JM FINN

Prospects

An unpopular government
Is it enough for Labour?

The Lifetime Allowance
A preferable tax charge?

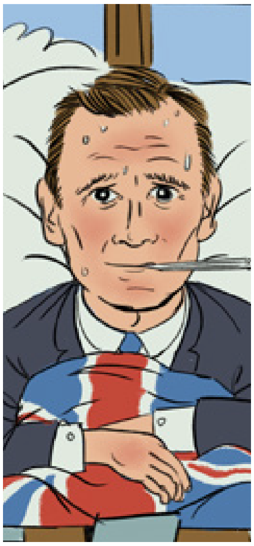
Online shopping
Can the high street bounce back?

The JM Finn Quarterly Periodical

No.42 *Spring 2023*

No.42

Spring 2023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JM FINN
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Password
Username
Password
Clear
Next
Forgotten username?
Forgotten password?
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Welcome

After a difficult year for investors in 2022, it has been an encouraging start to 2023 for the UK economy and stock market as a whole.

At the time of writing the FTSE 100 index has recorded an all-time high. This is good news although it is worth remembering that the index is very much weighted towards the larger more internationally focused companies with a concentration in resources and it is these which have rebounded the most. The more domestically focused FTSE 250 Index remains some 18% off its high. Elsewhere, international markets have broadly lagged in the period, particularly in sterling terms. The upshot is that the UK market performance has not yet translated into strong portfolio returns.

A key reason for the improving UK performance has been the removal of some of the political instability that was weighing on investor sentiment. The new Prime Minister has, for now, calmed the markets which have appreciated the Chancellor's more fiscally responsible approach; this has been a relief, particularly for bond investors. As for inflation, we hope the most recent rate rise may be the last for the time being. As a nation we are hugely sensitive to interest rates, with our shorter term fixed rate mortgages and high levels of personal debt.

Given the big lead the Labour Party currently have in the polls, we thought we would look ahead and examine how Labour, should they win the next election, might be seen by business and markets. Our guest editorial this issue has been penned by a former Labour member of parliament and it is encouraging that she shares our view that a Labour government would continue to see the financial services sector as hugely important to the health of the country. Interestingly she is not totally convinced of a Labour victory.

Whatever happens in the next General Election it is unlikely to change the battle that is still raging within the retail sector. Our editorial this quarter features a look at the strength of the high street and the continued threat of online retail. The suggestion is that physical retailers can continue to hold off the online giants via a re-imagination of what shopping looks like and of course, greater use of technology.

I would also like to draw our readers' attention to the news article on p19 which highlights the upgrade to our client portal. This is an important step in the development of our client offering with the new platform enhancing both the security of client data and providing the opportunity to improve the functionality of our core digital communication channel. We have been delighted that many of you have chosen to use the portal and the secure messaging service within it, which can offer a more secure method of communication.

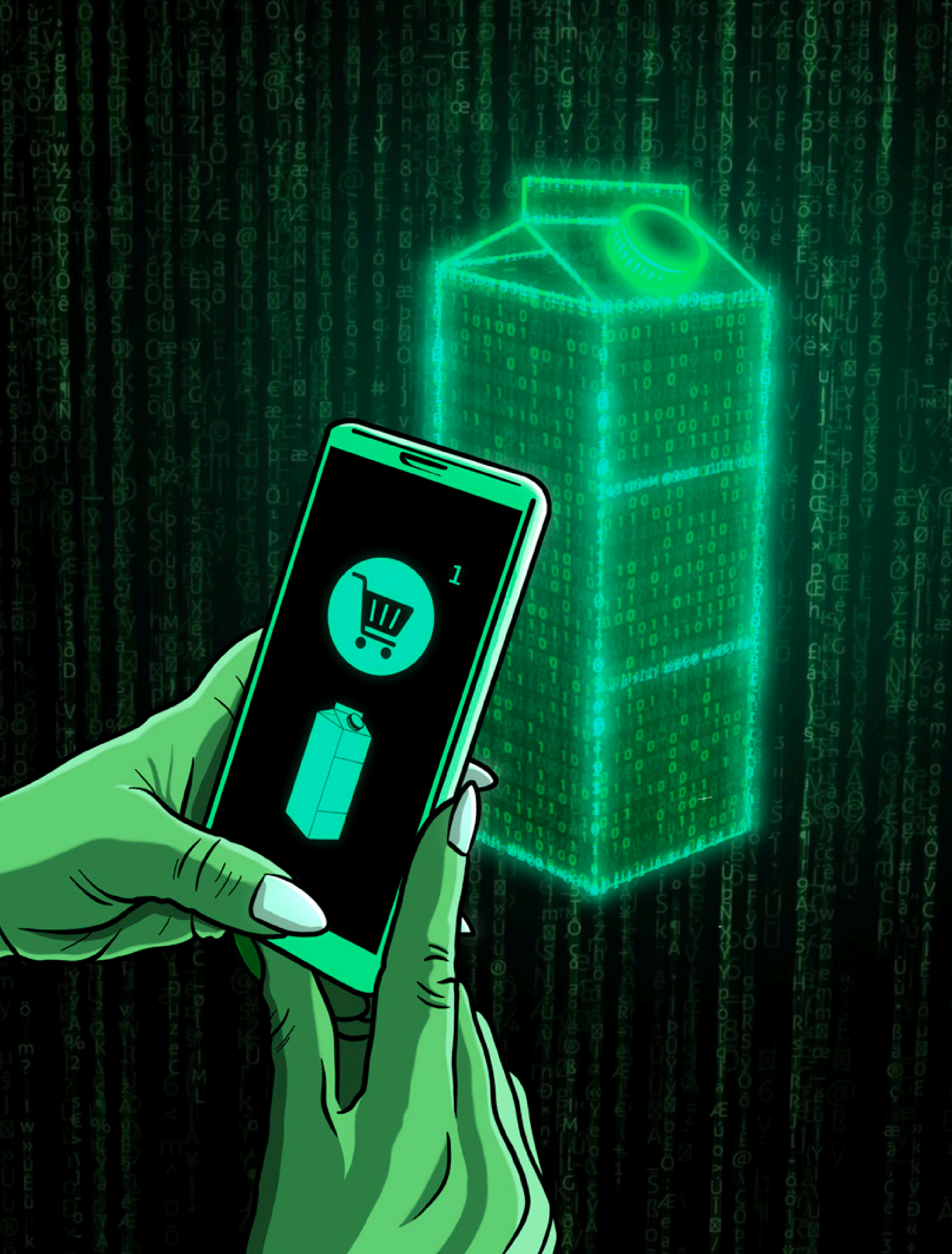
As we approach the end of the tax year, can I remind clients of some impending tax changes which we highlighted in the last edition of Prospects. As a reminder, both the CGT allowance and the amount of dividend charged at the 'nil rate' are both reducing from April and then reducing further again in April 2024. If you have any concerns with regard to this, do speak to your investment manager and remember that our wealth planning team can also help.

An increasing number of clients have appreciated the complexities associated with financial planning and pensions and retirement planning continue to be the focus for our wealth planning team. One area where we are seeing a sharp increase in people needing advice is in the Lifetime Allowance rules for pensions. Wealth planner, Atticus Kidd has summarised the key points on page 17, where he has simplified a dry and complex, but important, topic.

Finally, a new regulatory regime is being implemented later this year giving us the requirement to ensure that all of our communications are meeting the needs and understanding of the intended recipient. To this end, we will be inviting clients to take part in another client survey later in the year which I hope will be a good opportunity to share your thoughts on how we provide our services to you.

Hugo

Hugo Bedford
CEO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Editorial

Future of physical retail

James Ayling, CFA
Research Analyst

Illustration by Asa Taulbut

Media commentators have repeatedly remarked on the impending 'death of the high street', threatened by the apparent unrelenting rise of the internet and online stores.

Technology has undoubtedly altered the way in which we shop and will continue to augment physical retail shopping in order to improve the customer experience and/or reduce operational costs. The internet hurt physical retail by driving up price transparency (how many times have you googled the online price of a product whilst in store?) and providing near limitless choice from the comfort of the living room – a highly convenient and effortless experience.

Yet, although it has grown rapidly in recent years, it might surprise you to learn that e-commerce sales in the UK account for just c.30% of total retail sales[1]; physical retail retains the lion's share.

> E-commerce sales in the UK account for just c.30% of total retail sales.

Evidently physical retail is ceding market share on a fairly consistent trend rate of approximately one percentage point per year. The COVID pandemic certainly didn't help as e-commerce gained share via mandated lockdowns that forced vast numbers of consumers online out of necessity. Looking back allows us to see how UK footfall declined over -80% at various points in 2020 and 2021 versus pre-pandemic 2019 comparator levels. As of December 2022, UK footfall had staged a meaningful recovery; less than -10% below its 2019 level[2]. However, this raises the question of how might physical retail improve its competitiveness to mitigate market share losses?

