JM FINN

No.31 *Summer 2020*

Prospects

The JM Finn Quarterly Periodical

Dealing with pandemics
Looking at global leaders' responses

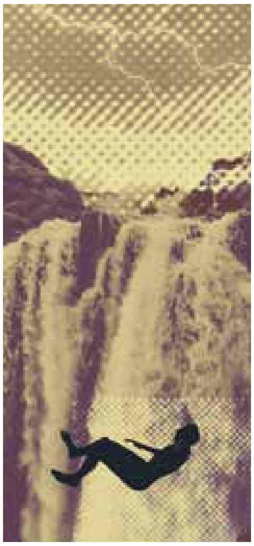
Looking at recovery
Which letter will prevail?

Saving for emergencies
Helping the next generation

No.31

Summer 2020





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

Important notice
Please note that the value of securities and their income can fall as well as rise. Past performance should not be seen as an indication of future performance. Any views expressed are those of the author. You should contact the person at JM Finn with whom you usually deal if you wish to discuss the suitability of any securities mentioned. Prices quoted are as at close of business on 28th May 2020. Tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

Data protection
If you no longer wish to receive a copy of Prospects and /or opt out of receiving marketing materials, including invitations to our seminars and events, please send an email to marketing@jmfinn.com.

We process your personal data in accordance with the law, and in particular with the European Union General Data Protection Regulation of 27 April 2016. You have the right to object to the processing and use of your personal data, to access the data that we process, and to request that your data be deleted or that any errors in your data be corrected. To exercise these rights, you may write to us by post or by email.

Editor
Oliver Tregoning
oliver.tregoning@jmfinn.com

Cover Illustration:
Adam Mallett/Graphic Alliance

Contents

Welcome	03
Editorial	04
Understanding finance	07
Guest editorial	08
JM Finn news	11
Company meetings	12
Economic focus	14
JM Finn news	16
Wealth planning in focus	18
Collectives commentary	22
Stock in focus	24
Independent view	26
Bond focus	28
Asset allocation focus	30
Meet the manager	32

Published by JM Finn on
12th June 2020

Welcome

There have been many financial, social and political crises and wars over the years, including in the 1950s, '60s and to a lesser extent the '70s, when some appalling flu epidemics struck the Western world; particularly in 1967/68 when over 80,000 people died in the UK. If we compare the current situation and the economic effect it has had with events in the past, to some extent Covid-19 has been more significant due to its unexpectedness but also because it came at a time when markets were high and the world economy appeared to be strong.

I have been surprised at how fragile the world economy has been over the last few months, the US in particular, with unemployment there rising to 30 million in the space of a few months. Human reactions feed off each other and in a world of mass media this is certainly what has happened, and reminds me of the Franklin D Roosevelt quote: "the only thing we have to fear is fear itself."

There are bound to be a significant number of changes and developments as a result of the pandemic, whether it be the way we travel or the way we work; for example, there might not be the same need for everybody to be in expensive offices in city centres. Drug and healthcare companies have been spending fortunes on developing vaccines and there are areas of new technologies which will continue to develop, whether it be new forms of energy, despite the low oil price today, and it is possible that those industries that do not re-engineer, may discover that they have made big mistakes.

International trade is bound to be affected by what has happened and to some extent, we will have to learn about not being so dependent, particularly with regards to food. I am not suggesting we should sever our links with the rest of the world but I do feel we should be making ourselves more resilient and it will be interesting to see to what extent governments take control of the situation.

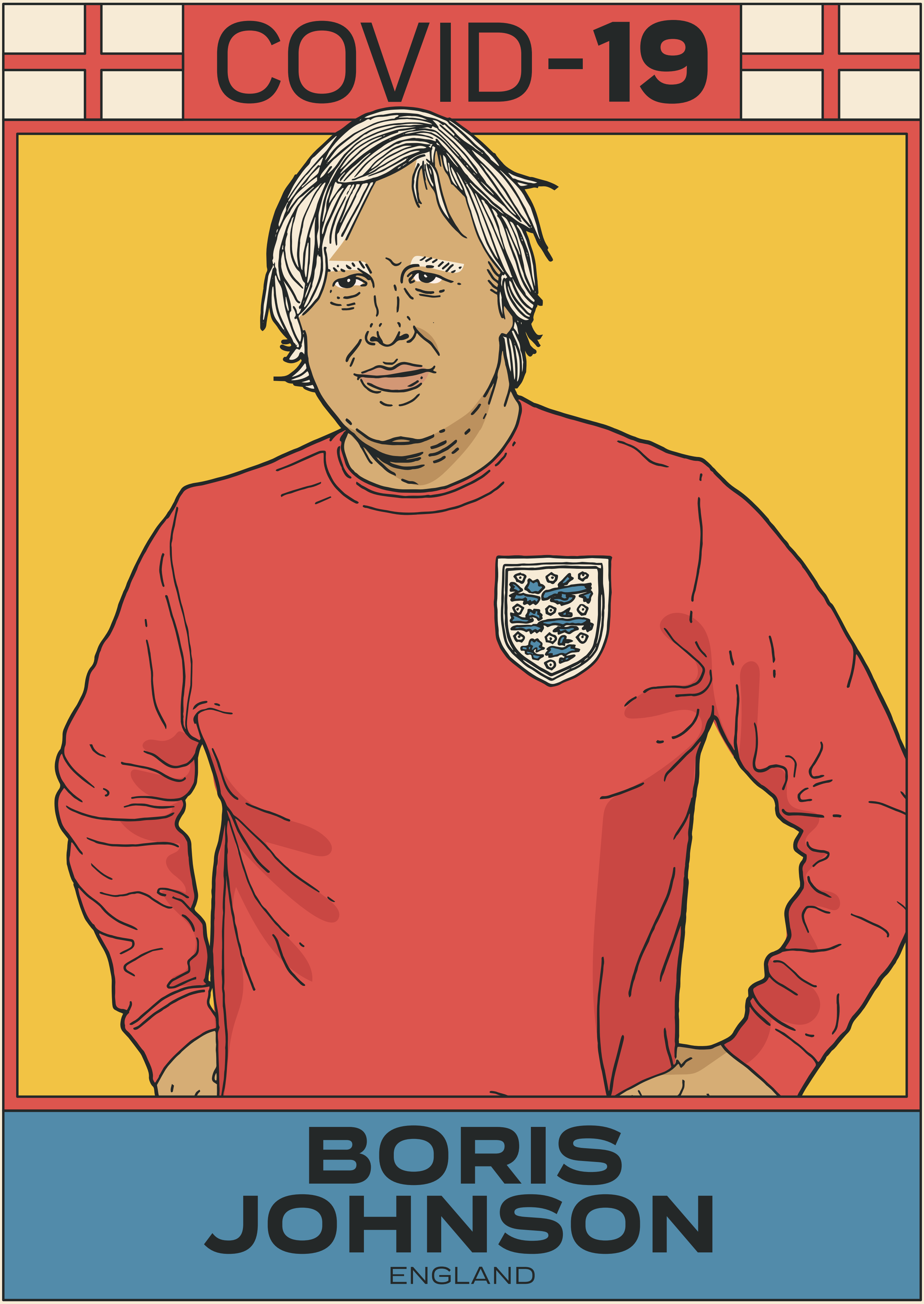
Governments have thrown trillions of dollars at the world economy, particularly in the US and to a lesser extent in Europe and this country. I believe that this has given some help but the monies will not necessarily find their ways into the right places and it could well be like pushing on a piece of string. The end result could be that excessive borrowing will have to be paid for by working taxpayers in the future. I am not sure inflation-wise how this will pan out; an excessive amount of liquidity in the system should eventually lead to inflation but it has not materialised in the last decade. What we are seeing today is in effect "Quantitative Easing Mark II" and considerably more of it.

Despite the recent market setback, it is worth reminding ourselves that investors who stayed invested have generally seen reasonable returns over the last five years. However, it is certainly a strange world where the so-called safest investments, namely First World AAA Government Debt offer negative returns and this is one of the reasons that gold has come to light again and equity markets rallied somewhat.

I know that all of us will have been touched by this pandemic in one way or another, be it due to an unforeseen change in circumstances, a bereavement or simply the absence of regular contact but I would like to finish by mentioning how proud I am of my colleagues across the firm. Swift action was taken to ensure that we were operational, despite the lockdown, to allow us to continue servicing our clients, whilst maintaining the safety of our staff. Thanks must also go to our clients in this difficult time for their understanding and loyalty and we hope that together we can look ahead to brighter days.

James Edgedale

James Edgedale
Chairman


COVID-19
BORIS JOHNSON
ENGLAND

Editorial

The Covid-19 Player of the Match Awards

John Royden
Head of Research

Illustration by Adi Kuznicki

I had hoped that by the time of writing this article, we would be nearing the end of the Covid-19 episode and that my chosen title would have fitted the ascent out of the doldrums of viral recession. Sadly, we are not quite there yet, so it is better to think of this as nominations for the Player of the Match Awards.

Giuseppe Conte of Italy, a political independent, was virtually unknown before becoming prime minister. He has made steadfast strides forward in terms of gaining the trust of Italians. I like him for emerging as a real alternative to populism, which may have something to do with the recent softening of Italian ten-year yields.

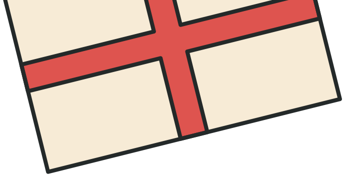
Angela Merkel might get some domestic German award for saving her party from an electoral defeat that looked likely. But will she finally underwrite saving Euroland by pivoting on joint debt issuance and fiscal spending? The jury is still out on that one. Her nomination must be tarnished by her constitutional court which launched a legal missile into the heart of the EU by ruling against the ECB's QE with its concept of disproportionate behaviour.

