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Prospects

The JM Finn Quarterly Periodical

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Contents

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Welcome

Markets started 2019 strongly after a very difficult final quarter of 2018, where a whole series of events convened, both politically and economically; you could have called it a 'perfect storm'.

The trade tariff war between the United States and China, a slowdown in the Chinese economy and the resulting effect on emerging markets, a 40% fall in the oil price, rising US interest rates, after more than a decade of ultra-low rates, Brexit, the potential of a new UK government and rising nationalism in many countries. Notwithstanding this list, US and UK markets have since recovered half their losses, so the fall could be considered a healthy correction, rather than the start of something more sinister.

Importantly for investors, most leading companies have produced reasonable profit figures for 2018. Many of the industrial and technological trends will continue and whilst the US market was led up and down by the big technology stocks, it is worth remembering today's leading companies and technology might be old hat in three years' time and there could be a whole set of new ones. Medical technology, in my opinion, is a particularly interesting area after a decade of few new discoveries; but thanks to gene therapy we are entering a new era and with maturing populations in China and the Western world, spending should continue to rise at high rates.

In the United Kingdom, we have a sharp differential in valuation today in companies dependent on the UK economy compared to international companies. I believe the politics of this country should calm down in the second half of this year, and therefore it is possible that international money starts to come back into the UK which may lead to an uptrend in the fortunes of British assets, such as companies dependent on the UK economy and British commercial and residential property.

I do think it is important we don't lose sight of what matters to us as investors amongst the Brexit debacle; namely solid fundamentals of individual companies. If we look back at British history and think of what our ancestors must have argued about in the past, Brexit might just pale into insignificance in relation to some of the historical votes, whether it be the Reform Act, Suffragette movement or even the Slavery Act. Values and beliefs will always change and this could prove to be a small point of time in our history and business will continue.

Markets aside, I am delighted to report that JM Finn continues to be in robust health, despite the slew of challenges that we and our clients face. Some clients will have received depreciation reports from us as a result of their portfolios falling by more than 10% since their last valuation, in the last quarter of last year. With a near 20% fall in markets it seemed inevitable that this new requirement to send notification to our clients within 24 hours was going to be tested – a particularly unwelcome Christmas present for some.

In other regulatory developments we will shortly be sending full cost disclosures to all clients about the total cost of investing, including total transparency of third party charges made by external unit trust managers. These reports show the charges that have always been included within the periodic statements that are sent, the difference with the new report is that indirect costs, or third party fund charges, those that are built into the price of funds, now have to be detailed explicitly and any other incidental charges that are listed on fee schedules are now itemised. Additionally, during the year we will require managed clients to sign a consent form to process your data, following the updated data protection rules.

Finally, I would like to remind clients of our wealth planning team who are on hand to help our clients in various aspects of your wealth management. If you would like any specific advice on retirement planning, pensions, inheritance tax or a general financial discussion please give your investment manager a ring to arrange a meeting.

James Edgedale

James Edgedale
Chairman

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BEHAVIOUR
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BIAS
RATIONAL
REWARD
CERTAINTY
INVEST
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IRRATIONAL
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FEELING
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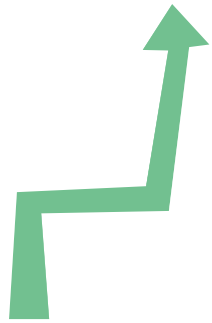
SURVIVAL

Editorial

Rationalising the Irrational

By Michael Bray
Research Analyst

Illustration by Adi Kuznicki



At the end of last year, whilst having lunch, I decided for my sins to watch an American financial news channel - I won't tell you which one (it will become obvious why). The news anchor was typically brash, and with some gusto was gesticulating and talking about Trade Wars and other news deemed negative to market developments. He then switched over to his 'charts guy' who was wearing a typically quirky outfit - large black rimmed glasses and a polka dot bow-tie – who then frantically scribbled over a flip chart in an effort to explain why the S&P 500 index had fallen and why the 'technicals' suggested it would continue to do so. This was while he was standing in the pit at the New York Stock Exchange, with traders shouting orders in the background, whilst bright red letters at the bottom of the TV screen said 'Market Sell-off'. All very dramatic.

As the day went on and stock prices recovered, I thought I would check what the reaction was from the channel. Needless to say, there was now bright green lettering on the TV screen saying 'Stocks Surge' whilst our news anchor was talking extremely positively about newly released US economic data, and Mr Flipchart was now drawing an upward sloping chart with multiple annotations.

In an attempt not to be overly harsh to the broadcaster, I must reference that this was during a period when markets were more volatile than usual. And as amusing as it was to watch this spectacle, it did concern me how frivolously evocative language and iconography was used, jumping from one extreme to the next in a matter of hours.

> ***It did concern me how frivolously evocative language and iconography was used***

I'd like to think this broadcaster was a particularly bad offender, but after viewing other market commentaries around the same time, I saw that a significant amount of the press do overdramatise, with even us supposed understated folks in the UK being guilty as well.

This got me thinking about not only the impact that the press have on investors' decision making, but also the overall effect that human nature has in determining market prices, prompting me to revisit the various teachings from the field of Behavioural Finance.

In classical financial theory, markets are said to be 'efficient' whereby they perfectly reflect all information correctly and as a result, financial assets always trade at 'fair value'. Now we all know that's not true, as we wouldn't have had such events as the Dotcom Crash or the 08/09 Financial Crisis! There are a few reasons for this, but the key determinant is due to the behavioural biases that we exhibit.

The extent of this influence can be seen in a paper co-authored by economist Larry Summers which investigated the 50 largest moves (positive and negative) in the U.S. stock market between 1947 and 1987. It concluded that on most sizeable return days, the information that the press cite as the cause of the market move is not particularly important. Press reports on adjacent days also fail to reveal any convincing accounts of why "future profits or discount rates might have changed." In layman's terms, more than half of the largest market moves were completely unrelated to anything that might be classed as fundamentally affecting a company's operating performance or the valuation.

Our evolutionary needs have meant that our brains are hard wired for survival, and depend on fast pattern recognition and decisive action.

So what aspects of human behaviour cause these unsubstantiated price movements? Our evolutionary needs have meant that our brains are hard wired for survival, and depend on fast pattern recognition and decisive action. This was dubbed as System 1 by behavioural specialist David Kahnman, who wrote the best-selling book 'Thinking, Fast and Slow'. Whereas the System 2 part of our thought process has developed relatively more recently and is considered to be slow, rational and deliberate. Unfortunately, the stereotyping and generalising of System 1 that helped in our survival, doesn't bode well when it comes to investing. This means some investors look for patterns that may not exist - particularly within the short-term – resulting in a number of behavioural biases.

We can apply two of these biases, herding and loss aversion, to explaining how the number one no-go of investing is committed time and time again: buying high and selling low.

