passing on assets within their lifetime.

It is very easy to see how simplification of CGT would be beneficial as some elements of the legislation surrounding it are unnecessarily complex. Additionally, the incentives surrounding the tax seem poorly balanced with increased CGT on second homes negatively impacting the likelihood of an individual putting that property on the market for the benefit of first time buyers. In addition, the gift of a property or invested assets from a parent to help their child on the ladder faces CGT and a potential inheritance tax liability if the parent passes away within the 7 year gifting period however, if they wait to pass the assets until death they only have inheritance tax to worry about.

> **It is very easy to see how simplification of CGT would be beneficial as some elements of the legislation surrounding it are unnecessarily complex.**

There are plenty of solutions available to simplify CGT such as a single flat rate, clear strategy on exemptions or doing away with the tax altogether.

In some respects, it would be helpful to see a restructuring of CGT that acknowledges the risk involved in investing within certain assets and adequately incentivises this, as well as allowing wealth to be passed through the generations, particularly given the nature of the economic situations impact on younger generations. Investors should not feel trapped in investments where the simplest solution is to die with the asset and have the gains wiped out.

There are plenty of solutions available to simplify CGT such as a single flat rate, clear strategy on exemptions or doing away with the tax altogether. It should be noted that the OTS was previously called upon by Rishi's predecessor, Phillip Hammond, to conduct a review into inheritance tax and we are yet to see any real overhaul to this tax despite the findings of the reports. Naturally, some measures for change will be able to bring in a larger amount of tax receipts than others and now is a time where this is of increased importance but, I do hope that positive changes are made and with the genuine intent to update this somewhat outmoded tax and the incentives it creates, rather than seeking solely to improve the Treasury's balance sheet.

The information provided in this article is of a general nature. It is not a substitute for specific advice with regard to your own circumstances and it may be prudent to consult a tax adviser.

PEARSON

Maude Holloway
Assistant Research Analyst

PRICE
£5.43

52 WEEK HIGH-LOW
£8.91—£4.12

NET YIELD
3.63%

HIST/PROS PER
16—19.47

EQUITY MARKET CAP (M)
£4,046

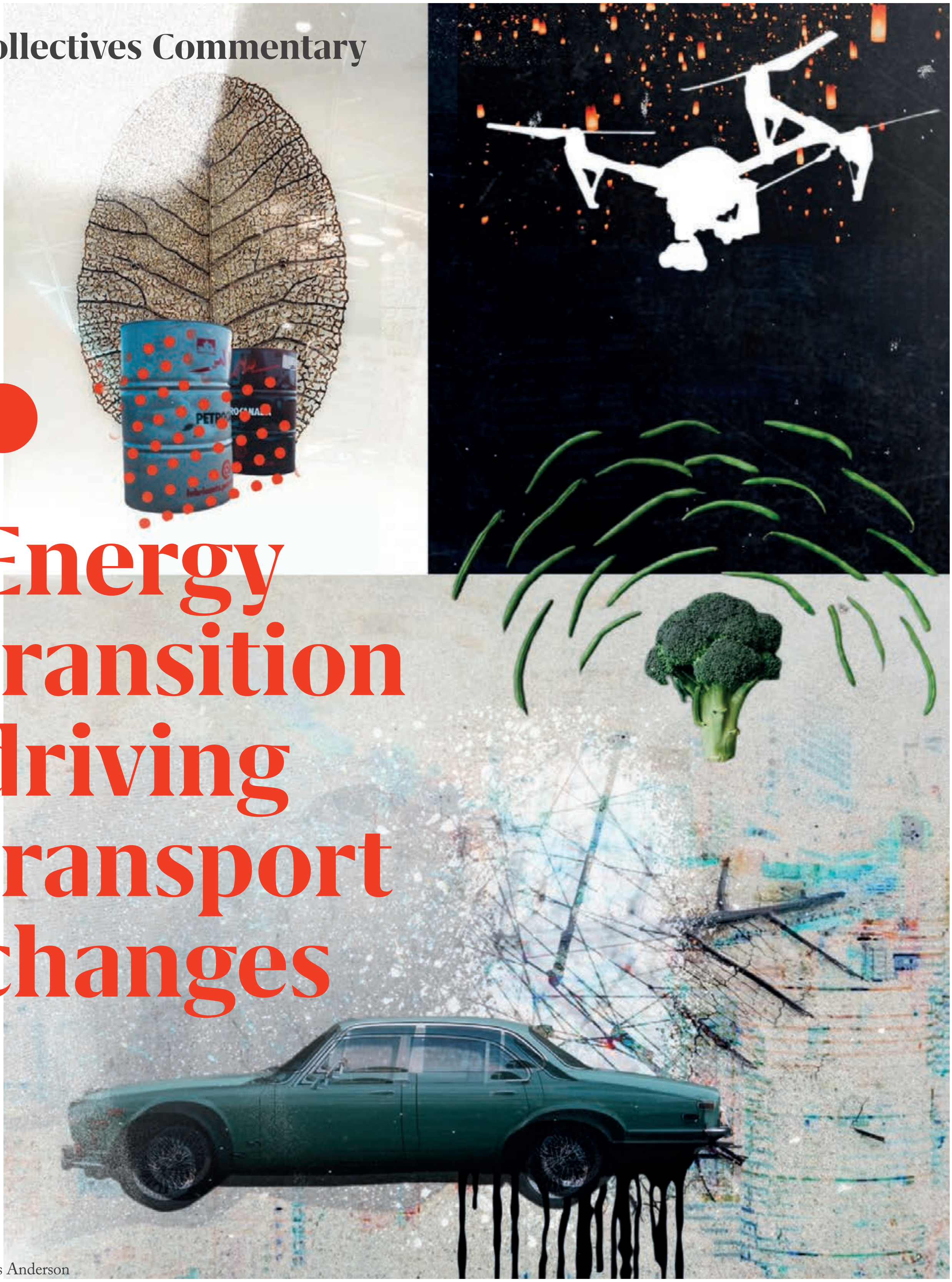
Pearson supplies courseware to students globally. In recent years the business has struggled: competition from second hand book sales and book rental schemes has impacted sales, and consumer indifference to switching to e-books from print, has meant that management's large cost saving plans have not borne fruit.