I was also unimpressed by Merkel's drawing up the German state borders. The Schengen area did not work so well as a concept when Europe, led by Merkel, suddenly defaulted to independent and isolationist tendencies around closed borders.

Boris Johnson's tussle with the virus and near-death experience has probably seen him rise in popularity with the NHS staff, as he now voices greater concern for their welfare than do the rest of his cabinet. I must also commend Boris for the exemplary and fast support measures, which he put in place to contain the economic impact, once he had worked out whether to run with herd immunity or containment.

> *Pedro Sanchez's government mishandled the pandemic but he was one of the first to respond with massive stimulus firepower.*

Pedro Sanchez of Spain did not do so well in the early days. His government mishandled the pandemic but he was one of the first to respond with massive stimulus firepower. For that, he needs to be commended.



Swedish Prime Minister Stefan Lovgren and Sweden's state epidemiologist Anders Tegnell, deserve mention for taking a scientific and rational approach that balances lives and livelihoods, and sticking to their guns despite criticism, unlike the UK who vacillated from the initial herd immunity theory to one of containment. Sweden's death rate per million is high; but it is much closer to getting herd immunity in the long run than those that opted for lockdowns. Also Sweden has probably gained market share globally by staying open for business.

> *Tsai Ing-wen of Taiwan was better prepared for the pandemic than many*

Having covered Europe, when I look East to Asia I find Tsai Ing-wen of Taiwan. She was better prepared for the pandemic than many and delivered a well-executed response. She warned the WHO of human transmission weeks before the WHO warned the rest of the world, and this was despite having been excluded from the WHO due to China's lobbying. Her astute planning meant that she was later able to send lots of protective gear and aid to other states whilst under pressure from Chinese pressure tactics, which included aircraft carrier military drills around her island. She has lots of political capital to execute state policies, but unfortunately is sandwiched in the midst of a US-China conflict that is heating up, as Biden and Trump compete for the nomination of "most-anti-Chinese" politician in the run up to the US elections.

Moon Jae-in of South Korea was also great at preparing South Korea for the pandemic. He delivered a well-executed response, which was verified by his party's electoral performance in April. He too managed to send aid to many other countries; his accretion of political capital leaves him with a blank slate from which to chart South Korea's economic rebalancing and diplomacy with the North.

Japan's Shinzo Abe handled the pandemic expertly, but fails to make the cut because of last year's tax hike which hurt the economy. That was not what was needed just before Covid-19. He also vacillated with his response as he tried desperately to save the Olympics for his premiership. He will probably have stepped down before the postponed games start running in 2021.

I have to mention Trump and China's Xi. The latter does not even get close to a nomination; at the start of it all China failed to mention the virus to the rest of the world in addition to its own citizens. Their offer of masks and PPE to the rest of the world will be insufficient to tame international anger and does nothing to temper the frustrations of their own people. Reforms to information containment and control will be demanded by the West. The post-steward's enquiry threat of vilifying Xi in the international press should bring enough pressure to extract reform. Xi cannot lead his people at home if he is seen as an international pariah.

> *Trump may yet come through for a late finish if he spearheads reform in China*

Trump's tweet that the cure can't be worse than the problem was full of economic sense but totally lacked any human consideration. But he may yet come through for a late finish if he spearheads reform in China and that builds on his impressive execution of fiscal and monetary support for the US economy.

Aside from our much loved Colonel soon-to-be-Sir Thomas Moore, I find myself being drawn back to our own PM for the player of the match award. I hope he can swing the success of my nomination onto the Brexit battlefield and deserve his accolade.

Understanding Finance

DURATION

John Royden
Head of Research

Another word for duration could be the average life of a bond. Most bonds pay annual or semi-annual coupons and have a redemption date. So whilst a bond maturing in three years and with a £5 annual coupon will have a life of three years, its average length is less, because you get a string of coupons over the life of the bond. The first coupon of £5 in a year's time has a life of one year and that lowers the average life of the bond.

Technically, duration is the weighted average length of time to the receipt of a bond's benefits (coupons and redemption value) with the weightings being driven by the present value of the benefits involved. So the first year's coupon of £5 only reduces the average life of the bond by a small amount. This approach is called Macaulay Duration.

The longer the duration of a bond, the more sensitive it is to changes in interest rates. Lower coupons and lower yields lengthen duration, which then begs the question: "What is the exact relationship to changes in interest rates and changes in the value of a bond?"

To answer that, we use what is called Modified Duration which calculates the percentage change in the price of a bond arising from a 1% change in yields. It is calculated by taking the Macaulay Duration and dividing it by (1 + [Gross Redemption Yield]).

Take a one year zero coupon bond and a three year zero coupon bond when interest rates are 2%, by way of example. The one year has a Modified Duration of 0.98% whereas the three year is at 2.94%. So, if interest rates rise by 1%, the three year bond will fall in price by 2.94%.

•

COOPER COMPANIES

Michael Bray, CFA
Research Analyst

PRICE
$316.63

52 WEEK HIGH-LOW
$365.68—$236.68

NET YIELD
0.02%

HIST/PROS PER
32.46—27.83

EQUITY MARKET CAP (M)
$16,886

Previously a sprawling healthcare conglomerate, Cooper Companies has now found its focus within the speciality contact lens (Cooper Vision, 75% of revenues) and women's healthcare (Cooper Surgical, 25%) markets. Although there are minimal synergies between them, Cooper has settled on these markets because of their differing qualities.

Cooper Vision has been growing revenues at +6-8% per annum. This has been off the back of wearers upgrading their lenses from hydrogel to the more comfortable silicon hydrogel material and the move towards daily rather than bi-weekly or monthly lenses. Cooper's highest margin product is their daily silicon hydrogel lenses (e.g. MyDay), where management continue to see good growth prospects. Whilst the annuity-like nature of contact lenses (Cooper's customers typically stay with them for seven years) provide a stable recurring revenue stream.

Cooper Surgical is a slower growth business (+2-4% revenue growth p.a.), as it operates in the more mature woman's healthcare market, which includes fertility, but is more cash generative. This allows the business to invest in perceived growth areas within the contact lens market, such as its recently launched paediatric myopia (short-sightedness) management lens, MiSight. However, MiSight's commercial viability remains unproven.

Please read the important notice on page 1.

Guest Editorial

The shape of things to come

By Neil MacKinnon

Illustration by Adam Mallett

The profile of any recovery is much debated, so we asked Neil MacKinnon, our consultant macro-economic strategist, to share his thoughts of how things might pan out.

One of the things economists do to have fun is pick letters of the alphabet that they think will describe the trajectory of economic growth from recession to recovery. The Covid-19 recession is the worst this side of WW2 and sufficiently bad to make comparisons with the 1930's Depression. When the first signs of the slump appeared, many economists favoured a V-shaped recession. The IMF and President Trump still do but as time has gone on, economists have become more circumspect about where the global economy is heading. So now, a U-shaped economy seems to be the flavour of the day for those who do not expect an early vaccine and anticipate a second wave of infection.

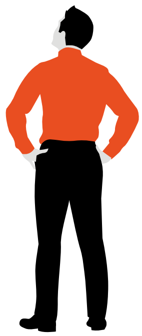
Pessimists look for an L-shaped recovery, although it is not really a recovery just stagnation. Sports logos such as the "Nike Swoosh" have also been drafted to describe a slow but sustained recovery. Will it be a "Swoosh"? Well, just think when will be the next time you go to a pub, restaurant, a football match, the theatre, opera or go on a foreign holiday. And then factor in "staggered" returns to work, employers figuring out they need less staff after the "work at home" experience as well as travel restrictions, mandatory vaccinations and biometric surveillance. You get the picture. The bottom line is that things will be very different which is hardly the greatest-ever insight.

The last financial crisis was over a decade ago and it seems that since the 1987 crash, we have one every ten years or so. In the last ten years, the major economies never really got off the ground despite radical monetary policies such as QE, zero rates and then negative rates. Indeed, many economies were actually in difficulties last year; such as Germany that crumbled in the face of a contraction in world trade and a "hard landing" for China, one of its main export markets. Japan slumped in the final part of last year after a mis-judged increase in the consumer tax last October. Amazingly, in the UK, the economy had actually outperformed Germany since the 2016 referendum, though the media has a curious habit of always knocking Britain. There is no good news only bad news.

> ***"The surprise for the pessimists might be a much higher stock market in all the major markets.***

The post-global financial crisis rescue policies did little to recover pre-crisis rates of economic growth. What they did was to inflate financial asset prices to record highs, both stocks and bonds. Official measures of CPI undershot the 2% official targets though many readers might be forgiven for thinking the actual cost-of-living is a lot higher. If such policies did little to revive the real economy first time around, why would they necessarily work second time around? And will it take another decade before any recovery fizzles out and we run into another (debt) crisis?

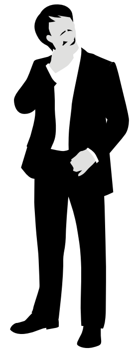
> ***Equity markets, after the fastest bear market decline, staged the fastest bear market rally.***



The other side-effect of cheap money was a build-up in debt especially in the corporate sector with the US and China being the main culprits. Now, the Covid-19 crisis is resulting in a massive surge in government debt and borrowing to address the cost of the slump and of tackling the pandemic. Global fiscal expansion is three times that undertaken in the 2007-2008 crisis, while central banks having mostly run out of interest rate ammunition, are expanding their balance sheets to record highs. Forget "Helicopter Money", this is really "Airbus Money". Most of the major economies will end up with government debt-GDP levels in excess of 100% which will become a major challenge at some point. Will it be the time-honoured method of reducing debt through higher inflation, will it be debt monetisation (already happening) or debt-write offs, or higher taxes?