[1]International Trade Administration: www.trade.gov/country-commercial-guides/united-kingdom-ecommerce
[2]Redburn

A number of retail surveys have suggested that consumers are actually willing to pay more for a product they can buy and collect immediately. This presents an opportunity for physical retailers or omni-channel retailers; those with both an online and offline presence. For physical retailers to excel in this area they need to ensure stock availability. Products need to be available on the shelf each and every time so that customers have high levels of confidence in their ability to fulfil a purchase transaction. This requires particular focus to be placed on technologies to improve inventory management. Meanwhile, omni-channel retailers may benefit from improving click and collect services. Greater focus on mobile-first digital design could prove increasingly valuable to reflect the broad consumer shift to mobile devices. Plus, greater flexibility around reserving or purchasing products ahead of time for pick-up in physical stores may boost satisfaction. Such measures would seem to reduce the primary focus away from price by enhancing the customer experience and hence, the value-add proposition offered by physical retail stores.

For online retailers, a growing challenge has been the increase in logistics complexity alongside the rise in shipping and delivery costs juxtaposed against a growing base expectation from consumers for 'free delivery' services and, easy returns processes. These issues, I believe, have worsened over the past few years and undermined the profitability of pure play online fashion retailers like Boohoo and ASOS. Competitor fashion retailers with less complex hub (warehouses) and spoke (physical stores) distribution setups could improve store and transport utilisation rates by incentivising customers to exclusively pick up, or return, orders to stores. This footfall pull strategy provides additional customer marketing opportunities and scope to better use existing fixed cost assets.

Management consultancy, McKinsey, recently provided their vision of retail shopping in 2030, outlining an increasingly personalised shopping experience driven by high levels of data analysis that could seek to go as far as tailoring the sounds and smells of the shopping experience. While I admire the forward thinking potential of data analysis, I think physical retailing should seek a bifurcated offering.

> **E-commerce gained share via mandated lockdowns that forced vast numbers of consumers online out of necessity.**

At the high end there seems great potential to become increasingly personalised and experiential where flagship stores delight customers with unique products, brand history and skilled craft. Skincare brand, Aesop for example, are developing highly immersive store emporiums that encourage consumers to visit, bring family and friends and, test the latest skincare products in a relaxed and inviting setting.

At the mass market end, convenience and efficiency may need greater focus. A clear technology driven opportunity for physical retail is checkout-less stores. Aldi are piloting their checkout-less supermarket, Aldi Shop&GO, in Greenwich. Shoppers enter the store after having downloaded a smartphone app which stores their payment details. The shopping experience begins by scanning a QR code from the app on an entrance turnstile. Shoppers then select products from around the store, add them into their bags before simply walking out. A receipt miraculously appears in the app later that day. The experience is seamless from the consumer perspective which could reinvigorate footfall and, retailers no longer need labour resource at the tills helping to cut store staffing costs.

> Consumers are willing to pay more for a product they can buy and collect immediately.

Computer vision is the exciting technology enabling checkout-free shopping and it could offer up revitalisation potential for physical retail. Computer vision is an area of artificial intelligence (AI) that uses algorithms and large volumes of training data to enable computers to recognise objects within images by breaking down image frames into pixels, which are then labelled by the computer to calculate the probabilistic likelihood of an image reflecting a certain object. This technology has the potential to provide a meaningfully better and more frictionless consumer experience that should help encourage people back into stores. Grocery shopping is a fairly repetitive task for consumers and queuing at the tills is seen as one of many pain points; the aggregate removal of multiple pain points improves the experience and lessens the pull to grocery shop online.

Overall I think e-commerce will continue taking share from physical retail but gains may moderate as the benefits of online retail have become more universal and competition has intensified. Physical retailers, meanwhile, have been under pressure and forced to adapt to better meet changing customer needs. Ahead, there seem to be growing pockets of opportunity in physical retail to delight consumers focused around physical product interactions or by removing traditional pain points. That might just hold the key to rejuvenating the outlook for physical retail.

CRANSWICK

Jack Summers
Research Assistant

PRICE
£30.54

52 WEEK HIGH-LOW
£37.68—£25.48

NET YIELD
2.48%

HIST/PROS PER
16/15

EQUITY MARKET CAP (M)
£1,637

Cranswick is a food producer specialising in high quality, predominantly pork and chicken products sold mostly into UK retail. The business is vertically integrated; 100% of chickens and c.60% of pigs are bred, reared, fed on grain grown and milled on Cranswick farms, processed and then packaged inhouse.

Revenue growth is derived from a strong track record of disruptive capture of market share, having focussed investment on genetics, automation and hygiene to a far greater extent than rivals. Cranswick has become the UK's largest pork supplier and established itself in the chicken market. Margins are protected from volatile commodity and carcass prices by an increasing number of cost of production linked contracts, the value of which has been particularly evident given recent elevated levels of inflation.

Unsurprisingly Cranswick was a big pandemic winner. As restaurants and cafes closed consumers treated themselves to higher quality home cooked food. Since then the share price has been punished despite a strong financial performance in 2022. Whilst the macro backdrop might be a concern for premium products, the diversified portfolio of relatively cheaper proteins (vs red meat/fish) could offer resilience.

Please read the important notice on page 1.


20%
Pro-business
Green Energy
Fourth Industrial Revolution

Guest Editorial

Prawn cocktail or beer and sandwiches?

Natascha Engel
Former Labour Member of Parliament and CEO of Palace Yard, a policy and research institute.

Illustration by Adam Mallett

With Labour's poll lead of around 20 per cent over the Conservatives, political betting sites are giving odds of 2/9 that Labour win the next General Election – and business is taking a closer look at what a Labour government might look like.

Keir Starmer's Labour is a different beast from the party that was led to defeat in 2019 by Jeremy Corbyn. For a start, the opposition frontbench has made engagement with business a priority.

Rachel Reeves is an impressive former Bank of England economist and a convincing Chancellor-in-waiting – even George Osborne thinks so, and Jonathan Reynolds is a popular Shadow Business Secretary who has been building relationships with industry and happily agrees that he is on a "prawn cocktail charm offensive" with business.

> **Energy will be at the heart of every manifesto.**

In Keir Starmer's recent speeches to business, he repeats the line that Labour is "not just a pro-business party but a party that is proud of being pro-business." He talks about a potential Labour government working in partnership with business and trade unions in a deliberate echo of pro-industry Tony Blair. But we are light years away from Labour's landslide victory in 1997 – and using the rhetoric of being pro-business is not enough on its own.

Covid and the economic lockdown of global economies, plus the impact of Brexit on Britain's migrant labour, have seen our workforce shrink. The Conservative government's answer is to find ways to tempt older workers off golf courses and cruise ships back into the office. Labour's message to business is that they are open to making it easier for migrants to work in the UK but in return, industry must persuade them that they have longer-term plans to improve skills and pay for domestic workers.

> **Starmer believes that green energy will bring economic stability, higher skills and growth.**

The most significant difference between now and 1997 is the war in Ukraine. Energy policy used to be largely left to data experts and engineers. Now it will be at the heart of every manifesto – especially Labour's. Keir Starmer believes that green energy will bring economic stability, higher skills and growth, likening his plans for a publicly-owned Great British Energy generating company to EDF in France and Vattenfall in Sweden.

To pay for this, Labour has called for a windfall tax on the 'excess' profits of oil and gas companies. Not only that, the party has made clear that there would be no new licences for oil and gas fields in the North Sea. Instead, Great British Energy will provide more capacity alongside existing firms to help the UK produce 100% zero-carbon electricity by 2030 by investing in wind, solar, nuclear, hydrogen and carbon capture and storage.

This, of course, means vastly more infrastructure – an exponential expansion of the current power grid, more electricity substations, charging points for electric vehicles and a network of hydrogen refuelling stations. Labour also talks about insulating 19 million homes and a green skills training programme to create an army of heat pump engineers.

Keir Starmer says that he wants to prepare the UK workforce for the fourth industrial revolution, which will see not just the electrification but also the digitalisation of the economy.

Reforming the much-complained-about Apprenticeship Levy to make it more flexible and able to tailor to individuals' and business needs will be popular, as will abolishing business rates to help town centre retail compete with online shopping giants. What will be a much greater challenge is to get the infrastructure built in time to deliver these ambitious proposals. Labour has announced the establishment of a new Industrial Strategy Council that will think through what needs to be built where and in what sequence.

> **Keir Starmer wants to prepare the UK for the fourth industrial revolution; not just the electrification but also the digitalisation of the economy.**

These are big plans. Their success depends on the voting public. More skilled and well-paid jobs in what used to be Labour's industrial heartlands will be welcomed; roads being dug up for electricity cables or more overhead pylons, less so. If the costs of insulating homes and fitting new electric heat pumps are not borne by the consumer, they might be persuaded to put up with the disruption. If they are out of pocket, it will be a harder sell.