Covid-19 looks to be an impetus for change for Pearson. Firstly, online learning and remote working has become the new normal. Students that do enrol into tertiary education this year can expect to attend courses which will be, at least in part, taught online. Students may be more willing to buy e-books for their online classes and the forced mind-set shift as much as a convenience shift from Covid-19 could help to fuel Pearson's digital transformation.

Looking ahead, as we enter recession, the countercyclical nature of Pearson means it should benefit as higher unemployment typically leads to more enrolments into higher education as people try to make themselves more employable. The difference this time is that enrolment is compromised by Covid-19. Enrolment is down c.40% this year with many students opting to defer their places until 2021. We will have to wait to see to what extent this volume drop offsets the cost savings of higher e-book adoption.

Please read the important notice on page 1.

Collectives Commentary



Energy transition driving transport changes

James Anderson
Co-Fund Manager of
Scottish Mortgage Investment Trust

Illustration by Andrew Park

Even before the global pandemic forced us into lockdown, transport news offered very little hope. There were rail delays and regular tales of gridlocked roads, while unfulfilled political promises did little to reduce transport's 15 per cent contribution to global carbon emissions. Pretty depressing stuff. But this could change dramatically.

At the start of this year, we saw one of the most significant developments in our lifetime - the beginning of the end of our reliance upon carbon. The cost of producing fossil fuels exceeded what buyers were willing to pay.

Some pointed to the pandemic as being the root cause. The real reason was the remorseless fall in the prices of renewable energy had finally tipped the balance. In the first half of this year, 56 per cent of Germany's electricity generation came from renewable sources, while the UK had a record 67-day streak without needing coal-fired power. With capital being invested into renewables, and innovation taking place, it adds up to an irreversible trend.

At Scottish Mortgage, we try to identify these big drivers of change in the world and then find the exceptional companies that can deliver on their promises, and back them over long time periods.

When thinking about companies, one of the questions we ask is: *do you contribute to society?* Some of the companies doing so are in the transport industry, where profound changes are taking place due to advancements in renewable energy and software. Earlier this summer, Herbert Diess, the VW CEO wrote "in five to ten years the world's most valuable company will be a mobility company - that could be called Tesla, Apple or Volkswagen." He was right to point to Tesla, which, in the words of its founder Elon Musk, is trying to "change the energy equation". Over a short period, the company has entered a huge and capital-intensive industry with a new technology, sells every car it produces, whilst adapting to manufacturing on an ever-increasing scale. This demonstrates an impressive learning curve that suggests much more is to come as the company expands its global footprint.

If we look around us, innovation in transport is already having an impact by removing friction from the global economy. Convoy, the 'Uber for trucks' is connecting shippers and truckers across the US via a smart phone app, as well as improving delivery times, reducing carbon emissions, and lowering costs by slashing *empty truck* miles travelled. In Africa, Zipline is overcoming the challenges of poor infrastructure by launching drones that put blood and life-saving vaccines in the hands of those in need. And in China, Meituan Dianping, the home delivery giant, is already piloting driverless home deliveries.

Soon, we too could be transported by self-driving vehicles, allowing us to use our time more productively. Tesla's autonomous driving functionality continues to gather sensor data from the billions of miles being driven by its growing fleet, while Aurora Innovation is developing technology that will provide other auto manufacturers with this functionality. But why must we limit ourselves to the roads?