Wall Street heavyweights recently warned about over-valued US equity markets and the end of "The Everything Bubble". Equity markets, after the fastest bear market decline, staged the fastest bear market rally, up 30% from the 23 March lows. Some Wall Street heavyweights warn of

> ***Central banks are expanding their balance sheets to record highs.***



a deflationary super-cycle while others worry about "The Great Monetary Inflation". At the moment bond investors' inflation expectations are most decidedly on the side of the deflationists and a slide towards "Japanification." Japanification might spread culturally. Might we end up bowing in the style of the Japanese tradition instead of shaking hands? However, we should be alert to the possibility of much higher inflation. It is worth noting that US M2 money supply growth (an indicator of money supply and future inflation) is already running at a 20% rate. This is higher than the peak rate in WW2 and in the inflationary 1970s. The current rate of headline US inflation is just 0.3%, which is not surprising when global demand is so weak and when oil prices have slumped considerably over the last year. Historically, strong money supply growth often translates into eventually higher inflation but investors should keep a watchful eye on the money supply numbers.

The stockmarket is often a good inflation indicator and the surprise for the pessimists might be a much higher stock market in all the major markets, especially the US and UK. Beaten up sectors like financials, cyclical stocks and real estate might make a comeback. For fixed income investors, the surge in borrowing means a steeper yield curve and could reverse the long term downtrend in market-based inflation expectations. Also watch the gold price. It is up 30% over the past year. A breach of the $2,000 level is on the cards, especially if more QE and debt monetisation undermine the value of the US dollar. And before I forget, the US Presidential Election is in November. V-shaped or pear-shaped?

Please read the important notice on page 1.

JM Finn News

Cyber crime awareness

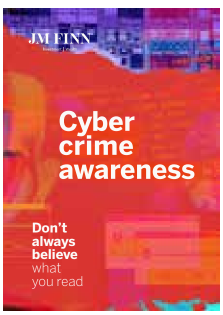
Cyber crime has been on the rise for many years as fraudsters look to take advantage of technological weaknesses.

Fraud and scams have been around since time began but what makes cyber crime such a huge issue is the access to huge amounts of data that is provided by a network. And the fact that within any network there can be vast amounts of people.

In the 1980s it was boiler room scams that made the headlines, which soon progressed to customer fraud and pension scams, when a caller rang professing to be from a trusted source and persuaded you to invest in x, y or z scheme. The premise today is very much the same, with the most prevalent type of cyber crime being phishing.

We have produced a guide designed to educate about the types of fraud, the risks they expose themselves to and some precautions to take to minimise those risks, such as:

- Protect your email and online accounts by using a strong password
- Install the latest software and app updates
- Turn on two-factor authentication on your email
- Always back up your most important data



To learn more and read further articles about how to beat cyber crime, download the full report at **www.jmfinn.com/cyber-crime-awareness**

CRH

Maude Holloway
Assistant Research Analyst

PRICE
£26.45

52 WEEK HIGH-LOW
£31.16—£15.00

NET YIELD
2.80%

HIST/PROS PER
14.41—20.16

EQUITY MARKET CAP (M)
£20,711

CRH is a leading global manufacturer and distributor of construction materials. It operates through three business divisions; Americas Materials, Europe Materials and Building Products. 99% of profits come from developed markets with two thirds from North America (mostly the US), and a third from Europe (mostly the UK).

The Materials businesses focus on aggregates, where stones and sand from CRH's own quarries are either sold directly to external buyers or combined with CRH's cement to make concrete, or with asphalt to make bitumen. The Building Products division manufactures pre-engineered products like office fronts from glass and aluminium. They are fairly resilient to market downturns as they benefit from low oil and energy prices. Cement manufacturing is very energy consumptive and carries a large carbon footprint.

CRH benefits from meaningful barriers to entry; the cost of opening a new cement plant or the environmental regulation required to open a new quarry deters new entrants. They could also benefit from US and UK government infrastructure spend packages, if and when these eventually come through. However, the high operating leverage within the company means the negative effect of a reduction in volumes would be magnified.

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 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

Maude Holloway
Assistant Research Analyst

BASIC MATERIALS
Rio Tinto, BHP Group
Givaudan, Victrex
Croda International

CONSUMER GOODS
Associated British Foods
Persimmon , Imperial Brands
Anheuser-Busch Inbev
Fevertree Drinks

CONSUMER SERVICES
Mccoll's Retail Group
Ocado Group
Moneysupermarket.com
Compass Group
RELX, ASOS

FINANCIALS
Derwent London, Barclays
Lloyds Banking Group
London Stock Exchange Group
Prudential, Big Yellow Group
Burford Capital

HEALTH CARE
Dechra Pharmaceuticals
Genus, Intuitive Surgical
Roche Holding

INDUSTRIALS
Hill & Smith Holdings
Rolls-Royce Holdings
Bae Systems, Bureau Veritas
Intertek Group, Bunzl
Ricardo , Grafton Group
Travis Perkins
Spirax-Sarco Engineering
Halma , Alpha Financial Markets
Diploma

OIL AND GAS
Ceres Power Holdings, BP

TELECOMMUNICATIONS
BT Group , Vodafone Group

1.

BP

Price **£3.14**
52 week high-low **£5.63 – £2.23**
Net Yield **10.70%**
Hist/Pros PER **31.53 – 126.31**
Equity Market Cap (M) **£62,439**

Oil and gas
Daniel Morris – IR Director

Following the arrival of the new CEO Bernard Looney, BP announced a revised strategy with a greater emphasis on sustainability and a new lower carbon emissions target. The new goals set an aim for net zero carbon emissions in operations and oil and gas production, including scope three emissions, on an absolute basis by 2050.

A company’s carbon emissions are classified as either scope one, two or three. Scope one refers to direct emissions from production. Scope two refers to indirect emissions from energy purchased by the company. Scope three refers to all the indirect emissions within the value chain of production, including the emissions from the end products' use. Scope one and two only account for c.10% of BP’s emissions.

The question becomes, how can an oil major reduce its scope three emissions without reducing volumes? Scope one and two can be reduced with offsetting, but scope three will require a more extensive approach. Additionally, as scope three emissions for BP will encompass scope one emissions for their suppliers or consumers, some collaboration will likely be required.

The new targets have pitched BP ahead of its peers but 2050 is a long way off. Whilst appropriate solutions will be needed in the long term, I wonder how much motivation there will be in the near term. Until BP outline concrete measurable goals at more realistic time intervals, I’m maintaining a healthy dose of scepticism. Despite the upheaval that Covid-19 has brought to markets and the oil and gas sector particularly, at the first quarter results, BP restated their plans and said that they will provide answers on how they plan to achieve their targets in September.

2.

Croda

Price **£52.08**
52 week high-low **£54.15 – £38.14**
Net Yield **1.74%**
Hist/Pros PER **30.02 – 28.92**
Equity Market Cap (M) **£6,676**

Basic materials
Jez Maiden, Group Finance Director & Nick Commandeur, Corporate Development Director

Croda International is a speciality chemicals company founded in 1925 by George Crowe and Henry Dawe who focused on extracting lanolin, a natural protective grease present in sheep wool, to make use of its many valuable chemical properties. Today Croda develop, manufacture and market high quality ingredients and technologies that form the basis of many key products in areas such as skincare and medicine. The business is split into four operating segments: Personal Care, Life Sciences, Performance Technologies and Industrial Chemicals. What really sets Croda apart is that c. 60% of Croda's raw materials are non-petrochemical (oil) based, whereas peers typically rely heavily on oil based raw materials. This gives Croda a differentiated competitive advantage, especially now, as consumers increasingly want to assess what's in a product.

Having met Jez Maiden at a relatively early stage of this pandemic I investigated how Croda was being impacted and responding to the Coronavirus challenge. Clearly, the regional impact was more severe in China relative to the US and Europe. However, as China is an important wool grease producer for the business, it was encouraging to hear that capacity had improved towards 80% of normal.

Meanwhile, on a divisional basis, Performance Technologies continued to face a challenged automotive backdrop, whereas Personal Care and Life Sciences had held up relatively well as, I suspect, customers brought forward purchasing decisions in anticipation of more stringent lockdowns. Clearly, ahead, Croda may face a lumpier order book as customers work down inventories but their divisional balance between defensive and cyclical sectors could help Croda weather the current storm.

3.

Vodafone

Price **£1.34**
52 week high-low **£1.69 – £0.93**
Net Yield **5.56%**
Hist/Pros PER **N/A – 19.72**
Equity Market Cap (M) **£36,267**

Telecommunications
Simon Hill – Senior IR Manager

Vodafone has been undergoing a period of simplification and geographical consolidation. Over the last year Vodafone sold its stake in Egypt to Saudi Telecom and withdrew from Australia via a merger with TPG. They confirmed that their portfolio is now positioned as they wish, with just the European and the Sub-Saharan Africa divisions. Within Europe Vodafone expanded its presence in Germany with the purchase of the cable company Unitymedia from Liberty Global, making Germany the largest division within the group. The structure of German cable TV is a little different than the rest of Europe; Unitymedia benefit from the Nebenkostenprivileg law in which landlords are able to add cable subscriptions to a tenant's rent. The contract is between the landlord and the cable company and tenants are unable to opt out of the service. Unitymedia serves about two thirds of its homes in multi-dwelling units and tenants pay between €5-7 per month as part of their rental package to receive a basic television service with little incentive to switch provider. This equates to around 11m locked in customers.