There is a lot of detail to get right but even before that, Labour knows there is still a mountain to climb. The Conservatives may be unpopular, but that is not enough to hand the keys to Downing Street to Keir Starmer.

So for now, on their mission to persuade enough people to vote Labour at the next election, the party will be serving beer and sandwiches – as well as prawn cocktail.

The view from the floor

Investment Director Charles Bathurst-Norman shares his thoughts from an investment standpoint.

The battleground will inevitably be the strength of the economy. Thatcher quipped "Socialist governments traditionally do make a financial mess. They always run out of other people's money." Starmer is conscious of this and is backing a new business-friendly agenda with which Labour clearly intends to go to the polls. While Sunak can't be accused of lacking big ideas, his five priorities look more like fire-fighting. By comparison, Starmer is on an electoral mission and has pledged to make the UK the fastest-growing economy in the G7.

The Labour leader's pledge of a fossil-fuel free electricity system by 2030 did catch my eye. Although the UK is not significantly dependent on Russian oil and gas, we will be impacted by price surges and Starmer has made addressing this at the forefront of his manifesto. At the World Economic Forum in Davos, he reiterated the Labour Government would make the UK a net exporter of clean energy and block fresh investment in North Sea oil and gas. A faster rollout of renewable energy schemes to cut energy bills and deliver energy independence would be implemented via a new publicly owned Great British Energy company with the aim to hit the 2030 electricity target by quadrupling offshore wind capacity, accelerating the use of floating offshore wind farms, tripling solar power, doubling onshore wind capacity and expanding the use of hydrogen as an alternative energy source. Labour also envisage the completion of new nuclear power stations at Hinkley Point and Sizewell, as well as backing new "small modular reactors". In my view, if Labour were to form the next government, exposure to these alternative investment themes should run keenly through the backbone of portfolios for long term investors.

Please read the important notice on page 1.

GREGGS

Henry Birt
Assistant Research Analyst

PRICE
£26.68

52 WEEK HIGH-LOW
£28.20—£16.50

NET YIELD
3.60%

HIST/PROS PER
23/23

EQUITY MARKET CAP (M)
£2,714

The UK high street has not been an easy place to operate in recent years but Greggs has bucked this trend. The purveyor of pastries and bacon rolls is a key player in the food-to-go market, with a commanding 10% share of the breakfast slot.

In the five years before the pandemic, Greggs was able to grow like for like sales (i.e. same store sales growth) at c.+5% p.a., combining this with growth in its own run store estate to grow revenue at c.+8% p.a.

Looking forward, Greggs will rely on two levers for growth. Firstly, it plans to expand its store estate by a further 150 stores a year, a big step up from the pre-covid average rate of net additions of 80 stores a year. Secondly, Greggs will attempt to increase sales per store by opening later in an attempt to penetrate the evening sitting. Time will tell if this strategy works for them.

Please read the important notice on page 1.

Economic Focus

The British Disease

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Adi Kuznicki

How is it that this country teeters on the brink of a recession, productivity is known to be behind that of other G7 countries and industrial action is rife, yet our benchmark FTSE 100 Share Index has managed to clamber up to a new peak, at the time of writing?

The answer is remarkably simple. The make-up of our principal index bears little relation to the composition of the domestic economy. To put it into context, these giant concerns conduct the majority of their business outside the United Kingdom.

This does not, of course, fully account for the recent impressive performance of the Footsie, but it does give a clue as to why we have been outpacing other major markets recently. True, the rise is not as great if adjusted for the US dollar/sterling exchange rate, but because the greater majority of sales conducted by these companies take place overseas, the weakness of the pound rather perversely helps the performance of the index.

> We have a reputation for failing to make the best of our workforce.

Companies like AstraZeneca and Unilever, two of the largest in terms of market capitalisation, are truly global businesses. Even HSBC, this country's largest bank in terms of the value of its shares, is focused more towards Asian markets than those at home. Indeed, HSBC (the initials stand for the Hong Kong and Shanghai Banking Corporation) used to have its primary listing in Hong Kong and only moved its domicile to London in order to facilitate the acquisition of Midland Bank.

The recent announcement that AstraZeneca was to build a new factory in Ireland rather than in Britain highlights one of the problems facing the UK government. While the initial reaction was to blame the decision on the unfavourable comparison between the corporation tax rates applied in the UK and Ireland, with ours due to rise shortly, the situation is more complicated than simply trying to limit the tax burden.

Britain compares less well in two important areas when judged against other major economies. Both productivity and investment lag other G7 countries. Productivity in particular appears a problem that the government acknowledges, but so far has seemed incapable of stimulating improvement. And although productivity has been an issue for some time, it is since the financial crisis of 2008 that real concerns have been raised.

According to the National Institute for Economic and Social Research (NIESR), during the period from 1974 to 2008 productivity in the UK improved by an average of 2.3% per annum. Sustaining productivity growth is important if we are to maintain our competitive position in the world and improve the living standards of our population. However, in the period after the financial crisis, productivity collapsed to an average of less than 0.3%.

Other major economies were similarly impacted by the recession that followed, but not to the same extent. The United States achieved productivity growth of 1% during the period from 2008 to 2020; France and Germany just a little less. We may be talking about relatively small numbers here, but the compounding effect on our ability to compete globally should not be underestimated.

> “
> **Sustaining productivity growth is important if we are to maintain our competitive position in the world and improve the living standards of our population.**

What can we do about it? The new Prime Minister and his equally new Chancellor have trumpeted the attractions of technology industries as a way out of our apparent malaise. Arguably, America’s encouragement of technology has helped it stay ahead of the pack in the productivity race. But it is hard to believe that placing greater emphasis on these businesses will provide the silver bullet so sought after by the government. After all, the industrial composition of our economy has changed dramatically over the decades.

> “
> **Poor industrial relations are often cited as the reason for our productivity lagging those of our competitors.**

Which brings me to the second of our apparent current shortcomings. The lack of investment. This was cited by AstraZeneca as one of the reasons behind its decision to favour Ireland over Britain for its new manufacturing facility. On the face of it, the facts appear to bear this out. Figures produced by the NIESR show that public investment grew at an annualised rate of 4.5% from the immediate post-war years until 1979. Since then it has dropped to a mere 1.5%. Of course, many capital intensive industries have withdrawn from the UK during the past half century, but it is a worrying trend nonetheless.

Some of the blame for recent developments can be placed at the door of the period of austerity ushered in after the financial crisis and the restrictions faced by the government following the costly bail out of our economy during the pandemic. But these are problems faced by other nations as well. We have, sadly, a reputation for failing to make the best of our workforce, with poor industrial relations often cited as the reason for our productivity lagging those of our competitors.

Our next election is likely to take place in around two years’ time. The current administration will be lucky to have achieved a turnaround in such a short period and the Labour government in waiting are endeavouring to build closer relations with the business community. Whoever sits in Downing Street will have a tough task on their hands. Fingers crossed that appropriate medicine can be found for this very British of diseases.

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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.

Sir John Royden
Head of Research

Michael Bray, CFA
Research Analyst

Henry Birt
Assistant Research Analyst

CONSUMER DISCRETIONARY
Frasers Group, Whitbread

COMMUNICATION SERVICES
Meta

CONSUMER STAPLES
Cranswick, Henkel

ENERGY
Shell

FINANCIALS
Beazley, Burford Capital, IP Group, Lloyds

HEALTH CARE
AstraZeneca, GSK, Novartis, Novo Nordisk, Roche Holding

INDUSTRIALS
discoverIE, Diploma, Raytheon Technologies, QinetiQ

INFORMATION TECHNOLOGY
ASML, Halma

MATERIALS
Givaudan, Croda International

REAL ESTATE
Big Yellow, Shaftesbury

UTILITIES
National Grid

1.

Beazley

Price **£6.76**
52 week high-low **£6.95 – £3.65**
Net Yield **1.87%**
Hist/Pros PER **18/37**
Equity Market Cap (M) **£4,508**

Financials
Sarah Booth, Head of Investor Relations

Beazley is a London listed insurance company which achieved sales of £2.4 billion in 2022, up from £1 billion in 2021. They have five main divisions being Cyber, MAP, Speciality, Digital and Property. MAP covers Marine, Energy, Cargo, Liability, Aviation and Space + Accident, Political, Life and Terrorism. Property covers North America Commercial, Jewellery, HNW homes and Reinsurance. Speciality covers executive liability, Environmental, Healthcare, M&A and Special Reinsurance.

They think that Beazley is good at innovative products for complex insurance needs and that complexity took them into areas where the insurance product was not commoditised. Beazley's divisions tended to be non-correlated, meaning they could make the best use of their capital via intra-group reallocation, rather than returning it to shareholders when market pricing was unattractive.