For many, the fanciful idea of flying cars recalls Marty McFly and the Delorean vehicle in the film, *Back to the Future*, but design innovation and improvements in battery technology are now bringing them from the silver screen into our skies. Lilium and Joby Aviation are developing flying taxis that will use the existing infrastructure in our modern cities for those wishing to travel within or between them. Reaching slightly higher, surely one of the most inspiring moments of 2020 was seeing Space X's Falcon 9 rocket calmly return from orbit, ready for re-use. This matters, in the near term it changes the economics of satellite installation. Beyond that, the possibilities are infinite.

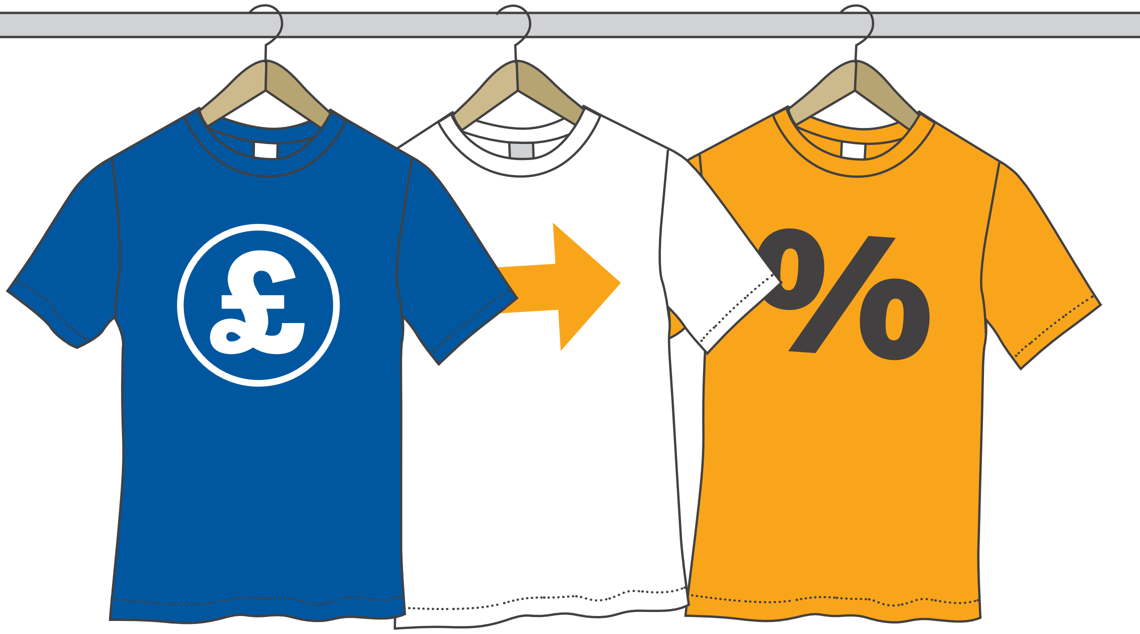
As we emerge from the lockdown, headlines will be filled with the economic consequences of the pandemic. Perspective is important. We turn to academia - in his work, *Foragers, Farmers and Fossil Fuels*, Ian Morris puts forward the case that the way our societies are organised is dictated by the way we capture energy. This inflection point is hugely important and influencing our research agenda. We are excited to be meeting with a diverse range of companies - many of which are private and led by ambitious founders – that are equipped to navigate this change and become the structural winners of the next twenty years. We sit now at a moment of extraordinary hope for the positivity we desperately need. This energy transition will create huge opportunities, whilst also creating benefits to society that reach well beyond changes in transportation.

By James Anderson

The views expressed in this article are those of Scottish Mortgage and should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect personal opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

Stock in Focus

VISA



Michael Bray, CFA
Research Analyst

Illustration by Adam Mallett

We have all heard of Visa, and have all probably used a Visa card at some point in our lives, but not many people actually know how the business works, its history and how it generates profit.

Visa is a network provider for the payments processing industry, which in a nutshell, means they provide the 'pipes' and the 'infrastructure' to transfer money from banks to acquirers.

Within the payments ecosystem, banks (such as Lloyds and Santander) issue cards and hold consumer relationships. Networks (such as Visa and MasterCard) provide the infrastructure for payments to be made from consumers to merchants; or more precisely banks to acquirers. Acquirers (such as Worldpay) hold the relationships with merchants.

In 1958 Bank of America (BofA) had the idea to drop unsolicited cards around areas of America in which they had significant market share. These cards were designed to transfer money between BofA account holders. A number of smaller banks formed a consortium which would replicate the model using a newly formed intermediary called 'Mastercharge' - now MasterCard - to process transfers between banks and accounts. In response to this, BofA partnered with a number of banks using their own spin out, Visa, to compete.