With herding, individuals follow the actions of the larger group. Due to our evolutionary need for security, it actually causes us social pain not to fit in with the majority. This can be difficult in many aspects of life, but particularly when it comes to investing and potentially missing out financially. The effect of herding amplifies market price movements and can lead to market bubbles and panic selling.

Loss aversion is a result of the pain we experience from a loss being nearly twice as strong as the pleasure of a gain. This leads to some investors selling at low prices, as markets fall, to avoid more losses and also causes them to miss out on buying opportunities due to fear of further losses.

Now linking this all back to my initial observations from our American broadcaster, these biases are accentuated by our susceptibility to useless information, or words that have no grounding, peddled by the financial press. Psychologists have found that when placebic information (words that mean nothing) are presented in a format that we are familiar with, we will mindlessly process it. No wonder that some investors, when faced with uncertainty, will cling to any vaguely plausible explanation, allowing media outlets to achieve the ratings they do!

The irrational behaviour of market participants is excellently described by Benjamin Graham's ('The father of value investing') analogy of Mr Market:

"Every day he tells you what he thinks your interest is worth and furthermore offers either to buy you out or sell you an additional interest...Sometimes his ideas of value appear plausible and justified by business developments and prospects as you know them. Often, on the other hand, Mr Market lets his enthusiasm or his fears run away with him, and the value he proposes seems to you little short of silly."

In summary, those that focus upon market price for advice are destined for failure. Celebrated economist John Maynard Keynes further points out the irony of the situation: *"It is largely the fluctuations which throw up bargains and the uncertainty due to the fluctuations which prevent other people from taking advantage of them"*.

So how can we save ourselves from ourselves, and ultimately make it more likely that we achieve our investment objectives? Firstly, it's important to recognise and accept the biases we all have. We also need to comprehend that important decisions should take time and that we should deliberately seek impartial views that challenge our own. Finally, a robust, objective and structured process is vital to minimising biases.

Understanding Finance

YIELD CURVE INVERSION

James Godrich
Research Analyst

There are three things that this piece will look to address; what is the yield curve, what do we mean by a yield curve inversion and what is the economic consequence of a yield curve inversion?

Imagine I run a business selling industrial components. I use a combination of debt and equity to finance the business and that debt is borrowed on different maturities. Debt maturing in two months is borrowed at a 2% rate. Because of increased uncertainty as to future economic growth, inflation and interest rates, debt maturing in five years is borrowed at a rate of 4%. And as a result of even more uncertainty, debt maturing in ten years' time is borrowed at a rate of 7%. That describes a normal upward sloping yield curve.

Now imagine that lenders fear a recession in the immediate future. Whilst the long term outlook still appears okay, there is an expectation that my business is going to struggle to repay its two month debt and may even struggle to repay five year debt. Additional risk means lenders require additional return.

The resulting yield curve prices two month debt at 9%, 5 year debt at 8% but still ten year debt at 7%. The yield curve has inverted.

Much that you will read says that an inverted yield curve is a signal from the market that a recession is imminent. I'd go one step further and say that it may even be the cause of a recession. Two month debt typically funds short term cashflow, perhaps inventory or wages. Ten year debt would fund capital expansion, perhaps a new factory. That is to say that short term debt keeps the lights on but long term debt underpins future growth.

If lenders receive a greater rate of interest for short term debt, there will be a greater incentive to loan money short and little incentive to loan long. That could lay the foundations for a near term recession by starving companies of long term growth funding.

COMPASS

James Godrich
Research Analyst

PRICE
£16.87

52 WEEK HIGH-LOW
£17.76—£14.27

NET YIELD
2.2%

HIST/PROS PER
23.9—20.2

EQUITY MARKET CAP (M)
£26,924

Compass haven't had it easy. December 2017 saw the tragic passing of the impressive CEO, Richard Cousins. This was closely followed by the resignation of long serving CFO, Johnny Thomson and global competitors reporting a number of profit warnings.

Despite these challenges, Compass have consistently delivered on their stated aim of 4-6% organic growth alongside modest margin progression. That has left the shares trading near record highs today.

Whilst it's easy at this stage to praise the business for strong new contract wins, good retention rates and a sensible tidy up of their non-core operations, perhaps now is a better time to look at what might be a cause for concern.

One of the small disappointments in recent results has been margins across the European operations. That has been caused by inflation creeping into the cost base against a fixed price structure – in the US the majority of contracts are inflation linked. Whilst management say that they have up-skilled their sales team to deal with difficult pricing conversations, old habits die hard.

With European revenues representing around 25% of the overall group, the question for now is, with the valuation where it is today, whether those concerns outweigh the broader positive trading

Please read the important notice on page 1.

Guest Editorial

Virtue signalling

By William Sitwell
Illustration by Kim Clements

VIRTUE-SIGNALLERS. They're everywhere these days. On TV, all over social media, in the papers and on the news and dripping through on email, paraded by PRs, and look, straight ahead: there's another one, staring right at you, in the mirror.

The problem is it's just all too easy. To parade your credentials on anything – from politics to the environment – all you need do is touch your phone. You can like, retweet or re-post. Or you can dig deep, up-load a photo on Instagram and then add some worthy, simpering bon mots. If you need a lesson in this just follow Gary Lineker. Really he should have two social accounts for people who don't like nasty surprises. One moment he's weighing in quite cogently on a cleverly-taken free-kick, the next he's grandstanding on Trump or second referenda. It can put you right off your vegan granola.

Speaking of which, it's food, of course, where virtue-signalling, or hand-wringing should we say, is most rife. The experts, of course, are influencers. These extraordinary creatures of the modern age who share images of their holistic, holier-than-thou lives for the rest of us to coo about. Except that influencers are called that for a reason, in that they are paid to influence. There are no regulations in social media, so your vegan mentor can chirp about a breakfast bar without having to tell you that they were paid to do it. Watch them as they appear to skip across the world sharing their beautiful lives and their deep-seated cares. I sometimes wonder how much fossil-fuel is burned so that some virtue-signalling influencer can report on the environmental credentials of some eco-hotel in Mauritius (which would have been much more eco if it had never been built in the first place).

Of course the business of the influencer – the social-lite – depends on their hordes of followers swallowing and lapping up their visions and desires for a perfect world. And to get started quite a few of them falsified those followers – at a time when you could buy a few thousand fake devotees for a fraction of that you would then earn with their affected love.

But, as my rant is pure and real, I should demonstrate that by saying that there are some good apples amongst the rotten. Not everyone on social media is false and shallow like me. Of the many good examples that exist I wish to highlight just one. The next time you have a few seconds free and are wondering what not to cook tonight, search for The Happy Pear on Instagram. This is a pair of Irish brothers, twins in fact, who are as strong as they are handsome and having spent their teens drinking their weight in Guinness and eating good Irish beef had a new awakening. One day they decided together to quit booze and meat. That was a few years ago and today they travel about inspiring people who themselves wonder if there's another way. They start each day with a dip in the Irish sea - in all weathers and seasons – and they make their own brand of sauces and dips, cereals and biscuits. The Happy Pear are a real pair. They practice what they preach and their signalling is virtuous and real. It's just that after about five days of eating their delicious food and following their lead in not abusing my body and avoiding alcohol I find myself aching: for booze and meat.