Cyber has been a recent success story with a rapid rise in sales. It is aligned with a consultancy service which audits cyber risk prior to agreeing to insure, reducing the likelihood of an impactful cyber-attack. They also have a post-attack service which helps with recovery and other issues like paying ransoms using digital currency. This makes for sticky clients and repeat business. Pricing in the other divisions remains strong.

Beazley appears to be a well-run insurance company that has just raised an additional £350 million to take advantage of strong insurance markets in Property in particular. They also raised another £40 million with a catastrophe bond. The risks are that social inflation (usually US juries awarding high awards in court cases) and claims inflation (such as the cost of property repairs escalating) continues and that bad weather drives larger than expected claims on their property and reinsurance books.

2.

Chemring

Price **£2.86**
52 week high-low **£3.84 – £2.71**
Net Yield **1.76%**
Hist/Pros PER **17/15**
Equity Market Cap (M) **£812**

Industrials
Andrew Lewis, CFO and Rupert Pittman, Director of Corporate Affairs

Rupert began with a review of the history of the group. For much of the noughties, Chemring benefited from demand from the Iraq and Afghanistan wars and increased this exposure through c.£450m worth of M&A, much of which was debt funded. Following the 2011 drawback from Afghanistan, Chemring's demand dried up and the group was left servicing expensive debt. The 2010s were punctuated with a series of divestitures and profit warnings until the current CEO took over in 2019 and overhauled the group. Following the sale of non-core, lower margin businesses the group has emerged smaller but more focused. 63% of the business remains in Countermeasures & Energetics (C&E) (i.e. missile deterring flares) for which the business was originally famous, but the remaining 37% is in the more exciting Sensors & Information segment (S&I), which has been funded by the steady cash flows of the annuity C&E segment.

They have tried to provide more information on this segment in recent years and shine a light on the Roke business in particular, which accounts for 68% of S&I revenue. Roke engages in cyber security, data science and electronic warfare and is expected to double over the next five years. The rest of the S&I segment is in the US and is made up of a small number of large programs with the US government. Chemring is well exposed to both UK and international defence priorities, but the near-term focus of investors will likely be the US sensors business where a big contract decision is due in H1.

3.

Diploma

Price **£27.60**
52 week high-low **£30.22 – £20.90**
Net Yield **1.93%**
Hist/Pros PER **36/24**
Equity Market Cap (M) **£3,483**

Industrials
Kellie McAvoy, Head of Investor Relations

On face value, Diploma looks to be a muddled industrial distributor. It has many operational businesses, it does not specialise in a particular niche and it operates across three seemingly disparate sectors of Controls, Seals and Lifesciences. It's hard to see the similarities of distributing motorsport fasteners, construction machinery gaskets and clinical diagnostic instruments.

But a company doesn't achieve a five year compounded annual sales growth of +18% (+6% organically) and a 19% operating margin (adjusted) without having a clear, tried and tested strategy. Diploma's strategy is underpinned by 'value-added' distribution. In practice this means that in addition to standard distribution services, Diploma can also provide technical advice, conduct component testing, and offer a broad product range alongside next-day delivery. Such value-added services create customer loyalty, pricing power and some of the best operating margins in the distributor industry.

This model works across different product categories. Aside from whether they can offer a value-added service, the only thing that holds the company back from moving into new categories is scalability. Diploma say growth opportunities are easy to come across, as they typically operate in fragmented markets where no player has a significant market share, but note that the group cannot manage an infinite number of product lines. Thus the ones they choose need to be scalable, over a long time horizon, in order for the group to achieve sustainable growth. Choosing the right products and successfully scaling them are therefore some of the biggest challenges for management.

Please read the important notice on page 1.

THE COMPLEXITIES

LTA

OF THE LIFETIME ALLOWANCE

Wealth Planning in focus

The Lifetime Allowance. Is it just a nice problem to have?

Atticus Kidd
Wealth Planner

Illustration by Darren Richards

Wealth planner Atticus Kidd explores the complexities of the LTA, an area where many investors diligently saving into their pensions, get caught.

The lifetime allowance (LTA) is the total amount that you are able to accumulate in pension benefits during your lifetime, whilst still enjoying the full extent of the tax benefits that pensions offer. Most notably, you are only able to take your permitted tax-free cash on pension benefits within the LTA and any pension benefits above the LTA are subject to an LTA tax charge.

For the majority of individuals the LTA stands at a rather awkward £1,073,100, having previously been indexed in line with inflation. This level has now been frozen until April 2026 and so this will remain the relevant figure for the short-term future. It is possible to apply for LTA protection that may allow you to benefit from a greater LTA provided you meet certain criteria.

In simple terms, the LTA tax charge is levied in one of three main scenarios:

1. **Death:** when passing away an LTA test will be conducted on the deceased's pension benefits.

1. **Accessing pension benefits in excess of the LTA:** if you wish to take pension benefits in excess of your lifetime allowance, then an LTA tax charge will be levied on the excess.

1. **Age 75:** when turning 75 there is an LTA test conducted.

Importantly, once the age 75 test has been conducted there are no further tests applicable. So options 1) and 2) are only applicable if they occur prior to the age 75 test. Also, the charge is purely levied on the excess pension benefits, being the amounts above the LTA. Any benefits within the LTA will not be subject to an LTA tax charge.

> **Although no tax is particularly pleasant, it may be that incurring the LTA tax charge is preferable to the alternative.**

The LTA tax charge receives a great deal of press and often garners much attention for the fear-inducing idea of a 55% charge. However, although it is possible to incur a 55% LTA tax charge, this is only where the excess pension benefits are taken as a lump sum and it is seldom mentioned that no income tax is incurred via this method. Additionally, most individuals need not worry about the 55% LTA tax charge as there is a potentially more palatable alternative 25% LTA tax charge where taken as income rather than a lump sum.

Although the idea of a 25% tax charge being described as palatable may seem absurd, the reason I have done so is that by opting for this method, the excess benefits are able to remain in a pension wrapper. Pension wrappers are highly tax advantaged assets benefitting from income tax and capital gains tax relief internally and, as they do not usually form part of an individual's estate, they are also exempt from inheritance tax. It is also worth remembering that contributions towards pension schemes are subject to tax relief on the way in too. By electing for the 25% LTA tax charge any benefits taken from the excess above the LTA will be subject to income tax but, unless you are an additional rate tax payer, the net distributions would still be equivalent or possibly lower than incurring the 55% LTA tax charge.

It can be all too easy to get caught up in the idea of avoiding an LTA tax charge and we often speak to individuals seeking to take assets out of their pensions for this purpose. However, all things are relative and although taking benefits out of a pension may help you to avoid a 25% LTA tax charge, if the assets are not required and simply reinvested, the income may be subject to income/dividend tax and any gains potentially liable to capital gains tax. Of course if investing in an ISA, it may be possible to avoid these taxes but, the ISA allowance is limited to £20,000 p.a. and the assets would form part of your estate and so potentially be liable to inheritance tax (which is 40% on assets above your available nil-rate band). Additionally, any pension distributions in excess of your tax-free cash will be subject to income tax. You may therefore be attempting to avoid one tax charge only to incur an assortment of others. Also, by taking assets, this may not cease the levying of an LTA tax charge as any growth in the value of the drawdown fund is still eligible for assessment against the LTA if not utilised.

It is right to be wary of any potentially unnecessary taxes but it is also important to recognise that the LTA tax charge is only one factor in the greater scheme of tax structuring. As Benjamin Franklin wisely wrote '... nothing can be said to be certain, except death and taxes'. Unfortunately an element of taxation is inevitable with any investment of this scale and so, although no tax is particularly pleasant, it may be that incurring the LTA tax charge is preferable to the alternative.

The way that the lifetime allowance is assessed against your pension will depend on the type of scheme and method of crystallisation (accessing benefits). In some cases this can be complex and so it may be best to speak with a financial adviser to get a full understanding of these matters and how they may apply to you.

The information provided in this article is of a general nature and should not be considered a substitute for specific advice provided by a qualified professional with regard to your own circumstances. Tax rates and allowances are subject to change by the HMRC. Any figures quoted are accurate at the time of publication.

New portal

Regular users of our client portal will soon notice that we have a new version.

Long standing clients will know that we were an early adopter of technology when it came to servicing our clients. Launching our first portal in 1999 was a major milestone for the firm and one that our clients took advantage of. Since then, we've added additional functionality but our over-riding focus has been on ensuring the data has been secure.

Whilst we have regularly tested our portal for security breaches and ensured it is surrounded by the latest cyber security, we have come to the point where we needed to deliver a new, more secure environment to house our client data. This new version is built using the latest technology in conjunction with our long-standing software partners.