Since Vodafone's purchase of Unitymedia there have been questions raised about whether this constitutes anti-competitive behaviour. There is now a move in Germany to allow tenants to individually break from these contracts and if this goes through, Vodafone could lose around 30% of profits from Germany. This will not happen all at once but Vodafone's new asset could shrink over a number of years. Vodafone are convinced this change in law will not get passed. It would result in increased costs for providers, which would be passed on to consumers as higher prices, and regulators will want to avoid this.

Please read the important notice on page 1.

Economic Focus

Which Letter will Rule the Recovery?

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Adam Mallett

It was American President, Harry S Truman who coined a phrase to describe the difference between a recession and economic depression.

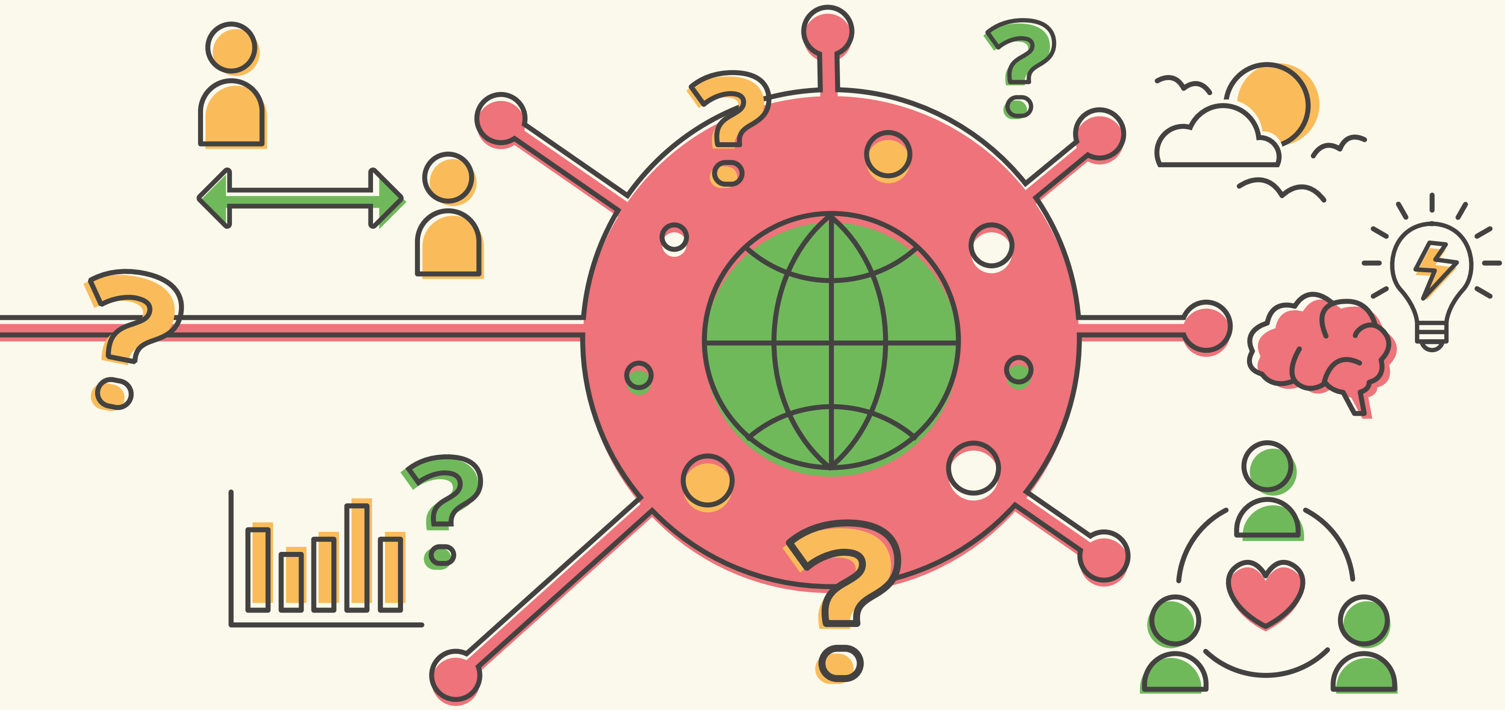
It's recession, he said, when your neighbour lost his job. A depression is when you lose your own. The current collapse in economic activity must surely fall into the depression category. We are, after all, currently experiencing the biggest setback since the great depression of the 1930s. The real issue must be, how swiftly can we turn things around and get back to a more normal business and economic state of affairs?

Normal is, of course, a rather less precise term these days. Few expect post pandemic life to be the same as that to which we were accustomed before. Life without some form of social distancing does not look feasible until a vaccine, or at least a cure to this particular brand of coronavirus, has been found and replicated in sufficient quantity to protect the world's population. Then we have the rebuilding of the global economy, which will need to take account of the knowledge that globalisation has created vulnerability in many areas. Easy it won't be.

> “*We could be looking at very different economic models a few years down the line.*

The market is clearly expecting a swift and robust return to economic growth and stability. Given the help that central banks and governments are providing to reverse the worst effects of the preventative measures introduced to combat the pandemic, this is not a fanciful attitude to take. We have also seen the rebirth of the community spirit and significant ingenuity when it comes to adjusting business practice to deal with what ever the new normal may look like. And there are other side issues that could provide a positive spin for the future, such as the significant drop in pollution levels around the world.

But is it truly realistic to be so sanguine since we live in, to use a now rather hackneyed expression, unprecedented times? Much will depend on the nature and speed of the recovery that will surely take place as we either find ways to operate in a Covid-19 environment or, better still, find a means to eliminate it altogether. Economic recoveries tend to be categorised by economists into four groups, each relating to a particular letter of the alphabet, as



Neil MacKinnon has mentioned in his excellent editorial piece. And there are copious examples to show how these particular events have taken place in the past.

Markets clearly have been expecting a V shaped recovery. The downward leg in economic activity has certainly been steep, but to qualify as a V recovery, the rebound in our economies will need to be just as dramatic. I am inclined to agree with Neil that this seems an unlikely outcome, given the complexities of recovering from the effects of lock down. Many businesses may never reopen, given the shock they have sustained during this difficult period. Home working could become a more popular approach, with all the concomitant effects this could have on transport and city centre office premises. And perhaps we will choose to travel less by air.

However, governments and central banks will be super keen to have as much of a recovery as they can swiftly engineer. A U-shaped recovery would be a result in this respect – and it is certainly possible. The only issue could be that different areas of economic activity are likely to prosper, while others may never regain their former glory. This will test the flexibility and foresightedness of investment managers as they seek to sort out the wheat from the chaff. We could be looking at very different economic models a few years down the line.

Neil added a fifth shape to the economic recovery – the so-called Nike Swoosh, where the recovery is slow and prolonged. This would be a disappointing outcome and one that governments and central bankers will be keen to avoid. But at least it would be better than the dreaded L, where the economy flatlines at close to the bottom of the recession. It has happened in the past. Arguably Japan has suffered an L shaped recovery pretty much since the peak of its economic success back at the end of the 1980s. And the third largest economy in the world is back into recession again.

This leaves just one letter unaccounted for – the W recovery. This is where the economy bounces back in a V shaped trajectory, only to run out of steam and slip back into recession. The recovery does resume, but only after some nasty shocks in the interim. This could certainly happen if a second wave of the pandemic develops before adequate preventative measures have been introduced.

This year promises to be difficult – socially, economically and in terms of investment decision taking. The good news is that we are all in this together, so the pressure is on to find a solution that will allow life to continue in as close a manner to the past as possible. And we will hopefully derive some benefits from the extraordinary experience we have been going through. Self interest will ensure we emerge from the other side of this crisis pretty much intact. But do not expect life to look the same post the pandemic.

JM Finn *News*

Going above and beyond

Supporting our clients often goes well beyond simply managing their investment portfolio. After all, one's savings can be the axis around which our lives are based so more often than not one's investment manager acts as a trusted adviser.

Our purpose is to be that trusted adviser to all clients, regardless of their specific circumstances and we believe we go some way to achieving this by retaining a very personalised, relationship-driven service. Now, possibly more than ever in recent generations, a need for a trusted adviser might well be heightened for many and we would very much like those clients who may need us, to feel we are there for them.

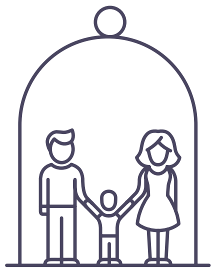
The lockdown situation risks many of our individual vulnerabilities being exacerbated due to the changing circumstances. It is normally in our face-to-face meetings that we learn of clients' unease at certain issues or a recent bereavement or diagnosis, but with the current restrictions those meetings are not taking place.

As a firm, we understand the importance of knowing our clients and our whole business model reflects this. We recognise that any number of new reasons might lead our clients to increased angst, including, but not limited to, the following:

- **Dealing with a sudden change in circumstances** such as a being furloughed or made redundant
- being stricken by **Covid-19** or having family and friends affected
- suffering from the effects of **not seeing loved ones and/or loneliness**
- at risk of the **rise in fraud and scams**
- being **overwhelmed by all the advice and news** out there

We take our responsibilities extremely seriously and we would like to remind all our clients that although our doors are not physically open, we are very much available for all clients to call and share any concerns you may have. Indeed, if you know of others that might need any form of support from you, it is worth bearing in mind that now might well be the appropriate moment to contact them.

Until we are permitted to resume face-to-face meetings, we are more than happy to arrange confidential calls and when some semblance of normality does resume, we will continue to be there for those that may need it.



"Our purpose is to be that trusted adviser to all clients, regardless of their specific circumstances"

In the meantime, as part of our aims to go above and beyond the services we offer, we have developed a guide to staying safe online to help our clients counter the increase in cyber crime and would encourage any clients to visit **www.jmfinn.com/cyber-crime-awareness** for some tips and hints about staying safe online.