> *There are no regulations in social media, so your vegan mentor can chirp about a breakfast bar without having to tell you that they were paid to do it.*

For yes, my intention may sometimes be pure but when it comes to food I'm a gluttonous sinner. That person in the mirror is indeed me – and it could well be you too. It's just that I am a little more careful about posting my foodie preachings on line. Although I do occasionally do it in the real world. I have stood on stages – at food and literature festivals – and professed my desire to embrace more plant-based recipes, to cook more from scratch and to eat locally and seasonally. I have talked about the importance of 'clean meat' (lab-grown proteins, don't you know) and how vital it is that we embrace insects in our diet – because – and this is the sort of thing I say – the likes of crickets can grow, live and be nurtured on waste – on the veg we throw away, for example. Think about that when you dunk your next grasshopper biscuit into your tea.

> *Not everyone on social media is false and shallow like me.*

And so here is my honest confession. But first I want you to imagine me in my kitchen. There I am in my well-insulated home, the underfloor heating fuelled by ground-source energy, my stove, powered by a windmill, turning up on the roof. Stock bubbles on the hob, the carcasses of a Sunday roast chicken flavoured with the ends of parmesan that I always store in the freezer, before committing it to the compost heap. I chop up my home-grown carrots, celery and onions and toss them into the pot before taking a quick slug on the cider I made from last year's windfall.

Instagram witnesses the various stages of my cooking, hashtagged to the gills with words like organic, homegrown, nature, real food, seasonal and sandals (ok, maybe not the last one). And then, when the soup is ready, I cut up slices of my home-baked crusty bread, and then welcome into my home a local immigrant family, hastily plucked from Syrian horror, to whom I have given free board-and-lodging.

The reality I'm afraid is that I do not have an insulated house, although I dream of one and wish I didn't burn quite so much oil in the vague hope of heating the place. And I want to cook like that, really I do but I'm just too busy writing about it, liking stuff on Instagram, watching food programmes on TV, attending talks, giving talks, appearing on TV, hosting radio shows and bashing out pieces like this one.

William Sitwell

William Sitwell is a writer, editor, TV presenter and food critic.
www.williamsitwell.com

The Taylor Rule ~ What's in it for me?

By John Royden
Head of Research

There's a hurdle to reading the rest of this article; and here it is:

$$I = \text{INFLATION}_{\text{ACTUAL}} + R^{*}\, \tfrac{1}{2}\left(\text{INFLATION}_{\text{ACTUAL}} - \text{INFLATION}^{*}\right) + 1/2\left(\text{GDP}_{\text{ACTUAL}} - \text{potential}\right)$$

This is the rule for working out what interest rates should be which was first put forward by Professor Taylor in 1993. Some of you might like to know what this means in plainer English?

The formula says that when inflation is higher than it should be and when GDP growth is higher than it should be, then you need higher interest rates. The trick is knowing what R* (sometimes called "R Star") is. We can only estimate this, but it is meant to be the real interest rate which keeps inflation at 2% and the optimum number of people in work.

We need to know about and apply the Taylor Rule because it is what the Central Banks talk about, which subsequently affects what interest rates are and where they should be going.

What is interesting is that when you look at the major economies of the US, UK, mainland Europe and Japan, you find that the Taylor Rule says that interest rates should be much higher than they actually are. In America interest rates are 2% lower than they should be. In the UK, the gap is 3%. The outliers are Sweden and Germany where the gap is closer to 5%. That is one of the reasons why I think you should keep a short duration bond exposure. A short duration bond exposure means holding bonds likely to mature in the next five years or so; shorter dated bonds are less sensitive to movements in interest rates.

There is always an uncomfortable compromise between accepting the very low yields of bonds with two or so years to run with the desire to be short dated. Any bond that sits within the one to five year life to maturity fits the bill as far as I am concerned.

I have lots of other reasons to want to be short dated. The surge of populist influence on government augurs for higher budget deficits which are inflationary. Quantitative easing (QE) is being reversed in the US and has recently stopped in Europe. We have had the US stimulating its economy into a tight labour market which usually drives wage inflation and then actual CPI inflation higher. I expect oil to bounce back to $80 on Saudi Arabia and Russia cutting supply by 1.2 million barrels per day and Venezuela getting worse before it gets better.

The big question is whether China stimulates to reverse out of its slowing growth as China is, by most yardsticks, quite leveraged so the only real way for it to generate economic growth is with a fiscal stimulus. This probably means more infrastructure spending and maybe lower taxes, rather than lower interest rates.

Watch for global inflation to surprise on the upside as we move into the second half of 2019.

TAKING THE PAST IN TO THE FUTURE: THE CHANGING FACE OF AUCTIONEERING

By Jane Tennant
Tennants Auctioneer

Illustration by Adam Mallett

The business of fine arts auctioneering will always be somewhat of a dichotomy; whilst dealing in the past modern consumer demands require this very traditional business to embrace new technology and adapt to a fast-changing market place. There is a constant push and pull between the traditional auction forum and the remote digital-based transactions that have become the norm today, and auctioneers have had to adapt to find a balance between the two.

Until the turn of the Millennium, auctioneering had remained virtually unchanged for centuries. Tastes, fashions and prices may have fluctuated, but the manner in which auctioneers operated has remained the same. Estate sales would be offered on site, or a curated sale offered in a traditional saleroom, and a printed catalogue for the better sales might only include the most rudimentary of descriptions. Auctions were aimed at those in the know – members of a small circle of dealers, buyers and those in the local area. Terms and prices were dictated by the auctioneer and the onus was on the buyer to come in person, hunt through the lots and stand in the saleroom to bid.

Since auctions began to be listed online nearly 20 year ago, the auction industry has been revolutionised. With the power of the internet, an auction has the potential to reach a global audience. From a base in the Yorkshire Dales, Tennants now connects over 200,000 buyers and sellers in over seventy countries. Now an increasingly tech-savvy audience has shifted the balance of power in the auctioneer/buyer relationship firmly towards the buyer. Today, buyers demand greater transparency and a greater level of information before they bid; clear and accurate cataloguing, high-resolution imaging and detailed condition reports are the norm. With the ease of online research, buyers approach a sale with a prior knowledge of auction prices and bidders are more risk adverse and rarely buy an item 'unseen'. In recent years online bidding and online payment transactions has in effect taken the auction to the buyer, who can now bid live from their desk at work or from their phone wherever in the world they may be.

Interestingly, we are seeing the digital revolution not just making changes to the transactional auction processes, but also influencing the market. For example, the buying power of the Far and Middle East and Russia is widely recognised to have had a significant effect on the prices of Asian and Russian Art. However, other cultures buying back indigenous art and artefacts has helped lift the market for ethnographic and tribal art in recent

"One of the many intriguing aspects of being auctioneers, is the ability to chart changes in our society's history by the objects made and sold.