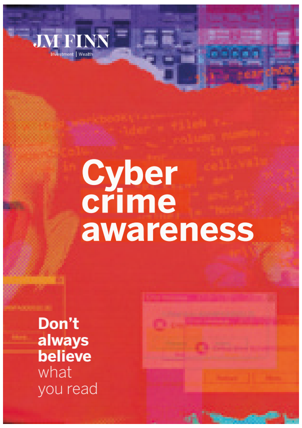
Whilst it can be inconvenient for existing users to launch a new portal, we have made every effort to minimise the disruption by retaining existing usernames, passwords and PINs and we have not changed the address, or url, where the portal is located. For those clients who use the app on their mobile device, they will have to reset their biometric login, but other than that we hope your experience of moving to the latest, upgraded version is seamless.

Users will notice the big difference is the dashboard, or home page, where we have tried to show all the relevant information, based on our learnings from clients' use of the portal. All other features are retained, with the ability to add more functionalities in the future. Once the new portal has bedded down and clients are comfortable with it, we will start adding in new features, which we expect to make the portal an even more attractive tool.

As a reminder, the portal is a secure method to view the valuation of your portfolio(s) and keep tabs on the latest transactions. We believe the real value of it, is the ability to store your account documentation digitally for three years. Via the personal library, periodic statements, contract notes and tax reports are stored, reducing the risks involved in sending your personal information by post. The portal also offers clients the opportunity to send messages, including personal documents, to your investment manager via means of a secure messaging service. This negates the need for email, which is considered the tool that is compromised by hackers the most when looking to access your personal data.

We also offer an app version allowing for even easier access on your preferred device. The key advantage of the app, which offers the same functionality as the desktop, is the biometric login ability, subject to the device, rendering it even more secure.

If you are not a regular portal user, please contact your investment manager who can help you register. To download the app, please visit your device's app store.



To help stay safe online, read our Cyber Crime Awareness guide, available online at: **jmfinn.com/cyber-crime-awareness**

Collectives Commentary

Why Europe Is Bouncing Back

Mark Denham, Manager
FP Carmignac European Leaders

Illustration by Adam Mallett

Back in August 2020 there was a headline that made for uncomfortable reading for us European investors: US tech stocks are now worth more than the entire European market.

As Europe seemingly shrunk in size, one could be forgiven for questioning whether it has also shrunk in relevance. Of course, we think not. Europe is very attractive right now but perhaps not for the reason you might think.

During my 20-year career, I have seen the continent move through different market environments and learned by experience that the region, regardless of the macro backdrop, offers interesting long-term opportunities. While the environment constantly changes, the embedded fundamental characteristics of businesses are what ultimately define their likelihood of succeeding. This understanding moulded our investment philosophy decades ago and still stands true today.

A year to forget?

2022 was a difficult year for world equities, and particularly for European markets. The region suffered primarily due to inflationary pressures bought about by the post-pandemic recovery and exacerbated by the war in Ukraine. The subsequent interest rate rises, a tool central banks used to fight inflationary pressure had a crushing impact on markets.

Since August last year, not only have European equity markets gained in value on an absolute basis but have done so almost at par with US stocks. As a result, investors are looking back at the region with a newfound interest and are taking advantage of the huge derating effect that 2022 had on companies' prices across the board. Momentum has been building since November and is now palpable. Multiple factors contributed to this but, above all, the unexpected resilience of the European economy as a whole.

Looking under the bonnet

While the favourable macro picture is welcome, we spend most of our time assessing the quality of each company's financials, strategic planning, governance dynamics and the impact they have on the environment or society.

More specifically, our philosophy is that companies with the best long-term prospects, regardless of the economic scenario, exhibit two characteristics: they can demonstrate a history of sustaining high profitability through the economic cycle, and they can find attractive opportunities to reinvest a large part of their profits for future growth.

The result is a natural preference for companies which are considered quality or growth stocks, as they possess visibility of earnings growth, competitive advantages and/or leadership positions. These types of companies are currently more abundant in sectors such as technology, health care, renewable energy, industrials and consumers. We believe that each of these areas will benefit from secular growth drivers for decades to come, such as digitisation and cloud migration, electrification, the sustainability push, an aging population, increased sense of wellbeing, necessity to fight pandemics such as diabetes or obesity and energy independence, etc.

Thus, last year was not all that bad. The good news is that it brought a lot of opportunities as well.

Seizing the moment

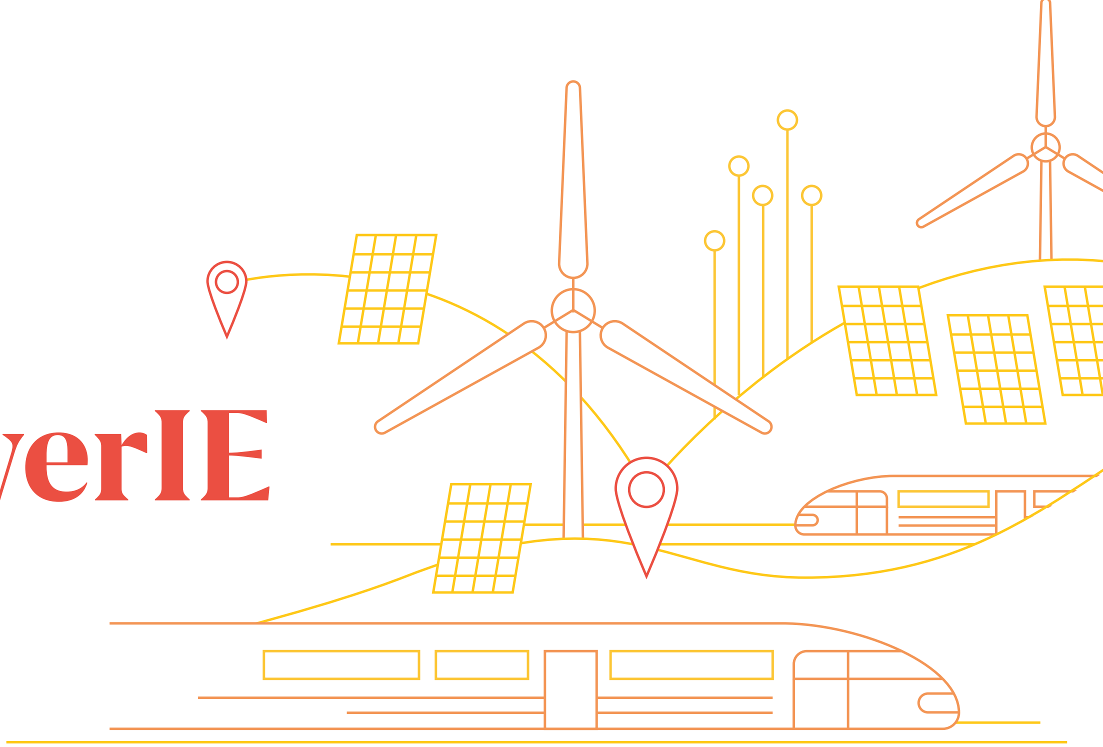
As during the Covid-induced market volatility of 2020 - just as the market was "shrinking" - opportunities opened in the travel and catering sectors, similarly in 2022, we were able to snap up shares in numerous high-quality businesses which were hit particularly hard by the negative impact of rising interest rates. We bought, for example, leaders in drug development and manufacturing, in consumer discretionary products, and in information technology services. We do not know exactly how long the valuations of such names will be under pressure, or exactly when inflation globally will subside, allowing central banks to relax, but we are confident that on a three- to five-year horizon, this was a great entry point.

> **Last year was not all that bad. The good news is that it brought a lot of opportunities as well.**

Regardless of the economic backdrop, to our mind, Europe is always an interesting place to invest. And after the turbulence of recent times, deserves even more attention. But rather than speculating on new or old economic/inflationary paradigms and the overall size of a market, we believe one's time is better spent analysing companies. When others are distracted and valuations fall, money can be deployed with the best long term returns in mind.

Please read the important notice on page 1.

Stock in focus



discoverIE

Michael Bray, CFA
Research Analyst

Illustration by Adam Mallett

There is a lot of doom and gloom around the UK economic outlook currently. Yet, there are bright spots, such as discoverIE which is one of the fastest growth stories within the industrial sector of the FTSE 350.

Founded in 1986, discoverIE (formerly Acal) was originally an electronic component and IT distributor, however CEO, Nick Jeffries, has transitioned the business away from this model. Jeffries, a former general manager at distributor RS Group (formerly Electrocomponents), had seen first-hand the boom and bust cycles which typically come with this model, and wanted to put discoverIE on a more sustainable growth footing.