Today Visa make c.44% of revenues from the US, c.28% from APMEA (Asia-Pacific, the Middle East and Africa), c.20% from Europe, c.5% from Latin America and c.3% from Canada. In terms of reporting divisions, they make around two thirds of revenue related to transaction processing and a third from cross-border transaction fees.

Despite their humble beginnings, Visa, and to a lesser degree MasterCard, now dominate the market with global relationships between issuers and acquirers. Market shares can be most easily understood by the number of cards globally. As of the most recent data, Visa host c.3.2 billion cards, MasterCard c.1.8 billion, AMEX c.113 million, JCB c.114 million and Discover Diners Club c.58 million.

To understand how Visa generates revenue, attention must be given to the four party payments system. This can be explained by a simple transaction of a consumer buying a t-shirt from a retailer.

The flow of money begins with the retailer that has accepted the transaction and inputs this order into their acquirers system (i.e. the shop assistant typing the value into the card machine and pressing 'enter').

The acquirer then sends a message to the network (e.g. Visa) associated with that card to request payment. The network subsequently sends a message to the issuers and, should sufficient funds be available, the issuer then asks the consumer to type in their pin code to verify that the transaction is legitimate.

Visa has been able to maintain its strong competitive advantage over many decades due to the 'network effect'.

PRICE
$213.35

52 WEEK HIGH-LOW
$217.35—$133.93

NET YIELD
0.60%

HIST/PROS PER
35—40.20

EQUITY MARKET CAP (M)
$428,849

A typical transaction costs the retailer 1% with revenues split 50/25/25 between the issuer, acquirer and network. So a £10 t-shirt would see 5p go to the issuer, 2.5p go to the acquirer and 2.5p go to the network. The issuer takes the largest share of revenue because they are the ones that take credit risk, but competition in the bank industry remains intense.

Visa has been able to maintain its strong competitive advantage over many decades due to the 'network effect', where the value of its service increases with their use. This is created by the requirement to hold relationships with both issuing bank and acquirers – Visa's two-sided network. Issuers' do not want to select a network that does not hold relationships with acquirers globally and, acquirers, will not develop and maintain relationships with networks that do not boast a significant card base.

Whilst past performance is not a guide to future results, growth rates have been stellar for Visa, its revenue and operating profit have compounded by +12.6% and +13.6% p.a. respectively for the past five years. This has been driven by consumers globally moving more of their spending habits from physical locations (i.e. shops) to digital - Visa's digital share is nearly 3x that of physical! Digital spending only accounts for c.14% of total global retail spend, so Visa still has a substantial growth runway from the move to e-commerce.

Outside of the $25tn global retail market, there lies a larger opportunity for Visa. They estimate that $185tn worth of global payments are transacted via antiquated methods of cheque, bank wires and ACH transfers (e.g. BACS). These methods have a number of flaws, which cause huge frustrations to businesses such as cost, inefficiency and untimeliness. Through the development of local (country) real-time payment infrastructure, Visa is building service and application software layers on top of this to enable real-time payments cross-border to help solve these issues. Such services will however take time to achieve scale and whether they become a meaningful contributor to Visa's revenues have yet to be seen.

A considerable near-term issue for Visa's current cross-border business is unsurprisingly from the impact of Covid-19. The company now expects revenue growth in its second quarter to be between 2.5-3.5 percentage points lower than the "low double-digit" growth level it had forecasted pre-Covid-19. Declines in cross-border payments also have an outsized impact on profits for Visa as they typically make a much higher margin on transacting them versus domestic payments. Whether cross-border transaction volumes recover is largely dependent on the trajectory of the pandemic; the outlook of which remains uncertain.

Please read the important notice on page 1.

Independent view

Don’t let all your hard work die with you

James Ward
Partner – Kingsley Napley LLP

Illustration by Jordan Atkinson

Owner managed and family owned businesses are the bedrock of our economy and can produce great wealth for the hardworking owners.

While these businesses are not often set up for successive generations in the first instance, if the business flourishes it soon becomes evident that this could provide financial security for the family; whether that be employment, income or future capital return. This objective is helped by the tax advantages of leaving a privately owned trading business to your children, as the current tax law allows these shares to be passed free of Inheritance Tax with a Capital Gain Tax base cost uplift.

Yet, without undertaking adequate succession planning, on the death or the loss of capacity of the director(s) and/or shareholder(s), your company and your loved ones may instead be surrounded by disruption, uncertainty, and conflict. They may also lose the tax benefits afforded to them.

Why is succession planning important for your business?

If a company’s constitutional documents (articles of association and shareholders agreement) do not sufficiently deal with what happens on the death of a director and/or shareholder, this can provide practical difficulties which may prevent the company from carrying on business as usual.