Above: A 1940s Robert "Mouseman" Thompson Panelled Oak 4ft Sideboard – Sold for £5,800 plus buyer's premium. Made from English oak with solid construction and rich patina, Mouseman furniture's Arts and Crafts style has a broad appeal at auction.

years. On a more practical and prosaic level, large, bulky items that are difficult or not cost effective to ship long distance will naturally suffer depressed prices as the pool of competing buyers is reduced. A buyer might bid on Rolex watches internationally, but only bid on furniture from their local auction rooms.

In the last couple of years online only auctions, a format more akin to eBay than traditional auctions, have been introduced. However, there is a risk of making buying at auction too clinical a process and losing the magic and theatre of the saleroom and the emotive nature of buying art and antiques. Away from the top end of the market, where the super-rich are buying big-name items to lock in storage for potential investment – collecting should be about pleasure and use. Whilst a Rolex might easily be bought online, practical items such as furniture, or paintings are so much better viewed in the flesh. Drawers can be pulled out, dining chairs can be tested for comfort, and the play of light over brushstrokes on the surface of a painting can be witnessed. Salerooms will always be a vital forum to engage physically with art and antiques; to delight in the tactile nature of a piece of oak furniture, to see how a diamond ring sparkles as it catches the light, and to gauge the patina on a bronze statue.

As our everyday shopping experiences become ever more clinical and detached, a purely transactional process with no personal contact, the traditional, social aspect of a physical saleroom becomes all the more important. Everyday, we see our buyers come through the doors at Tennants with friends and family, making a visit to our auctions a day out. Regular buyers have become long-standing friends and being in a crowded saleroom during a heated bidding battle and soaking up the charged atmosphere is a unique experience. Auctions exert a peculiar fascination – the combination of beauty, history and money captivates and excites, and it was in response to this fascination that Tennants expanded in 2014 to include permanent display galleries where visitors can come every day and see highlights of forthcoming sales outside of traditional auction public viewings.

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> ***Today the Holy Grail of toy collecting are pieces from the 70s and early 80s.***

One of the many intriguing aspects of being auctioneers, is the ability to chart changes in our society's history by the objects made and sold, by the changing tastes and demands for material and luxury goods. Not only can we chart these changes over the past few centuries, but it is also fascinating to see how a modern, everchanging society is reflected in the objects that we buy to fill our homes. Traditional brown furniture has suffered a much-publicised drop in prices in the last twenty years – for example prices for Georgian and Regency furniture have dropped as much as 30% since 2003. With smaller homes, more frequent moves and a trend towards bright and light decorative schemes, dark, heavy furniture has fallen out of favour for many. There is virtually no market for Victorian sideboards and the like. However, an increasing demand for mid-century design furniture fills the gap with elegant, light wood pieces by well-known makers such as Ercol seeing strong prices.

Yet all is not lost for brown furniture. It remains a useful and beautiful addition to the home; well-made and enduring, minor damage is easily repaired, and a rich patina only deepens over time. The market for art and antiques tends to shift with the generations, and we are seeing Millennial buyers who are less averse to buying on the second-hand market than their parents may have been. They are also increasingly viewing antiques as an eco-friendly source of affordable furniture. With a low carbon footprint, made from simple materials and easily resold or recycled, brown furniture beats the likes of imported flat-pack furniture hands down.

We often get asked what will be the next 'big thing', and as with the stock market, we cannot see into the future. The best we can do is analyse current trends and buying habits of our customers and be prepared to follow where they lead. For example, the market for toys and collectables shifts with each generation. Buyers tend to be those in their forties and fifties,

Above: A Kenner Star Wars Stormtrooper Figure with card advertising rocket firing Boba Fett figure – Sold for £220 (plus buyer's premium)

and with a little spare money are buying collectable items from their childhood. Twenty years ago, diecast toys such as those made by Dinky were at their peak, but today the Holy Grail of toy collecting are pieces from the 70s and early 80s and particularly pieces with a movie tie-in such as Star Wars figures.

Wherever changing tastes and technology takes us, auctioneers must respond with enthusiasm; we must adapt and grow lest we run the risk of becoming obsolete, and a world without the thrill of a live sale would be just that little bit dimmer.

www.tennants.co.uk

CRANSWICK

James Godrich
Research Analyst

PRICE
£25.18

52 WEEK HIGH-LOW
£35.02—£23.4

NET YIELD
2.2%

HIST/PROS PER
18.8—17.6

EQUITY MARKET CAP (M)
£1,301

You might not know it, but without Cranswick your traditional Sunday morning breakfast might be significantly different to that which you are used to today.

In the 1970s the business was formed when a group of Yorkshire farmers began to produce high quality pig feed in consortium. In the 1980s they then moved into food production; the idea being that as a group they would be able to supply butcher quality sausages to the mass market. That ultimately became what we now know as Sainsbury's 'Taste the Difference' and Tesco's 'Finest' ranges.

Today, Sainsbury's and Tesco still make up more than 50% of Cranswick's sales.

But even a business that creates its own market faces challenges. The latest set of results highlighted three in particular; gross margin pressure from a tougher commercial landscape, operating margin pressure as a result of Brexit-induced labour concerns and higher capital expenditure costs driven by increased investment in their new poultry facility.

The question today is whether Cranswick is a company facing new and significant challenges in a market they have dominated for so long, or whether this is a high quality company going through a temporarily tough time.

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 Godrich
Research Analyst

Michael Bray
Research Analyst

BASIC MATERIALS
Victrex

CONSUMER GOODS
Tate & Lyle, Imperial Brands, Nestle

CONSUMER SERVICES
Compass Group, Tesco, Daily Mail & General Trust, Whitbread

FINANCIALS
Jupiter Asset Management, Bank of America Corp, London Metric Property

HEALTH CARE
Novartis, GlaxoSmithKline

INDUSTRIALS
Lockheed Martin Corp, DS Smith, Wincanton, Alpha Financial Markets Consulting, Clipper Logistics, SThree, Smurfit Kappa Group, Equiniti Group, Automatic Data Processing, Halma, Electrocomponents

OIL AND GAS
BP, Royal Dutch Shell, Total

TECHNOLOGY
Apple

TELECOMMUNICATIONS
Vodafone Group, BT Group

UTILITIES
SSE, United Utilities Group

1.

Apple

Price **$174.97**
52 week high-low **$233.47 – $142.00**
Net Yield **1.6%**
Hist/Pros PER **14.4 –15.2**
Equity Market Cap **$825,032m**

Technology
Lucas Maestri, CFO

As the smart phone market matures and iPhone sales slow, the near-term growth potential for Apple now largely centres on its Services business.