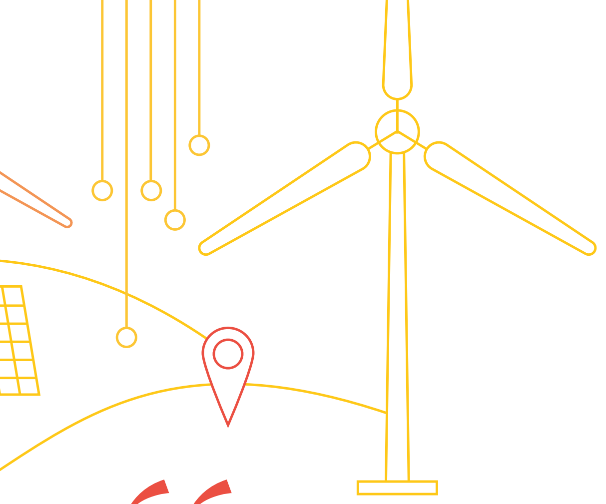
Since 2010, Jeffries has made a series of divestitures and acquisitions which have now made discoverIE a pure design and manufacturing company, focused on customised electronic components. The business sells into 66 countries with revenue split between Europe (48%), Rest of the World (41%) and the UK (11%).

By pivoting towards design and manufacturing (D&M), discoverIE has increased its repeat customer business and now counts 85% of its revenue as recurring. Under its D&M model, discoverIE's engineers collaborate directly with customer's engineers to design a bespoke component, such as a transformer for a wind turbine, which discoverIE then manufactures.

This engineer-to-engineer process requires technical expertise and can take up to two years. Customers are typically blue-chip multinational companies like Siemens and General Electric. Once approved, discoverIE's components are designed into the full life cycle of their customer products, which can range from four to ten years. Customers are therefore less likely to switch to a competitor, particularly as discoverIE retains all intellectual property associated with the component's design.

discoverIE also focuses on niche electronics and industrial applications, meaning competition is limited to small local operators that cannot offer the same level of supply-chain security.

The move to a D&M model has provided discoverIE with more resilience, but so has the decision to focus on structurally growing markets which are less sensitive to the economic cycle. The business derives 76% of sales from United Nations Sustainable Development Goals aligned sectors of renewables, medical, transport, industrial & connectivity.



discoverIE's components are designed into the full life cycle of their customer products.

PRICE
£8.12

52 WEEK HIGH-LOW
£9.27—£5.86

NET YIELD
1.35%

HIST/PROS PER
30/25

EQUITY MARKET CAP (M)
£776

Examples of discoverIE's products into these sectors include; vertical 'cone' scanning for wind turbines used to analyse wind speed and direction to ensure maximum efficiency and yield; electric motors used for powering electric and hybrid electric vehicles; absorptiometry detectors used in bone density scanners; and light detectors for harmful gas emissions. discoverIE has thousands of different product categories.

These strategic decisions have led to strong growth; since 2014 organic revenue growth (from continuing operations) has averaged +7% with the underlying operating margin rising from 3.4% to 10.9% (FY22). Moving forward, Jeffries believes that the business can continue to grow sales well ahead of GDP by moving up the value chain, acquiring more high quality businesses and further internationalising its operations into faster growing industrial markets like North America.

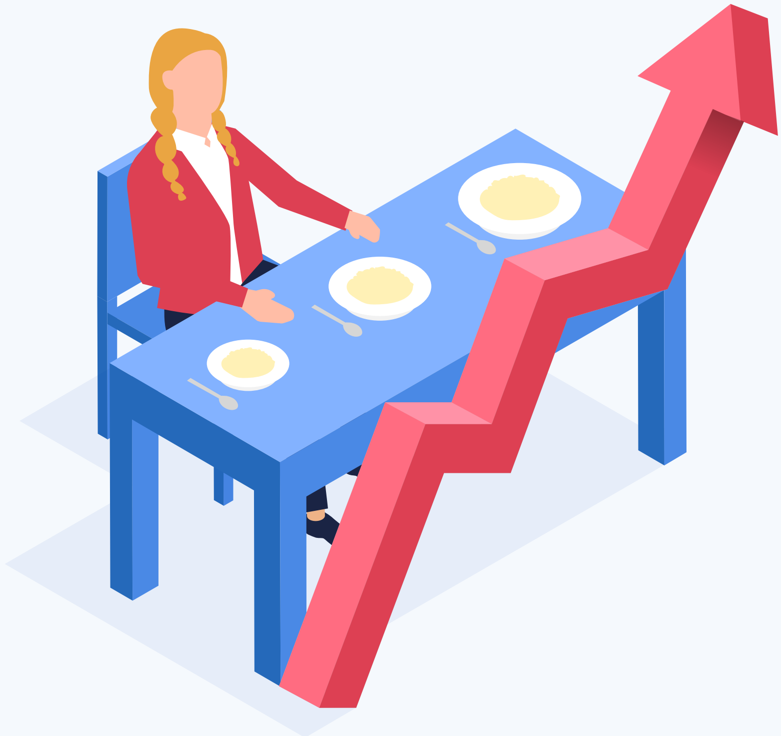
A strength and weakness of discoverIE is its decentralised model. The group is comprised of over 20 operational companies ('opcos') and 30 manufacturing sites. Each opco retains a high degree of autonomy but operates within a reporting and regulatory framework provided by discoverIE's head office. The advantage of this structure is that opcos are nimble and can make decisions more quickly, like dealing with covid-induced supply chain disruptions which have plagued the industry. On the flipside, senior management have less control meaning underperformance of opcos can take longer to address.

Perhaps the largest near-term risk to the group is global industrial demand. Currently, the business is performing well and has a record order book, providing c.6-7 months of sales visibility. Beyond this period though, they lack visibility, and believe that if demand does drop - due to a deteriorating macroeconomic backdrop - it will impact the group across the board and will likely occur abruptly. Forecasting how discoverIE would perform in a recessionary environment is challenging. Its business model has changed substantially over the past decade and assessing its performance against the atypical covid lockdown recession of 2020 does not provide much insight. This creates more forecasting uncertainties versus more established UK industrial companies.

Additionally, as supply chain bottlenecks are now starting to ease, customers are utilising more of their inventories, leading to slower order book growth. Pre-covid, discoverIE's order book visibility was c.4 months. Customers have remained tight lipped about whether they intend to return to these levels. If they do, this could amplify any macro economic weakness.

Please read the important notice on page 1.

Bond focus



Goldilocks

Sir John Royden
Head of Research

Illustration by Jordan Atkinson

A question on all investors' minds is what inflation is going to do? Head of Research, Sir John Royden sees economists divided into two camps.

Sticky inflation

The "Sticky Inflation" brigade are worried about an iterative and self-reinforcing spiral of wage inflation driving actual inflation, which in turn drives more wage inflation.

The concern is that wage inflation (5.2% in the US and 6.4% in the UK) is sufficiently strong that it will need high interest rates to drive a nasty recession to increase unemployment, to the point where employees become sufficiently scared of losing their jobs, that they stop demanding wage increases.

Right now, unemployment is sufficiently low (3.4% in the US and 3.7% in the UK) that workers have enough confidence that they can demand higher wages, and get them. Although it must be said that wage inflation (including bonuses) is falling. The implications of this are that the interest rates on ten year government bonds are 4% in the UK and 4.25% in the US.

Recently, the Fed said it might have to raise interest rates more than investors expected because it will probably take a "significant period of time" to tame inflation given stronger labour market data.

Goldilocks and the kinked supply curve

The more attractive expectation is that there is a kinked supply curve. What does that mean? Consider a factory that can make 1,000 washing machines per year. If demand is only at 800 per year, they will price competitively. Ditto for demand at 950 washing machines per year. But if demand rises to 1,050 per year then, in the short term, the factory can only respond by raising prices; and inflation takes off. The point at which prices get raised quickly is the "kink" in the supply curve. The reverse happens on the way down; small changes in demand drive big declines in prices.

The implications of this scenario playing out are that inflation falls back quite quickly, until it gets to the 3% level. To start with, ten year government rates would follow inflation lower to perhaps the 2.75% level in the UK and 3% in the US; stock markets should rally alongside bond markets. This scenario would be more likely if it turned out that employers had hoarded workers during the time of very low unemployment and that companies start shedding surplus labour into the fear of a recession and/or slower economic growth.

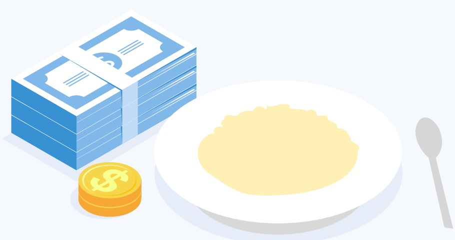
> **It will probably take a significant period of time to tame inflation.**
> *— The Fed*

This scenario is sometimes referred as the "Goldilocks" situation because it is an environment where investments do well: falling inflation, falling interest rates but corporate profitability continues. The perception that we have seen peak interest rates would, in turn, drive elevated levels of optimism that a nasty recession had perhaps been averted. China ending its zero-Covid policy and re-opening its country for business could help, if they manage their way through their own epidemic.

Third option

There is a third scenario which is that the "kinked supply curve" plays out and then the "sticky inflation" kicks in. This is the one that I expect, so enjoy Goldilocks whilst it lasts.

Please read the important notice on page 1.