Finally, we would encourage clients to use our client portal when sending documents and viewing portfolio information, as this can enhance the security and privacy of your personal data. For those who would like help setting this up, please contact your investment manager – we can even arrange for one of our specialist IT consultants to view your screen and show you around the portal, if looking at it for the first time appears a little daunting.

Looking out for each other and sharing our concerns can significantly reduce the risk of anxiety and we hope that by retaining that open, personal relationship, we can be the trusted adviser many of clients might need.

Lockdown with Tammy

This can be a tough time for all, particularly when it comes to mental strength. We got in touch with England cricketer and JM Finn brand ambassador, Tammy Beaumont to ask how she copes being cooped up at home.

"It's obviously frustrating at the moment, especially not knowing when it will all end. The main thing I've been trying to do is set and maintain some sort of routine. As a household, we've planned a week ahead; including who's cooking what when, what training I need to do on which days and even some more fun plans such as board games or quiz nights. So much of my on-field routines are coming in useful, like focusing on what I can control, and almost ignoring what I cannot. Another big one for me is maintaining good mental health. It's easy at a time like this to feel really stressed and overwhelmed. I've started restricting the amount of news I read or watch and I've started a couple of online courses to keep my brain active and ticked off some of the DIY 'to do list.' Another important thing is to reach out and communicate; I'm trying to speak to my friends and family who are more isolated at least once a week.

"One of the hardest things to deal with so far has been actually feeling guilty for enjoying many parts of isolation. I appreciate I'm in a lucky position living with some of my friends and family, along with having everything I currently need available to me, has made some of this lockdown lifestyle much easier for me than others. I think acknowledging this, allowing myself to enjoy what I can, while appreciating others may be having it tougher and hoping to lend a hand in the future, through volunteering, will hopefully continue to get me through this time."

Tammy Beaumont is a brand ambassador for JM Finn. For a more in-depth version of this interview, please visit **www.jmfinn.com/our-thinking**.

FERRARI

James Ayling, CFA
Research Analyst

PRICE
€151.80

52 WEEK HIGH-LOW
€169.05—€114.00

NET YIELD
0.75%

HIST/PROS PER
39.90—51.03

EQUITY MARKET CAP (M)
€27,720

Ferrari is an ultra-luxury car manufacturer with an iconic brand packed full of racing pedigree. Founded by Enzo Ferrari and headquartered in Italy's Maranello, its competitive racing DNA permeates everything Ferrari does – including its stock market ticker RACE.

Ferrari generates significant revenue from producing cars and spare parts. It also receives sponsorship income from Formula 1 and generates other revenue from race engines and branded merchandise. Yet, what makes Ferrari unique is the control Ferrari retains over its operations. All production occurs in Maranello and limited supply, aided by invite-only customer lists, results in highly sought-after, ultra-luxury 'driving experiences.' This tackles the biggest cost of car ownership (depreciation) as Ferraris offer impressive residual values.

Ferrari's valuation implies it is less a car manufacturer and more a luxury goods business. Looking ahead, investors expect a broader product range alongside higher volumes and higher average selling prices. That seems a tall ask - Ferrari needs to carefully drive ahead without diluting their premium image. Additionally, Ferraris don't exactly embody environmental friendliness. Should we not ask the firm, which develops leading electrification technologies, to do more to clean up its tailpipes?

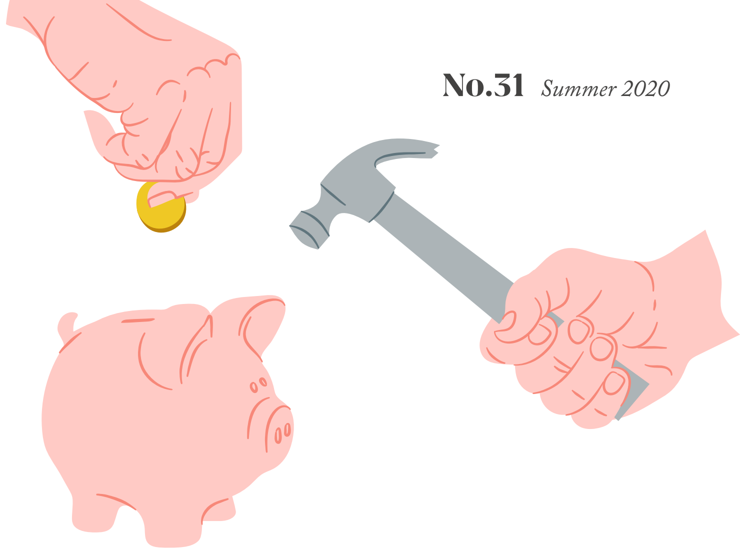
Please read the important notice on page 1.

Wealth planning in focus

Saving for the next Generation

Anthony McManus
Wealth Planning Assistant

Illustration by Adi Kuznicki



If anything, other than the myriad of struggles Coronavirus has brought upon society, it has awoken the painful ignorance in a vast number of young people towards saving not only for their future, but also for immediate emergencies.

For the millennial generation, the 'Bank of Mum and Dad' has acted as a last chance federal reserve to ensure they can continue to live through their blind profligacy. In the wake of the Covid-19 pandemic, the 'Bank' has now extended its services, providing bed and board for many.

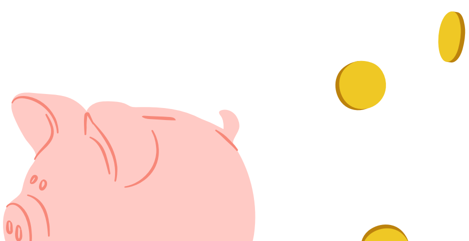
I may hyperbolise slightly, but Covid-19 has highlighted the need to start saving early for our children to ensure they are in a more secure financial position come the need to pay for studies, afford a first home or be prepared for immediate financial emergencies.

"

Research would suggest that it is family who act as the greatest influence on their children's saving habits.

When it comes to our children saving for themselves, certain behaviours affect their motivation, not least the rising cost of living having made it difficult to put money aside. Young people's spending and saving priorities also differ from past generations, as they feel more pressured to take on debt and spend more.

Research would suggest that it is ordinarily family who act as the greatest influence on their children's saving habits. Parents can ingrain good habits from a very young age and are the main source of financial advice for young adults.



Junior ISAs

With regards to providing your children with a greater financial foundation, Child Trust Funds (CTFs) were a wrapper offered between 2002 and 2011 offering tax-free savings accounts for children under the age of 18. Since 2011, CTFs have been replaced by Junior ISAs (JISA), which carry similar traits with an increased and generous annual allowance of £9,000 for this tax year. Parents are the only ones who can actually open a junior ISA for a child, but family members like grandparents can pay money into the account.

Contributing to a JISA can be used as a tactic to reduce your future inheritance tax liability. Making gifts is a good way to reduce the value of one's estate and to benefit the ones closest to you. Regular contributions (i.e. monthly) to a JISA for a child or grandchild can be exempt from inheritance tax, as long as they are gifts out of income and do not affect your lifestyle. Alternatively, if a regular payment is not an option, gifts to Junior ISAs by using your whole £3,000 annual gift exemption will not be liable to inheritance tax.

Given the JISA allowance is £9,000, if you are generous you may exceed your £3,000 exemption, for which the additional gifts will be classed as Potentially Exempt Transfers (PETs) for inheritance tax purposes. If you died within seven years of each annual gift, it would still be counted as part of your estate and may be liable to inheritance tax.

Junior ISAs are available for any child under 18 who doesn't already have a Child Trust Fund. As a parent or guardian, a JISA is a long term, tax free way to invest in your child's future. The parent or guardian will contribute to the account but only the child can access the money – and only after they turn 18. The good news is that Child Trust Funds can now be converted to JISAs.

Of course, you can open a JISA at any time before your child reaches age 18, but it is considered smart to open a JISA from the day they are born. The full 18 years means they can benefit from compounding and afford to take greater investment risk. With tax-free interest on the income and capital gains, the money you invest could grow even faster. It allows parents to lay the foundations for their child's financial future by granting long-term tax-free savings or investments. Ordinarily, should a parent invest or save money for their child using a different investment wrapper, any interest earned on savings in excess of £100 would be taxed at the parents' marginal rate of tax.

JISAs are a tax-efficient way of passing money on to children, particularly if the parent has already used their own adult ISA allowance of £20,000 for the tax year. The tax exemption for income and growth on JISAs is helpful where parents have no tax-free savings allowances of their own and would otherwise be taxed on the savings.

Given the age required to open an Adult Cash ISA is only 16, many people are not aware that a 16/17 year old can utilise not only their annual JISA allowance of £9,000 per annum, but they are also entitled to utilise an adult cash ISA allowance of £20,000, increasing their overall annual ISA allowance to £29,000. Note that one cannot open an Adult Stocks & Shares ISA until they reach age 18.

When I began this article I, possibly quite harshly, alluded to the liberal spending of children. With this in mind, a potential disadvantage for JISAs is that, ultimately, your child has the say on how to spend the funds. You should be aware that your child can take control of the account when they turn 16 and start withdrawing money from the age of 18. As a parent, you may have opened the JISA with the aim to pay off your child's university fees, but when your child turns 18, they may have other ideas.

A way to ensure your child uses the money saved sensibly is to educate them on finance and get them engaged in the decision making about how it is invested early on in the investment process. The JISA can be used as an opportunity to engage with and educate children on the importance of long term saving and investing.

Grandparent Bare Trusts

Bare Trusts are often used by grandparents who wish to provide for a grandchild (or grandchildren) who is/are too young to accept and invest a gift. Note that even though grandparents are used as an example, the provider of the property (i.e. investment) for a bare trust can be anyone including aunts, uncles and friends of the family.