Apple has 900 million iPhone users worldwide and a total of 1.4 billion active Apple devices, which includes iPads and Macs. This presents the company with a vast installed base that it can leverage to sell ancillary services to, such as cloud storage and Apple Music. Only around 30% of Apple's installed base currently pay for some kind of service.

CFO Lucas Maestri says this is underappreciated by some investors, who instead focus on the number of devices sold, particularly iPhones. He believes that not only can Apple increase the adoption of existing services, but can also offer new services like a video streaming service, similar to Netflix.

The emergence of the Services business as a more meaningful source of revenue, has prompted Apple to invest more heavily into hiring people with a background in subscription based models, such as pay TV. Maestri talked about how these individuals have experience in attracting new users, with free trials and keeping them, making their services stickier.
The positives for Apple are that Services revenue has continued to grow well, increasing by +19% year-over-year (Q1 2019). Overall margins from Services are also superior to that of Apple's hardware products, as they require minimal additional costs to provide.

The negatives are that despite Services generating $37bn in annual revenue (fiscal year 2018) the business still only accounts for 14% of Apple's total revenue. iPhones remain the biggest revenue contributor by some way, at 63%. This begs the question whether Apple's Services business can offset the declining sales growth of its iPhones.

2.

DS Smith

Price **£3.37**
52 week high-low **£5.42 – £2.86**
Net Yield **4.1%**
Hist/Pros PER **15.2 – 10.0**
Equity Market Cap **£4,746m**

Industrials
Hugo Fisher, Group Communications Director

Until October 2018, DS Smith shareholders would have had nothing but praise for the charming, enthusiastic and at times inspiring CEO, Miles Roberts. The business has grown, both organically and through acquisition, to be one of the largest paper and packaging suppliers across Europe, boasting customers such as Amazon, Nestle, Unilever, P&G and many more.

As an integrated player, DS Smith owns assets that collects used paper and corrugated cardboard from which their paper manufacturing facilities make the recycled paper used in corrugated packaging. They are then able to use their considerable data, knowledge and experience to advise mostly FMCG companies on efficient, innovative and high quality packaging with the aim of reducing cost and driving increased sales.

That story has been helped by tailwinds such as the growth of ecommerce, a shift from plastic to corrugated packaging, falling input costs and ongoing global economic growth.

Against this backdrop Miles Roberts has chosen to increase risk within the businesses through two large acquisitions and a significant increase in leverage above their targeted range. Unfortunately, this has come at the same time as the perfect storm of concerns around a macroeconomic slowdown and the threat of higher input costs squeezing margins.

That cyclical risk against an arguably over-leveraged balance sheet means DS Smith has become something of a binary bet over the short term I believe. Continued cyclical growth should allow the cash generative business to pay down debt, ultimately leaving a larger and more profitable business. However should the macroeconomic tide go out, the concern is that the debt laden DS Smith and Miles Roberts are seen to be swimming without their trunks.

3.

Electrocomponents

Price **£5.76**
52 week high-low **£7.79 – £4.78**
Net Yield **2.3%**
Hist/Pros PER **15.6 – 16.3**
Equity Market Cap **£2,594m**

Industrials
Polly Elvin, Head of IR and David Egan, Group Finance Director

In Spring 2017 we wrote that we thought Electrocomponents had 'a number of opportunities…to continue to brighten their ever optimistic outlook.' The shares traded then at £4.95 on what seemed an expensive 45x historic PE.

We followed that up in Spring 2018 with an article with the shares trading at £6.40 on a less pricey 26x historic PE where we said that 'a further leg in the share price, we think, relies on two factors… continued strength in global growth…and a shift to sustained profitability in the never-before-profit-making Asian region.'

Whilst we try not to repeatedly write on the same companies for this publication, we think this is another interesting moment to review Electrocomponents. With only one of our conditions having been met (2018 was the year when 'synchronised global growth' disappointed) shares have been treading water at best.

What is encouraging though is that, with management having achieved profitability in their Asian operation, they have now set about improving customer stickiness, growing the proportion of counter cyclical revenues and reducing the reliance upon global growth.

They have done this primarily through two small acquisitions, IESA and Monition. IESA is a business that provides value-added services to customers in three distinct areas; sourcing, transaction processing and inventory and stores management. Monition offers condition monitoring and predictive maintenance services. In plain English, these are businesses that allow Electrocomponents to work closer with their customers to improve utilisation and efficiency of the products which they supply.

If Electrocomponents are able to continue to both grow and improve the quality of their earnings then, provided the cycle doesn't turn against them, there is the potential opportunity of a higher multiple on higher earnings by Spring 2020.

Please read the important notice on page 1.

Economic Focus

Navigating Tricky Waters

Brian Tora, Chartered Fellow, CISI
Consultant

In more than half a century spent in the investment world, I cannot think of a time when so much economic uncertainty exists. True, there have been times when the outlook has appeared particularly poor, like in the aftermath of the Yom Kippur war of 1973 or the financial crisis of 2008. But the difference today is that there is no single issue on which one can focus to try to determine what likely outcomes might arise. Rather, there are a variety of areas where sufficient uncertainty exists to make forecasting even more of a challenge than usual.

Perhaps that is why markets have held up relatively well despite a flow of news that could well have seen investors heading for the hills. I am reminded of the situation that existed in 1974. The defeat of the combined Arab forces in their retaliation against the Six Days War that had taken place only a few years previously resulted in a quadrupling in the price of oil. This took place against a background of a full scale banking crisis which saw many so-called secondary banks go to the wall.

And the political dimension was just as complex, with Prime Minister Edward Heath calling a general election on the basis of who ruled Britain, following the three day week caused by the miners' strike which threatened to ruin the economy. He lost his majority in Parliament but, unlike Theresa May two years ago, was forced into opposition following a pact between Labour and the Liberals. Later that year Harold Wilson held a second general election and scraped home with a slim majority to usher in a period of high inflation and economic hardship.

The difference between then and now is that markets went into severe decline, resulting in a 70% fall in the then benchmark index – the FT Industrial Ordinary Share Index – though the subsequent recovery was just as dramatic. In those days, though, the options for managing the risk inherent in a portfolio were severely limited. Investing abroad was difficult and costly, so avoiding domestic equity risk was expensive. Alternative investment options barely existed, unless you were seriously wealthy, that is. Even then they were limited.

Moving simply into cash might have mitigated the effects of the severe bear market that ran from mid 1973 to the first trading day of 1975, but you'd have to be smart to get back in as the market recovered very swiftly and inflation had taken off big time, driving the rise in the cost of living up to over 20% and sparking a collapse in bond prices. Moreover, in these pre currency freedom days, moving money abroad was not an option.

Today managing risk is an ongoing part of any portfolio managers' responsibility. Aside from grading investments according to risk characteristics, the construction of a portfolio can do much to mitigate risk in most likely scenarios. Traditionally this is done through diversification, both by ensuring a single asset class is not over dependent on a single specific investment and by creating a mix of assets that, hopefully, are unlikely to perform in a similar manner if unexpected events disturb the investment equilibrium.