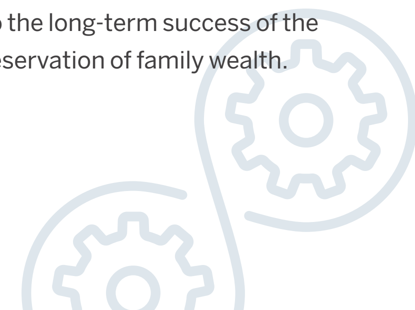
In reality, personal estate planning is only one facet of global succession planning – you should not overlook company succession planning.

For owner-managed or family-owned businesses, succession planning can allow you to plan for the continuity of the business in the event of death or loss of capacity. It allows you to plan for the future structure and growth of the business, transferring ownership when the time comes, expressing your wishes, and providing for your family and beneficiaries both now and in the future.

These can be very difficult conversations to have with a founder or a person who has run the business for most of their life. I have often encountered half-hearted attempts to hand over the business to children but still see control and ownership resting with the parent.

What do you want to happen to your business interests when you die?

As the owner of private business there are two key planning issues which you will need to consider in the context of what happens if you lose capacity and on death with regards to the long-term success of the company and the preservation of family wealth.



There are a number of questions you should be thinking about:

— What happens if a sole or majority shareholder dies or loses capacity?

— What happens if a director dies or loses capacity? What happens if this director is the sole director?

— Does the personal estate planning you have undertaken to date align with the aims of the business? You may have left company shares in your Will to particular individuals but you should think about how this works with your company's articles of association and any shareholders agreement that you may have in place.

— Do the company's articles of association/or shareholders agreement contain pre-emption rights on the transfer of shares?

— If you want your shares to be transferred to your business partner or a family member when you die, how will the transferee fund the purchase of your shares?

— Do you have suitable life insurance in place to facilitate the funding of the transfer of your shares on death?

— If you do have insurance, does this align with the relevant provisions in the company's articles of association?

Death is a traumatic event for the deceased's family, friends and those involved in the business. A lack of succession planning or inadequate planning can have significant unintended repercussions.

For example, companies that are family owned/controlled may find that the deceased's shares are transferred outside of the family. Alternatively, it may result in family members, such as the deceased shareholder's widow or widower, suddenly having a majority ownership of a company which they have no desire or experience to run.

What actions can be taken?

Simple and immediate actions can be taken now to make sure a business survives the first few months of a death of a key person. For instance, I would consider having more than one director, so that the company is not frozen after the death of the sole director. I would also make sure that financial details and bank accounts are not just restricted to that person to provide continuity for payroll, orders, transactions etc.

Long term actions need to be considered alongside whether the family want to keep the business going after death or want to extract value at death. A well-drafted Will can facilitate Inheritance tax planning surrounding the company and prevent shares being split up between a number of children. The use of discretionary trusts can preserve the shares as one unit and hold the business away from direct ownership by family members.