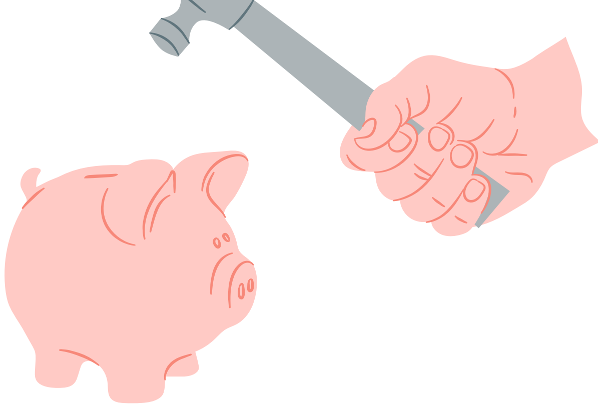
A grandparent may open a savings account in the name of their grandchild and transfer cash into the account. The monies belong to the grandchild but the grandparents would retain signatory powers and if appropriate might withdraw the funds to be used for the benefit of the grandchild (e.g. payment of school fees).

With regards to the tax treatment of the trust, the beneficiary (i.e. the grandchild) is treated as the beneficial owner of the property held – not the trustees. As such, any capital gains arising within the trust are those of the beneficiary who is entitled to the current annual CGT exemption of £12,300. Likewise, as the transferor of property is not a parent but is a grandparent, for income tax purposes the income is that of the grandchildren, who can use their own personal allowance of £12,500.

As is the case with a JISA, on attaining age 18 the beneficiary of the trust (i.e. grandchild), can demand access to the trust property and any income that has been accrued. It is this aspect of a Bare Trust that is often considered a disadvantage as, at times the sums invested can be quite substantial, and effectively too significant for a cash-hungry adolescent.

Premium Bonds

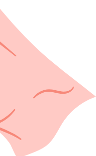
As a secure, 100% safe HM Treasury backed savings investment, Premium Bonds are often considered an attractive investment for your children. Premium Bonds can be purchased on behalf of children under the age of 16 and bought as gifts, as the purchaser nominates one of the child's parents to look after the bonds until the child turns 16 years old. Any prizes won and any payment for cashed-in bonds will be sent to the nominated parent, or the prizes will be paid to the child's premium bonds account if elected.



The potential to win a tax- free sum of between £25 and £1million in a monthly prize draw is incredibly attractive, but unlike other savings vehicles, premium bonds do not pay interest. This means the investment will gradually lose its value against inflation each year. As is the case with any lottery, the more Premium Bonds you buy, the greater your chances of winning. The issuer of Premium Bonds – NS&I – note that the average savings 'interest rate' would be 1.4% after regular 'wins' on the monthly prize draw. Nevertheless, you are not guaranteed to win, as the odds of winning for each £1 of bond purchased are 24,500 to one.

As a comparator, should your child's Premium Bonds 'win' regularly and attain an interest rate of 1.4%, this is still dwarfed by cash JISA interest rates that can currently exceed 3.00% from some providers. NS&I even offer a JISA with a top rate of 3.25%. When investing for young children, the term of investment is long so you may prefer to consider investing in the stock market than cash, to try and beat inflation.

A variety of investment vehicles exist to help parents save on behalf of their children to provide them with the best financial foundation in adulthood. Nevertheless, it is of equal importance to educate your children on saving for the future, or you can expect your children to be a more frequent customer of the 'Bank of Mum and Dad' for years to come!



To arrange to speak with one of our Chartered Financial Planners to discuss investing for future generations and learn how JM Finn can help, please contact your investment manager.

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.

•

FEVERTREE

Michael Bray, CFA
Research Analyst

PRICE
£20.79

52 WEEK HIGH-LOW
£27.15—£8.90

NET YIELD
0.73%

HIST/PROS PER
41.03—50.79

EQUITY MARKET CAP (M)
£2,400

The weather is getting nicer and although we can't enjoy pub gardens (yet), I am still craving a good G&T. Enter Fever Tree, the pioneer and market leader in the global premium tonic and drink mixer market.

Fever Tree has seen a remarkable rise in its 15 years of existence. Its premium products have been able to piggyback off the growth in artisanal gin consumption and they have been able to achieve consumer 'front of mind' status through superb marketing, after all "if ¾ of your drink is the mixer, make sure you use the best".

Fever Tree now generates £261M of revenue and is worth an estimated £2B. Business has however slowed markedly; revenue growth dropped from 39.5% in FY18 to 9.7% in FY20, as a result of slowing tonic sales growth in the UK (~43% of group revenue). Although the UK tonic market is maturing, demand for it is unlikely to abate.

For growth to reaccelerate, Fever Tree will need to look to international markets. The US remains a big prize for the business but growth is unlikely to come from tonic mixers: Americans prefer ginger ale/beer and soda mixers with their spirits of choice - Rum, Tequila, Vodka and Whiskey. Whether Fever Tree can truly crack the States is yet to be seen.

Please read the important notice on page 1.

Collectives Commentary

Challenging times for UK Equity Income investors

Hugh Yarrow
Fund Manager, Evenlode Income Fund

Illustration by Darren Richards

These are challenging times for investors who use the dividends paid by companies to generate an income for themselves. Royal Dutch Shell's recent dividend cut (its first since the Second World War) is the most high profile example yet of the challenge facing both companies and income investors from the current crisis.

In their most recent regular study "UK Dividend Monitor", Link Group* announced that they were 'withdrawing [our] formal forecast for dividends in 2020 until the depth and duration of the lockdown and associated economic impact becomes clearer'. In the study, the scale of the challenge for dividend investors was very clear; to the 5th April 2020, 45% of Britain's listed companies had already cut/cancelled their dividend or were certain to do so. The biggest impact has come from Banks, none of whom will be paying a dividend this year (worth over £13bn to investors).

The management teams and boards of many companies are feeling that it is prudent to cancel dividends that were due to be announced or paid during lockdown and look again at the situation later in the year. This is the case even for those that clearly have the balance sheet and liquidity to pay them. Whilst the current uncertainty warrants financial prudence, a key factor in these decisions has been the political and social perspective. In particular, it is difficult for a company that is making use of furloughing or other forms of government aid to announce a dividend during lockdown.

The situation is not all doom and gloom for dividend investors however. Some businesses are quite insulated from the crisis and others even thrive. Hardest hit sectors include airlines, leisure, travel, oil and mining. More resilient sectors include consumer branded goods, technology and healthcare. In these sectors many companies will either maintain their current dividend or in some cases may even grow them over the coming year.

Here at Evenlode we have always focused on investing only in market-leading, cash generative stocks and deploying a disciplined valuation and dividend filter, a patient mindset and ongoing management of fundamental risk. The Evenlode Income Fund portfolio entered the crisis with a healthy level of free cash flow cover relative to dividends, some very strong balance sheets across the portfolio and a bedrock of repeat-purchase business models. And the long-term structural positioning of the fund means that we will never have positions in certain sectors or industries such as banks, utilities, energy, mining and telecommunications. These sectors make up a large part of the UK market and are also some of the hardest hit sectors for dividend cuts.

However, the fund will not be immune to the current dividend situation and we do expect the income stream to fall in the short-term. For reference, cancelled/postponed dividends in the fund that have been announced (as at 22nd April 2020) account for c.25% of the dividend stream for the fund's current financial year (to February 2021). This includes assumptions for certain companies that we expect will also choose to pass dividends for the rest of the year, but there may be some further announcements relating to dividend disruption in coming weeks. Offsetting this risk somewhat, and based on management comments, a portion of these disrupted dividends may be paid later in the year. Looking further ahead, the portfolio is focused on market-leading businesses that we think will be able to endure this crisis and, in many cases, emerge with their competitive positions strengthened. This should bode well for free cash flow and dividend growth if one looks past the immediate crisis to the longer-term.

As a broader point, investors should be aware of the behaviour of individual companies during the global pandemic as actions taken now will have direct ramifications for their reputation in the coming years. The fortunes of a business are dictated not only by the shareholders and management, but also by relationships with customers, suppliers, employees and society at large. A company's long-term profitability is dependent upon maintaining a balance with these groups. Companies that adopt a positive approach in their responses to the pandemic are demonstrating a commitment to the long-term. For long-term investors such as Evenlode, our view is that the "right thing" is most often the "profitable thing" in the long-term. As former Intel CEO, Andy Grove, put it "bad companies are destroyed by crises; good companies survive them; great companies are improved by them".

Views and opinions have been arrived at by the author and should not be considered to be a recommendation or solicitation to buy or sell any products or securities that may be mentioned.

Please read the important notice on page 1.

•

**Link Group: UK Dividend Monitor, Issue 41 Q1 2020*

Stock in Focus

Johnson Matthey

Maude Holloway
Assistant Research Analyst

Illustration by Adam Mallett

Johnson Matthey (JM) is a global chemicals company and leader of sustainable technology. Its aim is to use science to research, develop and deliver technologies to help build a cleaner world, make a positive contribution to society and improve lives.

It was founded over two hundred years ago and applies its accumulated years of expertise to provide solutions to the world's environmental problems. The company began as an assayer and refiner of precious metals and developed into being a specialist in the platinum group metals (PGM). This helped it to become a global leader in catalyst manufacture, a key component of which is platinum. It prides itself on its ability to continue to develop and adapt as a company to meet the evolving demands of the global community.