HOWDENS

Sir John Royden
Head of Research

PRICE
£7.13

52 WEEK HIGH-LOW
£8.54—£4.72

NET YIELD
2.9%

HIST/PROS PER
11/15

EQUITY MARKET CAP (M)
£3,959

Howdens manufactures and sells kitchens having seen success with a steady climb in trade accounts over time. Howdens attribute some of their success to the higher than usual delegation of commercial decisions to their depot managers. They have stronger margins than the competition which is driven by the company's sales channel being relatively specialised, as they only sell to kitchen fitters who themselves sell and price kitchens to the end consumer. Whilst the company is sensitive to the housing market and interest rates, it is thought that they have enjoyed a degree of counter-cyclical resilience as many home-owners will move to redecoration in a recession rather than the more costly option of moving house. Historically, Howdens have tended to see sales fall less during recessions, than the overall kitchen market.

The share price has rallied on the back of the perception that we have seen peak rates in the market. The risk is that persistent wage inflation means that rates need to climb again to take demand out of the economy; and that would not help the business.

Please read the important notice on page 1.

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

Overweight   Neutral   Underweight

Communications

We have seen a faster than expected unwind in digital demand from peak levels reached in Covid. Competition in online media appears to be intensifying with high content spend set against a consumer that is seeking to trim expenditure. Online gaming spend is expected to moderate as player engagement reduces. Digital advertising spend is also contracting as advertisers are reducing ad budgets on macroeconomic slowdown concerns. The telecommunications sub-sector may prove more resilient, helped by inflation-linked contract price rises, but represents a small weighting overall.

Consumer Discretionary

Consumers still have excess savings built up but these appear to be shrinking as high levels of inflation have undermined spending power. Consumer sentiment is weak by historic standards and recent noise of corporate cost cutting, including job cuts, is expected to weaken confidence ahead. The cost of living crisis is squeezing disposable income with higher necessary outlays on food and energy taking a bite out of consumer discretionary spend. Additionally, higher interest rates are pushing up mortgage and rental costs in addition to the cost of unsecured borrowing which is discouraging credit card spend.

Consumer Staples

Consumer Staples businesses tend to be of high quality and are less sensitive to the economic cycle, given the necessity of their goods. Sector valuations look fair and whilst the sector faces rising cost inflation, we have seen evidence of inflation pass-through to customers. The deteriorating macroeconomic backdrop is of concern, so focus more on the earnings resilience of the sector.

Energy

Longer term environmental considerations have dissipated as the geopolitical situation has forced investors to focus on short term supply in a world where Russia faces constraints on its exports of oil and gas. Economic uncertainty has increased and with energy prices heavily correlated to GDP, we are less positive on the sector. Capital returns to shareholders should nonetheless remain strong.

Financials - Banks
The balancing act with banks is to understand the negative driver of higher credit losses into a recession vs. the prospect of greater net interest margin expansion. The former, credit losses, are to a degree budgeted for with more than generous provisions. And whilst interest rates look to be peaking, there are likely to be a few more hikes in store, leaving us with a net positive view for this sector, within the near-term.
Diversified Financials
This sector includes a very broad range of stocks and is generally geared to the investment markets. On balance we are positively disposed to this sector so long as a recession continues to be avoided.
Insurance
We are positive on life insurance as higher rates drive long term liabilities lower and increase prospective returns. General insurance does better on higher rates helping cash deposits perform better, but also appears to be benefitting from stronger insurance pricing.
Health Care
Demographic tailwinds and the relative resilience of global healthcare spend mean this is a sector that offers growth and defensive attributes. We distinguish between biotech, life sciences, medical technology and pharma sub-sectors. We continue to think pharmaceutical and medical technology companies can exhibit good relative earnings growth at undemanding valuations.
Industrials
Geopolitical uncertainty has benefitted the earnings outlook for defence exposed names yet a higher proportion of companies have more economically sensitive industrial end-markets. We are cognisant that industrial demand can turn quickly, particularly with order book visibility typically less than a year.
Information Technology
We take some confidence from the relative economic resilience of many technology names, whose products/services are increasingly viewed as non-discretionary by consumers and businesses alike. We do however believe the valuation will be the bigger driver of performance within the near-term. We remain concerned that higher inflation will persist given the sensitivity of the sector to interest rates, we believe it prudent to be underweight.
Materials
The short term outlook is uncertain as backward looking Chinese data is still weak however the markets have rallied on Chinese reopening optimism. Balance sheets remain strong so any weakness could be weathered better than previously. Longer term we remain bullish on energy transition metals but flag short term weakness.
Real Estate
The rise in interest rates is now feeding through to valuations so yields are rising which is offsetting any growth in rental income, as a result of inflation-linked leases.
Utilities
The sector is typically defensive and has inflation protection built into regulatory models, which should protect companies from input cost increases and margin pressure.

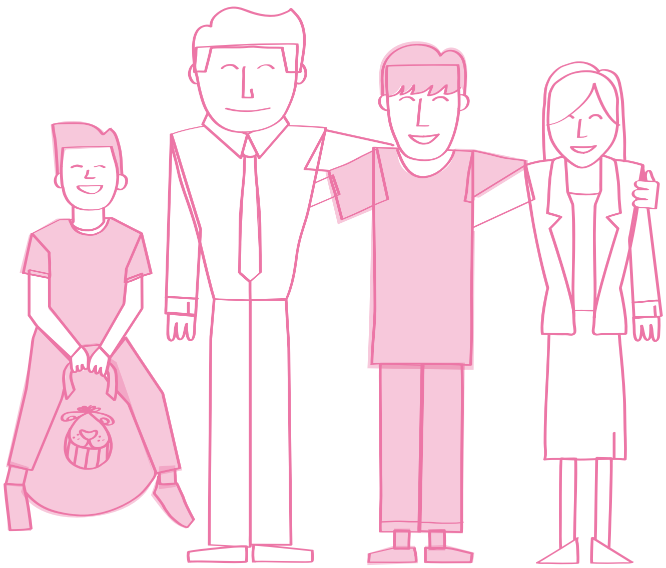
Asset Allocation

Overweight Neutral Underweight

UK EQUITIES	
UK	UK equities offer greater valuation opportunities versus overseas equities and seem historically undervalued in the context of higher interest rates; a contrast to US equities. The UK is more exposed to Financials that benefit from rising rates because of widening differentials between lending and deposit rates and, Energy & Materials, which are viewed as better insulators during inflationary times. Political risks have reduced and markets have appreciated the more fiscally responsible approach. We expect headline inflation to fall as UK consumers are rate sensitive due to shorter term fixed rate mortgages.
INTERNATIONAL EQUITIES	
North America	Equities look relatively expensive and higher interest rates could place greater strain on valuations. We remain concerned by the overvaluation of the dollar which, if weakened, could prove painful for UK investors. The US consumer has proved resilient and employment has been strong. Good news for the economy is bad news for the Federal Reserve, who might be required to hike interest rates, which could place greater strain on the growth orientated US market.
Europe	Sentiment has been weak for a prolonged period and equities are under-owned. This might ease: Europe rebuilt gas reserves to avert a crisis and with energy security a key political priority, easing energy prices should prove economically supportive. Monetary policy is tightening gradually and the labour market has spare capacity. Rates should peak at a lower point to reflect Europe's softer growth trajectory.
Japan	We hoped weakness in the Yen would revive exporters yet Japanese manufacturing output has shifted into contractionary territory making us more cautious ahead. Moreover, the Bank of Japan has eased up on their yield curve control policy and their appetite to continue such accommodative conditions looks to be moderating.
Asia Pacific	Geopolitical flashpoints between the West and East remain high. Western military support for Ukraine continues to expand and tensions between the US and China have re-flared. We view companies having to re-evaluate their supply chain exposures as a multi-year theme and expect diversification of supply chains outside of China into Asia Pacific, which should be a net positive for the region.
Emerging Markets	Equity valuations look cheap relative to developed markets but central banks have tightened policy ahead of developed markets and, with global growth slowing corporate earnings could prove more vulnerable.
BONDS	
Conventional	A rising yield environment tends to push down bond prices but we are adding to short dated government bonds as yields rise because newly issued bonds have to offer up higher coupons to encourage investors in.
Index Linked	With a positive real return they are necessary protection against inflation. If inflation proves stickier over the medium term, inflation-linked bonds should receive higher inflation returns.
Corporate	With spreads on government bonds having moved tighter we think the risk/reward trade-off has become less favourable as firms have indicated they are finding it more challenging to access credit.
CASH	
Cash	We have been deploying cash to expand our UK equity overweight and reduce our government bond and corporate bond underweights to reflect the rising yields available on those fixed income instruments.
PROPERTY	
Property	Moved to underweight on concerns that high levels of inflation push up the need for higher interest rates, hurting near term capital values of property assets as financing becomes more expensive.
ALTERNATIVES	
Alternatives	We are seeking less correlated opportunities and more market neutral hedge fund investments. We allocate to gold as a diversifier, inflation hedge and as a way to reduce currency debasement risk.