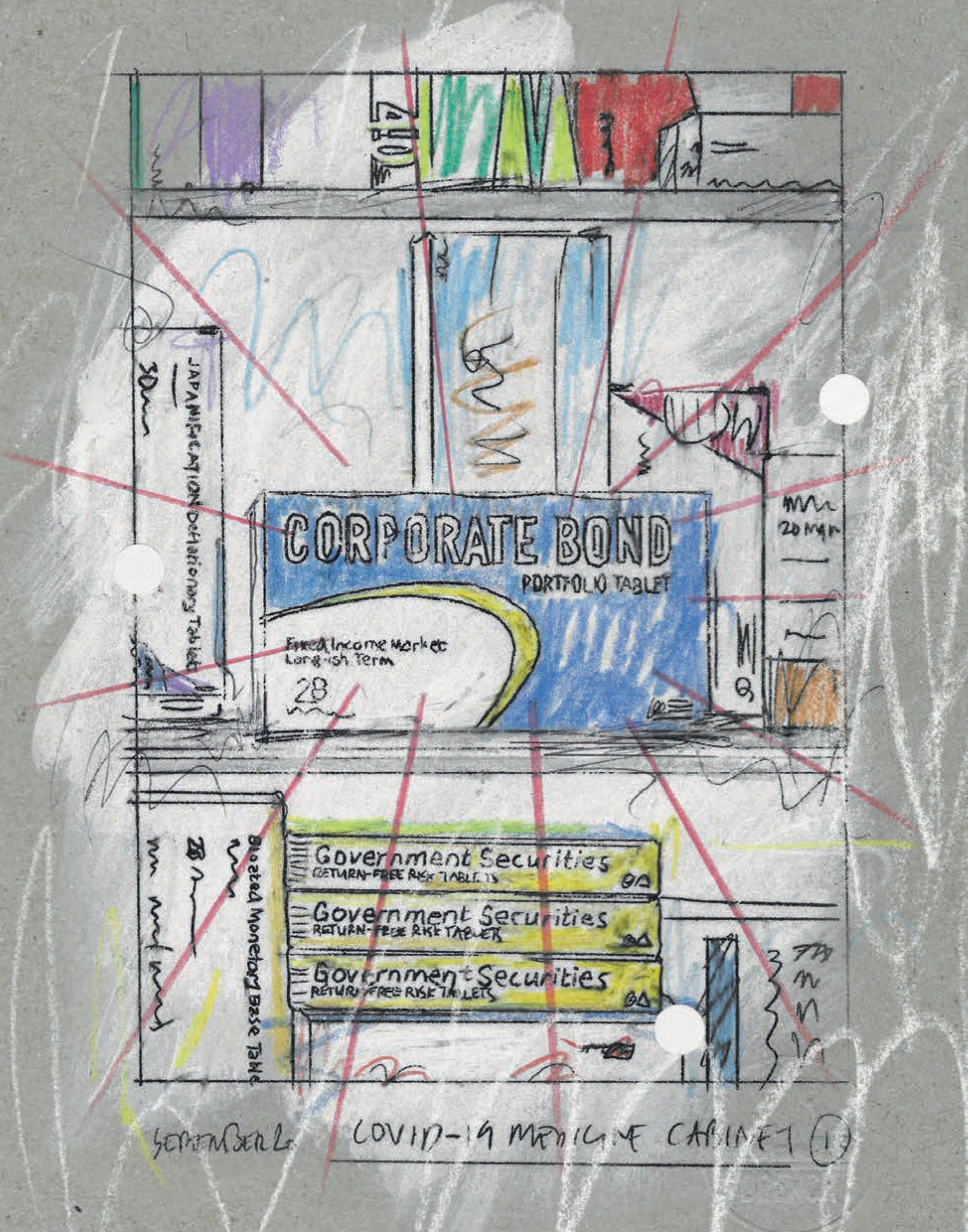
It is also worth considering life insurance to pass on wealth to the next generation or to facilitate a purchase of shares by a business partner. Often private businesses are illiquid so injecting insurance money into the structure in a careful manner can allow for value to be extracted but for the business to continue.

These issues are very real and if not prepared for, can cost the family money, unity and future value. I would always recommend that business owners get proper legal and financial advice surrounding the succession of their businesses as soon as possible, because when it is too late the options greatly dwindle.

James Ward is a partner and heads the Private Client team at Kingsley Napley.
www.kingsleynapley.co.uk

The above must not be taken as advice and is generic. Advice should be tailored to an individual situation and it would be strongly recommended that such professional advice is sought on any of the above.

Bond Focus


CORPORATE BOND
PORTFOLIO TABLET
Fixed Income Market
Long-ish Term
28
Government Securities
RETURN-FREE RISK TABLETS
Government Securities
RETURN-FREE RISK TABLETS
Government Securities
RETURN-FREE RISK TABLETS
JAPANIFICATION Deflationary Tablets
Bloated Monetary Base Table
COVID-19 MEDICINE CABINET

Where next? Onwards and upwards?

John Royden, CFA
Head of Research

Illustration by Sir Radar Drench

Most articles about bonds need to start with the question of where do interest rates go from here? In the short term that depends on how the world copes with Covid-19.

Whilst the localised flare-ups are often talked about as being the second wave, it must be borne in mind that this seems mostly to be amongst the young who are more inclined to socialise with an indifference to their perceived risk to the virus; whilst the older and more at risk cohorts stay at home. This leads me to believe that herd immunity or vaccination are the most likely end scenarios and that the path to these ends will be less volatile than the initial outbreak.

Over the medium term, the path of rates has split economists into two camps: those that think the bloated monetary base will bring inflation and those that worry about a deflationary environment, often called Japanification. The bloated monetary base simply means that there are more pounds, euros and US dollars in circulation due to the money that the central bankers printed in order to finance their quantitative easing (QE), or bond buying, as part of the Covid-19 support. Basic economics says that if there are more pounds trying to buy the same limited number of goods then the price has to go up. That's fine, except this time the surplus pounds seem to be being used to buy equities and for saving, rather than extra cans of baked beans.

The other side of the argument is Japanification, which is illustrated by Japan's nearly 30-year battle against deflation and anaemic growth, characterised by an extraordinary but ineffective monetary stimulus propelling bond yields lower even as debt burdens ballooned. An aging population comprised of fewer workers paying more taxes to support more old people who are spending less is part of the process as well.