JM operates under four divisions; Clean Air, Efficient Natural Resources, New Materials and Health. Firstly, Efficient Natural Resources (ENR), accounting for 35% of operating profit, sells mostly base metal chemicals for use as catalysts in the manufacture of ammonia, ethanol, and hydrogen and also in the refinery cracking process. The division also refines and recycles precious metals as well as supplying glass manufacturers with key chemicals and supplies the Clean Air division with its raw ingredients. ENR earnings are correlated to PGM prices and prices of palladium and rhodium rose to all-time highs in 2019, following the introduction of the strict China VI legislation around vehicle emissions and the subsequent soaring demand for catalysts. Following the onset of the Covid-19 pandemic, automotive demand and manufacture has plummeted and prices have fallen, with the recovery timescale uncertain.

The Clean Air division accounts for 59% of operating profit, and develops and manufactures catalysts for the automotive market which remove harmful nitrogen oxide and carbon monoxide from the combustion process. One in three new cars carries an emission control catalyst from JM, who say that in some cities the air coming out of their catalysts is cleaner than the air going in. This division may have had its heyday if the world moves to an electric vehicle solution for transport as diesel vehicle bans and restrictions have already been introduced in many countries and it is expected more is to come. Whilst JM's main diesel vehicle market may be in decline in Europe, stricter emissions controls are being introduced in Asia opening up the catalyst market in China and India.

PRICE
£21.97

52 WEEK HIGH-LOW
£34.10—£16.14

NET YIELD
4.07%

HIST/PROS PER
10.62—10.76

EQUITY MARKET CAP (M)
£4,120

> ***Johnson Matthey prides itself on its ability to continue to develop and adapt as a company to meet the evolving demands of the global community.***

The New Markets division is still in its formative stages and does not contribute to the Group's operating profit yet but is working on the development of advanced new materials for hybrid and full electric vehicle battery cells. JM is aiming to build battery technology that can compete in three key areas: 1) charge time; 2) distance travelled per charge; and 3) price. The battery technology that JM is working on differs from its competitors in its composition such that their battery has a relatively low cobalt requirement which, if it works, may have a cost benefit. Cobalt is hard to source as over 60% is found in the Democratic Republic of Congo and this scarcity drives higher prices. Instead the batteries JM produce contain lithium and nickel and are called lithium nickel oxide batteries (eLNO). It is a more complex process but with its metals chemistry background, JM is confident that it has the experience to have an advantage here. Progress with the eLNO cathode technology has been encouraging with positive customer feedback, however running at full production capacity is unlikely until 2022 at the very earliest with further delays probable following the Covid-19 disruption to the automotive market.

The final division is Health, bringing in 6% of operating profit and focussing on developing active pharmaceutical ingredients (APIs). Their key application is in controlled substance generics within the USA, again relying on JM's accrued complex knowledge and experience. Its products include anti-opiate addiction remedies as well as new immunotherapy oncology treatments. This division is often forgotten about but has a good pipeline of products and opportunities for growth.

Having been around for over two hundred years over different industries, Johnson Matthey is a company that has proven its ability to adapt and evolve to meet changing demands over the very long term. However, a number of headwinds continue to face the business, which include the structural decline of diesel vehicles and the growth in demand for electric vehicles. Whether the business can develop and manufacture more efficient battery technology to offset this will be the key determinant of its future success.

Please read the important notice on page 1.

Independent view

Estate planning: now is the moment

Bruce Clarke
Partner – Private Client Team
Rix & Kay Solicitors LLP

Illustration by Adam Mallett

For many, the only thing one has been able to say with any certainty in recent times is that Covid-19 has resulted in uncertain times for many. Although recently the residential property market has 're-opened for business' and the financial markets have perked up a bit, for many the financial impact of Covid-19 has seen a fall in value of their net worth.

From as early on as mid-March, the government was forced to introduce measures to support those affected by Covid-19, which have amounted to billions of pounds. Whilst these measures were much needed, and the effect they have had cannot be underestimated, it will at some point be necessary for the government to fund these measures. How it will do so is yet to be seen, but one of the obvious routes is via tax hikes. Ian McCafferty (who previously sat on the UK central bank's Monetary Policy Committee) has been quoted as saying "We will have to pay for the fiscal action that's been required...Growth will not be sufficient on its own".

For those who have already seen the value of their estates diminish, tax hikes are unlikely to be welcome news. With this in mind, now is the time for those who are in a position to do so to undertake some estate planning and take advantage of the current tax rules and the lower asset values. In the normal course of events, it is very difficult to pass on wealth to future generations without some exposure of risk to a tax liability, either now or in the future. Although we are still weathering the economic storm caused by Covid-19, we do know what the current rules are, and with some careful planning and utilising the rules (and in particular the reliefs available) as they stand at present, there is an opportunity to pass on wealth to future generations.

> *For those who have already seen the value of their estates diminish, tax hikes are unlikely to be welcome news.*

For example, those with investment properties who have seen the values of the properties fall could consider gifting one or more properties to future generations. For inheritance tax purposes, the value of the gift (which generally speaking, falls away provided the person making the gift survives by seven years) will be lower, meaning that if it is brought into account when working out any liability to inheritance tax the potential tax bill is less.

> *Now is a good time for those who are thinking about estate planning from an asset protection point of view.*

The same premise applies to any potential capital gains tax liability. A gift is a disposal for capital gains tax purposes and if the value of the property is above its acquisition cost, the overall capital gains tax bill will be less (and there may be other reliefs, exemptions or allowances that can reduce the overall bill further).

With the above in mind, now is also a good time for those who are thinking about estate planning from an asset protection point of view, as there is the opportunity to combine estate planning with tax planning. Those who have been considering how best to pass on wealth whilst ensuring it is protected for future generations are often advised to create a discretionary trust which would allow the beneficiaries to potentially benefit from the assets put into trust, whilst ensuring that the person creating the trust retains some control over the assets.

The creation of a discretionary trust is a 'chargeable lifetime transfer' giving rise to an immediate charge to inheritance tax to the extent that the transfer exceeds the available nil-rate band. This has meant that those creating such trusts have only been able to put assets into the trust with a limited value. The fact that the value of assets has fallen means that there is the opportunity to put more into such a trust and get the future capital growth out of their estates.

Creating such a trust is also a disposal for capital gains tax purposes but it is possible to defer any gain arising so that this is taxed on the trustees or the beneficiaries depending on the circumstances. With some careful planning it is possible for the gain to be eradicated over time.

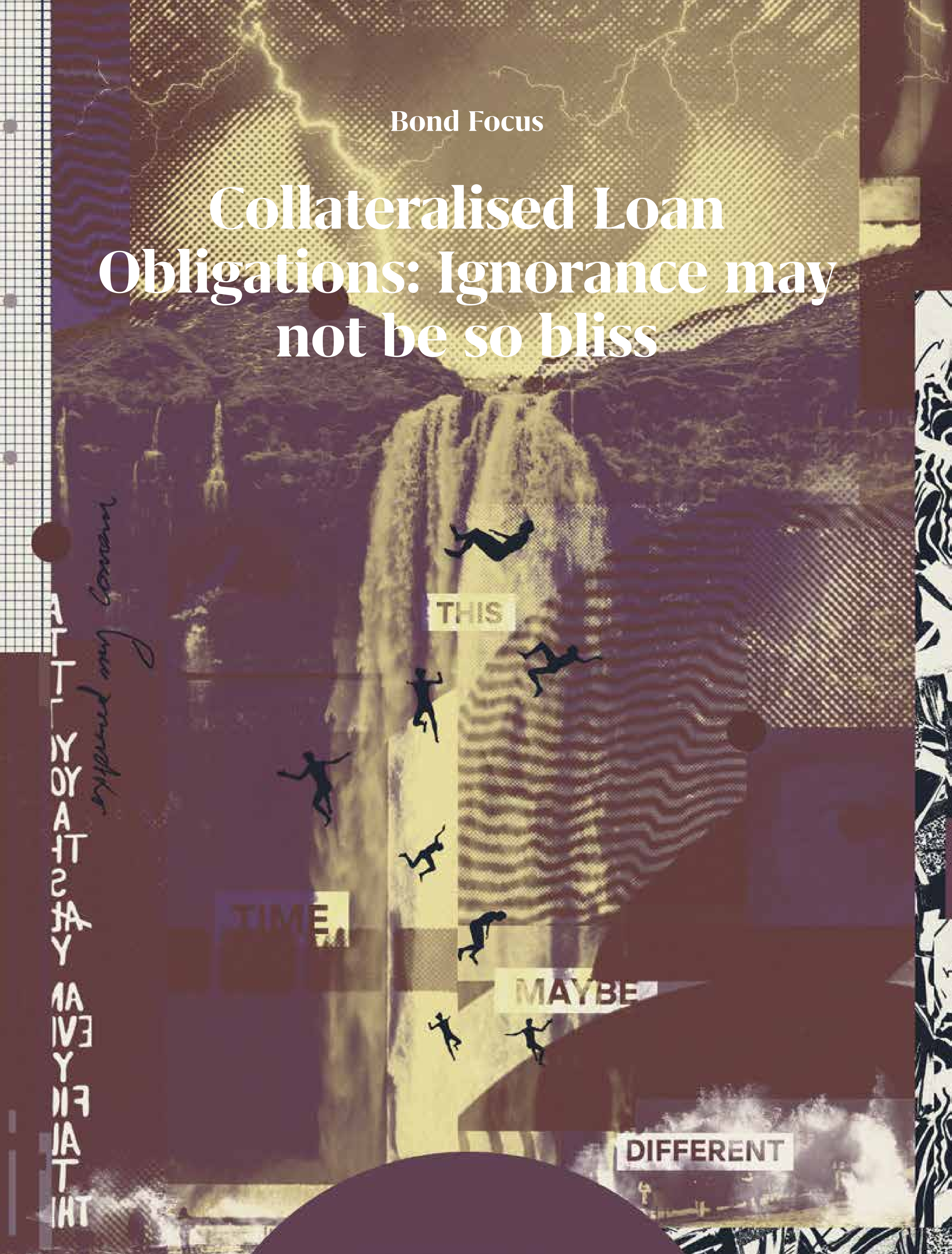
Although the current circumstances do present those who want to with an opportunity to undertake some effective estate and tax planning, given that it is quite possible that we will see a hike in taxes further down the line, it is advisable to consider the simple, tried and tested methods first before looking at complex arrangements. It has been known for legislation to be introduced to combat complicated tax avoidance schemes and it waits to be seen what measures the current or future Chancellors need to put in place.