You can even invest in risk. There is an index, popularly known as "The Fear Index", which measures volatility. The more volatile markets become, the greater degree of perceived risk. Officially called the CBoE Volatility Index, it is better known by its ticker – VIX. This index was a central character in a novel by Richard Harris about a hedge fund manager in Switzerland. It is a good read, but those of a nervous investment disposition should probably give it a miss.

Visiting the website for CBoE you will find VIX promoted as a tool for managing risk, creating diversification and even generating income. Presently standing at around 18, for much of the time it has existed its value has hovered around an average in the mid-teens, though in 2008 it spiked at nearly 33, only dropping marginally the following year and staying relatively high until 2013. It ended last year at an average of 16.7.

> **"*You can even invest in risk. There is an index, popularly known as "The Fear Index", which measures volatility.***

But for most of us, managing risk is more about ensuring a proper degree of diversity exists in our portfolios and that we have an appropriate time frame for our investments. Warren Buffett once remarked that time, not timing, is the most important element in equity investing. The shorter the time frame, the greater the degree of risk, so if the money you are investing might be needed in short order, place it in cash or short dated bonds – not equities that require time to deliver to expectations.

As for asset diversification, the choice these days are legion. Property, infrastructure, energy, commodities and other even more esoteric asset classes are available in some measure. Not all will be appropriate for every investor, but it does demonstrate that options exist in ways that were simply not available when I started out in the investment business. So when economic conditions are as difficult to assess as they are at present, you don't need to dash for cash, which can be just as risky over the longer term.

Perhaps the most important lesson to learn, though, is that conditions constantly change. At the end of 1974, it felt as though the world was coming to an end for investors. After Black Monday in October 1987, I recall the head of research in the major investment house where I worked telling us that he couldn't understand what was happening. The financial crisis of 2008 caused many to signal the end of capitalism. We survived all these. We'll get through the current uncertainty too.

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Collectives Commentary

Investing in insurance

By Nick Martin
Fund Manager

Illustration by Emily Nault

The Polar Capital Global Insurance Fund has recently celebrated its 20th anniversary. Here, Fund Manager Nick Martin looks forward to the next 20 years of offering "dull and boring" returns for investors.

In today's technology-driven world the pace of change continues to accelerate, in many cases exponentially. It is rare that a week passes without one of the tech behemoths seemingly turning their attention to a new industry and potentially turning it on its head and threatening incumbents. Insurance has been and will continue to be affected by technological innovation but we believe the impact is more muted than in many other sectors and in the aggregate is a significant opportunity for our sector and companies.

Insurance fundamentally is nothing more than a promise to pay an amount of money when something bad happens. The sorts of thing that trigger claims payments are accidents, human negligence, bad weather, natural catastrophes and terrorist events. As great as the tech giants are there is little they can do to mitigate these triggers. Insurance will be relevant as long as risks remain in the world. We believe it will continue to be the oil that greases the wheels of world trade for many decades to come.

We have always strived to stay ahead of industry developments by being forward-thinking in our analysis, remaining curious and being respectful of, rather than beholden to, quarterly financial reporting. In 2015 we decided that given the accelerating pace of technological change we needed to spend more of our time looking further down the road and trying to see around corners. We therefore began to immerse ourselves in the emerging insurtech ecosystem, the insurance version of fintech. Today we mentor on three startup accelerator programmes, Startupbootcamp, Accenture's Fintech Innovation Lab and the Lloyd's Lab.

Inevitably parts of the insurance market will be vulnerable to innovation but it is likely this will be concentrated on personal lines, auto and home. The Fund has always been underweight personal insurance and tech innovation is just one more factor to add to the many reasons to be cautious in investing in this part of the market. Although the timing is debatable it is hard to see how autonomous cars will not significantly change the landscape for auto insurers with a consequent material drop in industry premiums. We have seen no drop in overall premiums historically as the declining frequency of car accidents (due to, for example, assisted braking and more stringent laws on drink driving) has been largely offset by the increased cost of an average claim (think of all those sensors, car mirrors and bumpers we have today). Autonomous cars will likely cause a significantly large enough decline in loss frequency to shrink the overall pie of personal auto insurance. More risk will also move to the commercial markets and away from the individual driver as more mobility solutions are introduced. In contrast, for commercial lines, where the Fund is focused, we view tech innovation as a significant opportunity. It is often forgotten that insurers are arguably the original data companies. AI and machine learning are additional tools that we believe will widen competitive moats as the best underwriters are already ahead of peers when it comes to data analytics. Technologies such as drones are already being used in claims assessments, for example assessing roof damage after hurricanes.

> **"*Insurance is an industry that is disconnected to many parts of financial markets and can therefore provide some valuable diversification to investor portfolios.*"**

Over time the nature of insurance will evolve as more tech capability is incorporated into the product. Many insurance propositions today are already leveraging the power of sensors (the internet of things) to become preventative risk solutions. A common example is using water sensors in the home that automatically switch off the water in the event of a leak preventing a more costly flood. Sensors also mean that insurance pricing can become more usage based (e.g. pay more when driving your car than when it is parked in the garage). In many areas, especially health, insurance will become more personalised as data from wearables is used to nudge positive behaviours, like exercise, with customers being rewarded accordingly. In some sectors insurance will also likely become one component of broader risk solution. We have already seen this with cyber insurance where insurers are partnering with security firms to offer a more complete customer offering.

As we look back over the past 20 years much has changed but many things remain the same. What remains undiminished is our determination to deliver strong and consistent returns to shareholders. Insurance is an industry that is disconnected to many parts of financial markets and can therefore provide some valuable diversification to investor portfolios. It is an industry where the power of compounding is very evident, something not lost on Warren Buffett many decades ago when Berkshire Hathaway entered the insurance business. Few people get excited about insurance which leads to relatively steady valuations over time and therefore a strong correlation between stock performance and growth in book value and dividends per share. We believe our companies can continue to grow book values at attractive rates for many years to come and over any reasonable time horizon share prices will inevitably follow suit. Sometimes insurance looks dull and boring and short-term returns are unlikely to shoot the lights out but that is fine with us. We remain content on eating our own cooking and compounding returns slowly.

Please read the important notice on page 1.

20 YEARS OLD

The insurance market was not in good shape in the 1990s which led to a seismic change to how the market was funded. In 1993 corporate capital was introduced, reducing firms reliance on Lloyd's Names. Many of the larger agencies floated on the London Stock Exchange resulting in their withdrawal from managing capital on behalf of their Names.

Alec Foster, who became Group Investment Officer of Hiscox in 1976, then launched the Hiscox Insurance Portfolio Fund on 16th October 1998 to facilitate Lloyd's Names investing in the global insurance market. The fund was moved out of Hiscox in 2008 to create HIM Capital and in 2010 that business was acquired by Polar Capital. Nick Martin took over as sole manager of the fund in 2016 having joined Alec in 2001.