> In the UK, the average spread in March peaked at
> **2.81%**
> At the time of writing, it stands at
> **1.48%**

I think rates have pretty much reached lows because the US and UK central bankers have both indicated that they do not wish to see negative rates. That leaves me with the view that investing in government securities is getting close to return-free risk. That's the price you pay for the security of what are essentially government deposits.

The case with corporate bonds is different. Whilst rates may firm up a little, the prospect of further spread compression may outweigh the downside from rates. Spread is the difference between the yield on a corporate bond and the underlying government equivalent of the same maturity. In the UK, the average spread peaked at 2.81% in March; it now stands (at the time of writing) at 1.48% but that is still way above the low of 1.2% back in mid-February 2020. With central banks now all buying investment grade corporate debt and the prospect of more monetary stimulus if things turn ugly again, I think that a long-ish duration corporate bond portfolio is probably the best place to be in the fixed income market for the time being; as long as that fits with your personal investment objective.

Asset allocation and sector focus

As part of our focus on providing a high quality, personalised investment service, we look to support our investment managers in their decision making when it comes to constructing client portfolios.

Our asset allocation committee is one example of this, via their monthly output showcasing their views on a global basis; this is then complemented by a sectoral view from the stock selection committee. The combination of these top down and bottom up opinions is an important resource for our investment managers to validate their own investment theses or to generate new investment ideas.

These committees, which consist of members of our research team and a number of investment managers, aim to provide a view that seems most suitable in the current climate. The output of the monthly meetings remains a suggested stance and it is important to note, that the views expressed are those of the committees and may not necessarily be those of your individual investment manager.

Here we present a snapshot of the current views.

Sector Views

Materials	Covid-19 has impacted commodity prices. Evidence shows Chinese demand coming back and there are early signs of stabilisation in commodity markets. Majors with strongest balance sheets should continue to pay dividends.
Consumer Staples	We like the sector for its defensive attributes and high quality businesses and it has shown its resilience over the last few months. However, valuations do not look that compelling and so retain a neutral stance.
Consumer Discretionary	There are many high quality companies and we favour those with structural and disruptive growth characteristics with an online presence. We have upgraded based on these businesses emerging from the current recession stronger, with many new and retained customers.
Financials ex Banks, Life Insurance, Property	This includes a broad range of stocks which are generally geared to investment markets. Valuations not at a level to turn more positive.
Financials Banks	High levels of regulation, falling interest rates globally and recessionary conditions makes us reluctant to turn positive yet. Longer term structural headwinds as well as no dividend support for next 12 months. We think balance sheets generally are solid enough to endure the current crisis.
Financials Property	Whilst acknowledging the structural difficulties on the high street and concerns over liquidity in open ended vehicles, we do see value in some areas. We would rather see more visibility on timeline for lockdowns before becoming positive again.
Financials Life Insurance	We see these companies needing to hold more regulatory capital post Covid-19 and with their geared balance sheets we are concerned equity investors will not see value creation for sometime.
Real Estate	Global real estate may offer better value. Caution on bond proxy status and Covid-19 impact.
Health Care	Growth and defensive attributes and global demographic tailwind. Distinguish between pharma/healthcare/biotech sub sectors. Remains a key theme for medium term, reinforced by current crisis.
Industrials	We had hoped for a full rebound in manufacturing cycle however coronovirus will delay this. Focus on high quality defensive names for now and hold through until certainty returns.
Energy	We recently downgraded as the dividend support has now been removed. The sector remains under pressure as supply/demand dynamics look poor for capital growth or capex expansion. Coronovirus impacting the oil price and further headwinds from a sustainability perspective.
Information Technology	We are positive but be selective and wait for market weakness to add to the quaility names.
Communication Services	Recently restructured sector - be selective and focus on quality stocks and avoid traditional telcos.
Utilities	Sector has seen some safe haven support however is not immune from the slowdown as business customers suffer.