Bruce Clarke is a Partner in Sussex and Kent based law firm, Rix & Kay and an expert in inheritance tax.
bruceclarke@rixandkay.co.uk
www.rixandkay.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 advice is sought on any of the above.

Bond Focus

Collateralised Loan Obligations: Ignorance may not be so bliss



James Ayling, CFA
Research Analyst

Illustration by Sir Radar Drench

Collateralised Loan Obligations (CLOs) share similarities to mortgage backed securities that we know caused significant financial and economic challenges during the 2008 Global Financial Crisis.

Mortgage backed securities, like CLOs, are a subcategory of collateralised debt obligations (CDOs). CDOs are debt securities that pool together debt instruments e.g. loans, bonds, mortgages etc. to offer investors an investment product that seeks to provide some diversification benefits versus purchasing a single debt instrument alone.

As well as offering loan diversification, when you invest in a CLO you can also decide how much risk exposure you want to take on the underlying loans. This is because CLOs are split into risk buckets, known as tranches, which create a waterfall structure within the CLO. The waterfall structure means that cash payments received on the underlying loans initially go to pay investors in the lowest risk tranche of the CLO. Once that tranche payment is covered, the remaining cash trickles over to pay investors in the second lowest risk tranche and, so on. This means that if a small number of underlying loans default, the highest risk tranches absorb these losses first whilst investors in the lowest risk tranche of the CLO may continue to receive their normal level of return.

CLOs offer investors a financial debt instrument that can help diversify away a single loan's default risk (specific risk) and give investors the potential to better tailor their overall risk exposure to loans to more appropriately suit their individual level of risk tolerance. However it is important to understand that, as with any financial instrument, not all risk can be diversified away. Investors will still be exposed to economic wide risk (systematic risk) which is exacerbated during times of financial and economic stress – as we are now seeing under Covid-19.

Furthermore, the overall quality of a CLO ultimately depends upon the quality and stringency with which lending standards and loan covenants were applied at the point of issuance of the underlying loans. Anecdotally there have been murmurs that lending standards had slipped over the past few years and today that might mean CLO risks are underappreciated.

Poignantly the Financial Times recently wrote that the top tranche of a CLO has never defaulted. This statement fills me with dread. For it implies that the top tier tranche of CLOs have garnered a 'safe' reputation. I fear this reputation may have inadvertently shortened the depth of due diligence undertaken on the loans that make up CLOs. I also suspect that the longer a reputation builds; the greater the complacency becomes.

> ***It is important to understand that, as with any financial instrument, not all risk can be diversified away***

Since the start of 2020, CLO yields have risen. I believe this represents the market attempting to re-assess what Coronavirus may mean for the credit worthiness of the underlying loans. Yet, if underlying lending standards have become too lax – investors may be unaware of their true risk exposures. All financial crises affect different parts of the economy to differing degrees. This financial crisis would seem to impact companies to a greater initial degree than consumers. So, whilst CLOs have weathered previous storms … this time may be different…

CLOs and CDOs are categorised as complex products and therefore JM Finn cannot transact in these securities on behalf of clients. However, certain collective investment schemes that clients may invest in will own these types of products, though these will also be categorised as complex.

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	Coronavirus 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 in the sector however we acknowledge the short term negative impact of coronavirus on airlines, luxury, entertainment and travel sectors. Avoid these for now but look for buying opportunities in those names with structural and disruptive growth characteristics.
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.
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 coronavirus will delay this. Focus on high quality defensive names for now and hold through until certainty returns.
Energy	Sector under pressure as supply/demand dynamics look less supportive for capital growth or capex expansion. Coronavirus impacting the oil price and further headwinds from social investment perspectives.
Information Technology	We are positive but be selective and wait for market weakness to add to the quality 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	Neutral	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. That said UK equities look like good value on a relative basis.
INTERNATIONAL EQUITIES		
North America	Overweight	Given that pressure on the Chinese may turn to vilifying Xi for his early cover-up, this allows Trump to take the pressure off the trade war rhetoric. We are less wary that China will cause problems into the next election because they fear a Democrat government more than Trump. This puts Iran, as a potential trouble-maker, on hold as well. Caution on how the FAANGs dominate the indices and the risk that the coronavirus does more damage to the US on a relative basis.
Europe	Underweight	The inability of Europe to agree a substantial fiscal package will hamper the continent. Public pressure is driving corporates to update their business processes which in turn could increase the cost of capital and lower returns. If the next round of Chinese stimulus is more focussed on domestic consumer demand, rather than infrastructure spending, then this could dent expectations for an export led recovery.
Japan	Neutral	On the one hand, Japan has been out of the trade war news and the Yen has started performing in safe harbour mode as the coronavirus episode has dragged on. On the other, 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, leveraging is supporting the economy in a co-ordinated way. China was first into the coronavirus and should be first out in a way that leads the region. We hope that if the trade war morphs into a war of diplomatic words around China's handling of coronavirus in the early days, that this will help the region.
Emerging Markets	Neutral	Extreme USD strength is no longer a concern but there is the risk that a weak Renminbi will pull other emerging markets' currencies down. Argentinean contagion is a worry and raises the risk premium. Trump taking trade war to South America would not help.
BONDS		
Conventional	Underweight	We have reached the stage with conventional gilts that they are now being described as return free risk. Yields on the ten year are now at 0.17% and the Debt Management Office recently sold some three year gilts on a negative yield. If interest rates climb from these low levels there is only 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.
Index Linked	Overweight	The market is pricing in weak inflation but we think that there is a risk that the monetary stimulus to combat coronavirus could cause an overshoot in inflation by year end. That would be good for linkers. 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	Overweight	We have been favourable towards gold and infrastructure within the sector of asset allocation and remain so.

Meet the manager

Marcus Holden-Craufurd

Investment Director, London

Lives Near Royal Tunbridge Wells, Kent

Family Married with two children

Started at JM Finn October 2019

Charity The Cure Parkinson's Trust and Cancer Macmillan

Favourite Film The Usual Suspects

Passion Rugby, formerly playing then coaching my son's mini and junior teams, to refereeing today.

Person you would most like to have dinner with Stephen Fry, who would inform and amuse in equal measure.

What have you particularly enjoyed about JM Finn since your arrival in October?

In my introduction to the company, I met with individuals from all parts of the business and I was most encouraged to hear a similar mantra from all; that their focus was to enable the investment staff to give the best possible service to their clients, by assisting us wherever possible to maximise the time spent managing investments and looking after our clients. A noticeable aspect that struck me when sat at my desk was the marked increase in noise levels on the floor. It soon became apparent that in the main, this was a mixture of staff on the telephone to clients or external analysts, talking to each other about various companies they were researching themselves and, just as importantly, the sound of people enjoying themselves It was very apparent that the mantra was indeed working and therefore it came as little surprise that the results of the client satisfaction survey, published in the previous quarter's issue of Prospects, was so remarkably impressive. The collegiate atmosphere is driven by the management team, most of whom have experience in managing clients and understand the implications that their decisions make. The focus throughout JM Finn is to create the environment to maximise the client experience and is one I look forward to enjoying long into the future.

In light of the market uncertainties, have you made any significant alterations to your portfolios?

John Royden and his team of researchers have given exceptional guidance to the investment teams throughout the whole of this period and erred on the pessimistic side from the outset. I have recently looked back through our morning meeting notes since the start of the crisis and the steerage they have given us. I have been flexing portfolios away from certain assets, sectors and geographies, such as corporate bonds, banks and Europe and towards areas which have proved more robust, including gold and technology. This will have certainly helped clients' portfolios during the recent falls. It is important however not to lose sight of the longer term implications of this cycle, which is equally important to the longer term investor and the work that the research team have carried out on sustainable dividend paying companies may prove crucial to clients that rely on income streams from their portfolios.

On the basis that it is going to take time for a recovery, what do you think will be most concerning for clients?

I believe the biggest concern will be from those who invest for income. Since the start of the crisis we have seen fiscal action from global governments to support companies, in the hope that when the crisis abates, these companies will still exist. Understandably, they have instructed the companies who are utilising these schemes to cease dividend payments, which will have a hugely derogatory effect on the availability of income paying equity. When companies resume dividend payments, we may well also see them coming in at lower levels than offered before as the company continues on its recovery path. The amount of money that will be pumped into the system will put post-2008 Quantitative Easing in the shade. The implications for this could have a marked effect in the longer term on all asset prices and this could lead to inflation. If this out-paces interest rates and therefore available income, it will be a difficult time to live off income alone for those only just getting by.

Our Offices

London

4 Coleman St.

London. EC2R 5TA

020 7600 1660

Bury St Edmunds

60 Abbeygate St.

Bury St Edmunds

Suffolk. IP33 1LB

01284 770700

Leeds

33 Park Place

Leeds. LS1 2RY

0113 220 6240

Cardiff

14 St Andrews Crescent

Cardiff. CF10 3DD

029 2055 8800

Bristol

31 Great George St

Bristol. BS1 5QD

0117 921 0550

Winchester

4 Walcote Place. High Street

Winchester, SO23 9AP

01962 392 130

Follow us on:

info@jmfinn.com
www.jmfinn.com