Independent View

Providing for future generations



Chris Thurlow, Managing Director
Ludlow Trust Company

Illustration by Adi Kuznicki

Chris Thurlow from Ludlow Trust Company suggests how, with sensible planning and using appropriate trusts, more assets might be passed to your beneficiaries.

Would you want 40% of your wealth to be paid to HMRC on your death? Or would you prefer to pass assets down to your children or grandchildren, to help them on the property ladder, provide them with a top quality education, cover any medical costs or simply ensure that they are financially secure?

A continued growth in inheritance tax (IHT) receipts over the past decade have seen HMRC receive £6bn for the year to 31 March 2022 compared to £5.3bn the previous year.

At the same time, many opportunities to use family trusts to provide for descendants in a tax efficient way are overlooked.

Protected, secure, tax efficient. Family trusts are a great way to set aside significant assets for loved ones on your terms.

Every individual can generally set aside up to £325,000 into trust every seven years. However, there are lots of opportunities to set aside additional funds and below we look at some of the many ways that family trusts can be used to benefit children and grandchildren in a tax efficient way.

Trusts for business owners

Many people don't realise that their business might qualify for 100% relief from IHT on their death. However, if that business is sold, the IHT rate goes from 0% to 40% overnight.

There is a significant, often one off, opportunity to put funds aside for future generations before the business is sold.

Case study 1

James and George were business partners who were selling their business.

James has three young adult children and wanted to set aside £5 million from the sale proceeds to help his children on the property ladder and provide for future generations.

George had a slightly smaller shareholding but wanted to set aside £1 million to help pay for his grandchildren's education.

Both James and George set up trusts in advance of the business sale for these amounts, not limited by the usual £325,000 allowance. Assuming they are still alive in seven years' time, they will save £2 million and £400,000 of IHT respectively, whilst ensuring funds are there to help their children and grandchildren when they need it most.

Protected, secure, tax efficient. Family trusts are a great way to set aside significant assets for loved ones on your terms.

Trusts for excess income

Another valuable exemption that is often overlooked is the ability to give away excess income on a regular basis. Unlike other gifts where you have to survive seven years, these gifts are immediately free of IHT.

Case study 2

Stephanie is a director of a FTSE 250 company and she has found that her earnings were outpacing her and her husband's expenditure on their lifestyle. Year on year, their cash balances were increasing which Stephanie knew was simply increasing the value of their estate for IHT purposes.

Stephanie decided to set aside £100,000 a year into a trust for her children and grandchildren.

After 3 years, she had set aside £300,000 which, because it was from her excess income, was immediately outside of her estate for IHT purposes, saving £120,000 in IHT and with no seven year period to survive.

Trusts for school fees

With the rising costs of school fees, many grandparents want to do what they can to help their grandchildren get a great education, to give them the best opportunities in future.

Case study 3

Philip and Heather wanted to help their children with the payment of their grandchildren's school fees. They had calculated that they would need to set aside £1 million to see their grandchildren through school.

Philip and Heather each set up a trust using their IHT nil rate band of £325,000 with the balance of £350,000 split between "bare trusts" for each grandchild. This provided protection should all funds not be used by age 18 whilst allowing Philip and Heather to give more than their IHT allowance, reducing their IHT bill by £400,000 if they both survive seven years.

Getting your wills right

Remember that with all of these trusts, you cannot have the funds back yourself once you have gifted them. It is therefore essential to ensure that the gifts are affordable.

For assets remaining in your estate, it is then crucial to ensure that you have appropriate wills in place. Have you thought about including trusts in your wills to provide protection for your family members, flexibility for changing circumstances, tax efficiency using available reliefs and privacy after you die? These benefits are often missed in "simple, straightforward wills".

Ludlow Trust Company is a Trust Corporation, which allows us as a corporate body to act as professional trustees. This means that when we are appointed, we will be on hand to deliver informed, personalised guidance at every step. To contact Ludlow Trust Company visit www.ludlowtrust.com or email them at enquiries@ludlowtrust.com

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Understanding Finance

ACQUISITION ACCOUNTING

Henry Birt
Assistant Research Analyst

When a company takes a stake in another, it often has a choice of accounting policies. If a company is deemed to have significant influence, it will use the equity or one line consolidation method. If instead the company is considered to have control, the acquirer will consolidate the acquiree.

Under the equity method the acquirer's proportionate share of the target company's assets and liabilities will be disclosed in a single line on the acquirer's balance sheet. The acquirer's share of the acquiree's profit is then disclosed as a single line on the acquirer's income statement. If the acquiree generated £100m of income over the year and the acquirer had a 20% stake, the acquirer would record +£20m in its income statement. This method significantly distorts key financial ratios. Take the net margin ratio (net profit / revenue), this is likely to be overstated because we are including acquiree net profit without also including the proportionate share of revenue. If we assume the acquirer had £200m of revenue and £50m of net profit (25% margin) this extra profit would push the margin up to 35%.

If a company chooses to consolidate, the acquirer will essentially combine its own assets and liabilities with those of the acquiree, leaving assets and liabilities higher than if the equity method was used. The acquiree's income statement is also combined with the parent's on a line-by-line basis. Revenue and costs are included in proportion and so profit margins are not distorted. The choice of method can help to flatter various financial metrics which are used to assess company returns and balance sheet strength. Acquisition accounting should therefore be analysed carefully.

RS GROUP

Jack Summers
Research Assistant

PRICE
£9.86

52 WEEK HIGH-LOW
£11.69—£7.90

NET YIELD
1.88%

HIST/PROS PER
20/17

EQUITY MARKET CAP (M)
£4,659

RS Group, formerly Electrocomponents, is a global industrial and electronic product and component distributor which stocks more than 700,000 products from switches, pulleys and sensors through to circuit boards, and semi-conductors. The company's competitive advantage is largely derived from its highly sophisticated and efficient distribution network, which enables superior delivery speed and scale to rivals.

It's broad range of simple generic component style products mean that the business operates in a highly fragmented market. RS Group estimate that their market share is less than 1% of the total addressable market, offering significant opportunity for consolidation going forwards, particularly given the number of small scale specialised distributors.

Whilst the business became higher quality under recently departed CEO Lindsley Ruth, high exposure to the cyclical industrial and manufacturing sectors remains and is reflected in like-for-like revenue growth that has ranged from +0.5% to +26% in the last ten years. The forward outlook of these two end market sectors is therefore a key consideration when determining an attractive entry point for RS Group shares.

Please read the important notice on page 1.

Meet the manager

Paul Dyas

Investment Director / Head of Investment Management

Lives Sissinghurst, Kent

Family Married with three sons

Started at JM Finn 1993

Hobby / pastime Gardening, skiing, cricket and golf, although I get more enjoyment out of watching my children play sport these days as they are significantly better than I am!

Last holiday Some much-needed winter sun in Dubai

Hero The golfer, Seve Ballesteros

Favourite film The original Italian Job

Would like to meet Sir David Stirling, founder of the SAS

Favourite restaurant ROKA, or closer to home, Rocksalt in Folkestone

Your role has recently changed; what does this mean for you day-to-day?

Following the retirement of a former colleague, I have taken over as Head of Investment Management, now overseeing our 80+ investment managers across all our offices in the UK; prior to this I was Head of London. Of course this is in addition to my core responsibilities looking after my clients' portfolios.

How do you combine the management responsibilities with your client role?

A key strength for the firm as I see it, is having practicing investment managers on the management committee. This genuinely means that all our decisions are seen through the eyes of the client and allows us to continue our focus on putting our clients first. Having been on the management team since 2001, I am quite used to balancing the two roles, thanks to the excellent team I have around me.

This year marks your 30th anniversary at JM Finn. What do you think it is that encourages people to stay at the firm for so long?

The long tenure of many of our senior staff is something we've always been very proud of, but also something that seems to contradict the approach of younger people who have joined the industry in recent years. Staying at one firm is not for everyone, and despite some of my colleagues suggesting (jokingly I hope) that I lack ambition, I believe it is the exactly the opposite. JM Finn has always been a firm that rewards loyalty and dedication, and a company where both clients and staff feel valued. Therefore it can very much be a firm for life, and I hope people will continue to see this in the future.

What are your thoughts for the year ahead for the firm?

There is another huge piece of new regulation – Consumer Duty - that we need to implement and which takes effect in July this year. This is a huge undertaking for the firm, but we've made good ground on the new rules, which are designed to enhance customer understanding when engaging with financial services providers. We are also updating our Client Portal, which we hope more of our clients will use, not least to help mitigate the risk of their personal data being intercepted, something sadly that we are seeing more frequently. Finally, of course regarding markets, the ongoing uncertainty caused by the conflict in Ukraine will I'm sure lead to further volatility, but we'll be working hard to ensure our investment managers stay focused on the job in hand.

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