Stock in Focus

Tesco: BOGOF to end

John Royden
Head of Research

Illustration by Alice Lariviere

Who knows what BOGOF means? Well, if you worked at Tesco then you'd know it stood for Buy One Get One Free. Shares peaked at £5 back in 2007 and they now trade at £2.29; relative to the 2007 price, you can now buy one and get one free!

I think the BOGOF offer is coming to an end. To understand why, we need some historical context to Tesco's troubles. From 2007 investors took on a growing perception that their Fresh & (not so) Easy expansion in the US was not going so well. Fresh & Easy was eventually sold in 2013. We also saw Philip Clarke (CEO, 2011 to 2014) move to an increasingly antagonistic relationship with suppliers by exerting heavy-handed purchasing tactics, which backfired in many ways. There was also a realisation that Tesco had probably got too much property space and then in 2014, an accounting scandal broke the headlines and undermined confidence yet further.

At the same time that these troubles boiled up, Aldi and Lidl realised that they could run stores with less capital expenditure (capex) and less operating cost. Same sized stores meant that Aldi and Lidl did not need architects and engineers to start from scratch every time they built a new store; they just told the builders to "do it again". Basic shelving carrying fewer SKUs (stock keeping units), fewer checkout staff and cheaper lighting kept costs down as well. Their commercial strategy begun to blossom at around this time and take market share from Tesco, and others.

> ***"The discounters were not buying packets of cereal for less than Tesco was, they were just better at running stores.***

With lower overheads and fit out costs, this meant that the discounters could charge less than Tesco and still make a similar cash profit. The discounters were not buying packets of cereal for less than Tesco was, they were just better at running stores.

In order to compete, Tesco and the other incumbents had to slash margins and become much more capex efficient. This is what Tesco achieved under Dave Lewis who took over in 2014. Tesco's cash profit (EBITDA) margin used to be close to 8% back in 2011. Their capex margin was 6%. Today the EBITDA margin stands at 5.2% with the capex margin at 2.8%.

Tesco also had to contend with wage inflation and input cost inflation. From 2014/2015 the pound was in a bear market which pushed up the prices of imported goods and squeezed margins. But going forward, and barring a hard Brexit, I now think the pound has bottomed. Whilst some economists fancy the pound back at $1.45 by end 2020, our thinking is more that the bear market is over. This will take the pressure off Tesco's margins. UK consumers are now enjoying real wage inflation (wage inflation > CPI inflation), so consumers should in theory start spending more and being less price sensitive.

When Dave Lewis took over, he also sought to rebuild relationships with suppliers and build trust with consumers. Market surveys, like BrandIndex and industry chat suggests that he has done both. This should let Tesco make more from its higher margin, own label goods. Lewis's improving availability (being able to buy what you want to buy) from 80% to 95% must have helped. He has also got the company to realise that when you throw home delivery into on-line shopping, it is not so attractive compared to getting shoppers into your stores. Pricing is now less biased to promoting the on-line shop.

PRICE
£2.29

52 WEEK HIGH-LOW
£2.66—£1.87

NET YIELD
1.6%

HIST/PROS PER
20.4—16.3

EQUITY MARKET CAP (M)
£22,564

So you could argue that Tesco's future looks a bit brighter. They have adjusted the business model to compete with the discounters, the stronger pound should help margins and we expect the UK consumer to spend more. And it looks as if they have finally sorted out the ill-conceived expansion into Eastern Europe (12% operating profit in FY 2018). Their operations in Thailand (15%) look as if they are now being run properly as well. In addition to merger synergies, Booker should gain ground against sub-scale and weaker competition now that the company's talented CEO, Charlie Wilson, has recovered from his cancer operation. Booker is close to 10% of the enlarged Tesco. And another thing; if the Sainsbury/ASDA merger goes through with few forced sales of store sites, then this could make the market less competitive with fewer players.

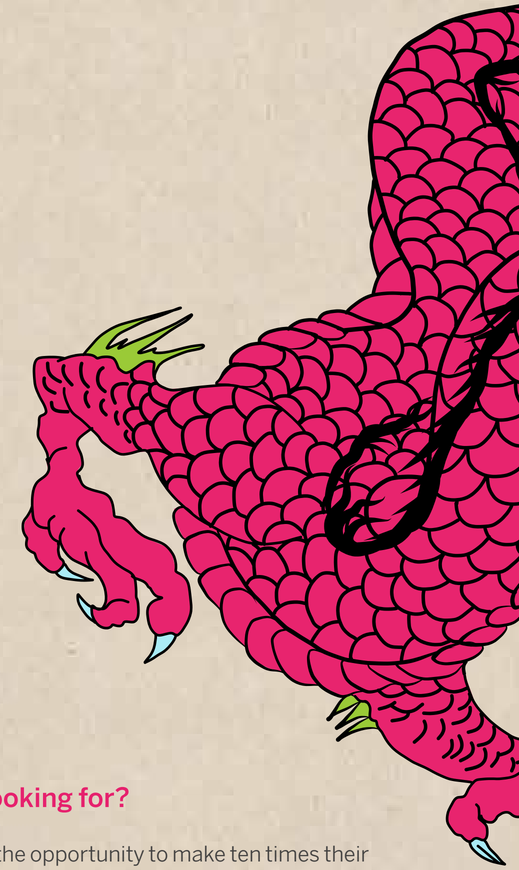
The downside is that a poor Brexit drives slower growth and a weak pound drives more input inflation which Tesco can't pass through to customers. Any Brexit inspired disruption to the supply chain would not help them either. We also hear that the big four grocers are facing equal-pay claims from more than 30,000 shop floor staff, which solicitors Leigh Day say could cost them up to £8 billion if they lose.

When we weigh up the arguments we come to a neutral conclusion but could be persuaded to predict the end of the share BOGOF offer if the negatives retreat.

Please read the important notice on page 1.

Independent view

Enter the dragon's den



By Nadim Zaman
Senior Corporate Layer, Keystone Law

Illustration by Andrew Rees

To accompany our regular feature where entrepreneurs share their start up challenges, we asked Nadim Zaman, senior corporate lawyer at Keystone Law, to share some thoughts on how business owners should approach the important funding stage.

Many business angels are looking to get actively involved in the companies in which they invest. This means that they, typically, prefer local investments and investments that they understand, often on account of their own knowledge in the relevant business sector. The average size of an angel investment is £42,000 per investor and the average percentage stake acquired is 8%. Though on occasion a business angel will invest alone or invest more than £100,000 in a business. There is an even 50:50 split between angel investments in revenue generating businesses and pre-revenue businesses, though recent surveys suggest the average may be moving in favour of revenue generating companies.

What are investors looking for?