Asset Allocation

Overweight · Neutral · Underweight

UK EQUITIES		
UK	Underweight	We acknowledge Brexit risk which could still yet rear its head. There is also a risk that a Brexit inspired run on the pound could make overseas investment more attractive. UK equities appear keenly priced on a relative earnings basis and we watch for signs of a cyclical rally in financials, banks and oils.
INTERNATIONAL EQUITIES		
North America	Overweight	US indices have been driven by the FAANGs. Whilst some are worried of over-valuation there is probably more upside and potential for the non-tech universe to catch up. The US election is difficult to call but we are less worried about Biden's threatened tax hikes than others are. We think the Chinese would probably prefer Trump; he thinks soybean exports are strategic, the Chinese think military expansion into the South China sea is strategic; and that is what Trump's sowing of discord amongst his allies has allowed.
Europe	Neutral	We upgraded Europe to neutral following their EUR 750bn support package. Public pressure is driving corporates to become more focussed on governance and responsibility, which in turn could increase the cost of capital and lower returns. If Chinese stimulus is more focussed on domestic consumer demand, rather than infrastructure spending, this could dent expectations for an export led recovery.
Japan	Underweight	Japan has been out of the trade war news and the Yen has started performing in mild safe harbour mode as the pandemic has dragged on. However, we are still wary of much needed corporate reform delivering on its promises.
Asia Pacific	Overweight	China is not imploding under a debt burden as many once feared. Instead, leverage is supporting the economy in a co-ordinated way which we expect to be supportive for Asia Pacific equities. China was first into the Covid-19 pandemic and should be first out in a way that leads the region. Recent data has been encouraging for the region and we expect prospects to improve further.
Emerging Markets	Neutral	Extreme USD strength is obviously no longer a concern and a gradual improvement in commodity prices, linked to a Chinese infrastructure stimulus, could help those emerging markets more sensitive to commodity exports. Argentinian contagion is a worry and raises the risk premium and tensions between India and China have heightened. We should monitor this situation carefully. Trump broadening out his trade war agenda to South America would not help investor sentiment either.
BONDS		
Conventional	Underweight	We have reached the stage with conventional gilts that they are now being described as return free risk. Ten year gilt yields are now at 0.30%. We don't see ten year rates being in negative territory and if interest rates climb from these levels there is greater downside risk.
Corporate	Underweight	Given our overweight equity position we would prefer to be underweight corporate bonds. There is a possibility that corporate spreads could reduce further but we think Linkers provide a more favourable risk/return trade-off as corporate bonds will likely be more sensitive, initially, to interest rate hikes.
Index Linked	Overweight	Linkers are a good hedge against the deflation-sayers. It is not beyond the realms of possibility that the pandemic induces strong money creation which could drive inflation above current expectations. Be wary of buying maturities beyond 2035 due to RPI methodology change risk.
CASH		
Cash	Underweight	We are underweight cash because it does not produce a yield and there is sufficient opportunity elsewhere.
PROPERTY		
Property	Underweight	We weigh up many factors including Brexit risk, valuation and weak interest rates helping demand. Overall the commercial slant of most listed property assets leads us to dislike the sector for the time being.
ALTERNATIVES		
Alternatives	Underweight	We have been favourable towards gold and infrastructure within this sector and remain so.

Meet the manager

Simon Temple-Pedersen

Investment Director, Management Committee

Lives Near Frome, Somerset

Family Married to Sarah with three grown up children

Started at JM Finn 2000

Favourite Film Where eagles dare

Passion Skiing, particularly in Italy and especially with my son

Favourite gadget iPhone 11 and my near 140 apps

Missed luxury during lockdown Restaurants!

Having moved to head up the Bristol office last year, what has been your main focus?

The Bristol office is unusual in that most of its investment managers have worked together for over 30 years, which provides a very collegiate atmosphere and an environment where many of us know each other's clients. My focus has been to capitalise on this strong platform to ensure that we are better placed to provide our clients with the excellent standard of service that they have been accustomed, whilst dealing with the various challenges that we are thrown, be it by the markets or regulatory or technological change.

One area which had become increasingly popular over the last few years, and even more so through this pandemic, has been the adoption of paperless reporting through the JM Finn portal, which aside from being more environmentally friendly, avoids the need to deal with sensitive hardcopy paper documents. Another big focus recently was finding a new office, which I am delighted to say we have now moved in to, albeit only with a skeleton staff thanks to the current social distancing guidelines.

Tell us more about your office move?

Having been in offices in Great George Street for over 20 years our move to archiving traditional client files following the introduction of an electronic filing some 15 years ago left us with a large and fairly unusable excess space. A break clause in our lease provided the catalyst for either committing to a major and much needed refurbishment project or to consider moving elsewhere.

Our new offices in the tranquil and beautiful setting of Queen Square, which is close to the railway station, provide us with first-rate client meeting rooms and a more usable floor plate. This offers us an excellent base from which to continue servicing our growing client base and our network of third party professional advisers, for which Bristol is well served, and I know the team is looking forward to welcoming clients and contacts to our new home, as soon as is practical.

What seem to be the biggest financial concerns for your clients?

Clearly, the volatility surrounding the pandemic induced sell-off in investment markets around the world was nothing if not extremely distressing. Historically, dividend income has proved to be robust in the face of other short sharp sell-offs.

However, on this occasion it has provided a catalyst for company boards to reflect on their dividend pay-out ratios as some recognised that they had perhaps become overly fixated on meeting these payments at the expense of continuing to invest sufficiently in their underlying business.

Whilst it has certainly been unpalatable, this may result in our needing to consider the funding of historic income payments by potentially introducing a mix of both income and capital withdrawals. Clearly, this will not be suitable for all clients but is certainly worth discussing with your investment manager.

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