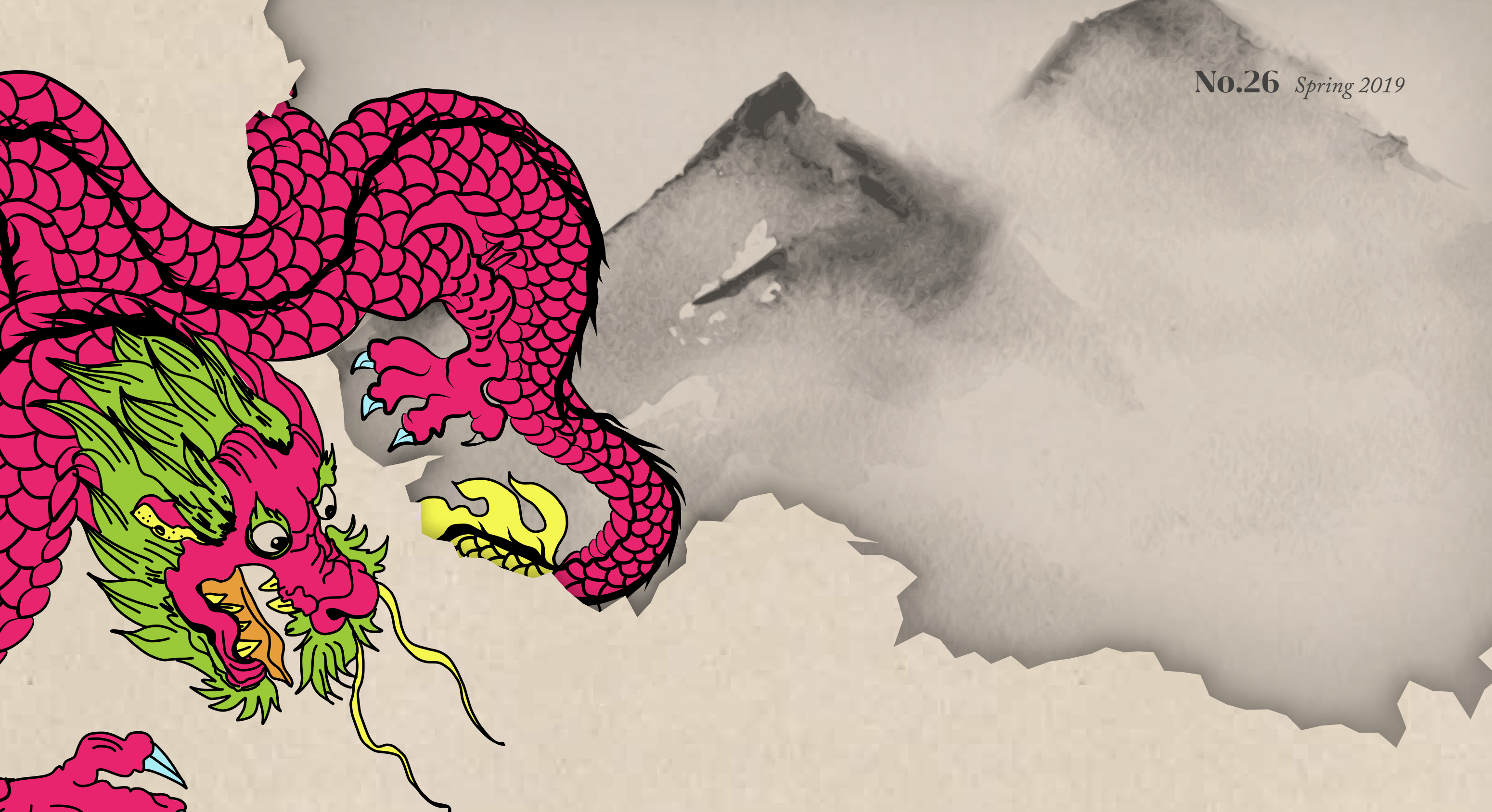
Investors typically look for the opportunity to make ten times their investment in around five years; the less the risk, the lower the return they expect. They tend to look for the right team to back to produce a successful exit and always like a good track record. They favour opportunities with a large addressable market undertaken by a company that knows its target customers, how to sell to them and how to generate revenue from each sale.

They like businesses they can understand and help with to some extent. Many investors will open their "black book" of contacts and often this is every bit as valuable as the cash they provide. They also like tax efficiency!

What are investors looking to avoid?

Failing to describe what your business does: Many entrepreneurs struggle to describe, succinctly, what their business has been set up to do and why it differs from the competition. The old idea of the elevator pitch really holds true for most angels and you need to get to the point in a minute or less. Experienced angels can assess an opportunity quite accurately in the opening minutes of a presentation - because we see so many ideas it's essential to focus on the key points. So work hard on that opening presentation, it's absolutely vital.

Entrepreneurs who over-value their businesses: Early stage entrepreneurs are frequently unrealistic about what their businesses are and what they will be worth over the period of the investment. They see headlines about massive valuations for the likes of Google, Facebook and Twitter but fail to appreciate that these are the exceptions rather than the rule. They also often apply the 'hockey stick' approach to sales forecasting, where their expectations of massive growth determine their overall valuation.



> *Investors typically look for the opportunity to make ten times their investment in around five years.*

Valuation issues aren't reserved for "naive companies"; 90% of the businesses which excite us still fail to receive investment due to valuation issues. It's important to be brutally honest and realistic about valuation – aggressive and ambitious numbers are great news, but only if you have the evidence to support them. As a rule of thumb we are looking to achieve at least a 10 times return on our investments.

Entrepreneurs who don't research what investors need: It is not unusual for businesses to seek investment without doing any research about the potential partners they are pitching to. There is little point in pitching a business idea to an angel who has no interest in the entrepreneur's market segment. Similarly, most venture capital funds are not going to be interested in an investment of a few hundred thousand pounds and most angels are not going to look at multi-million pound funding rounds.

Large founder salaries, large debts: Angels worry if the business owners plan on paying themselves a large salary. What's the objective? Is it just a lifestyle business or is everyone involved going to earn a real return? Equally, a business looking for investment when it already has large debts may be looking to survive rather than excel.

Bad funding models: Growing businesses need their management team working on what makes them a success, not constantly raising finance. So, a business which plans to raise one tranche of money and then more again in six months can quite easily be held back by the sheer effort this process requires. As investors, we want to see the company raise sufficient capital to ensure that they have a realistic chance to reach critical value milestones – at least 12 months cash on prudent financial forecasts is a good figure.

No clear exit strategy: It can be difficult to imagine exiting from a business when you're still on the road to success. Entrepreneurs will often at best have only a rough idea but it's a vital consideration for us – who are the likely buyers? When will our investment mature? What strategy will get us all to the point when we can meet the objective of the exercise, which is to make a profitable investment?

Business owners who can effectively address all these issues early in their relationship with any potential angel investor have a much greater chance of success – not just in securing financial backing, but in realising the ambition which has brought them to us in the first place.

Nadim Zaman is a senior corporate lawyer at Keystone Law, who acts for Angel Investors, including Lord Stanley Fink and a host of other high net worth individuals. This article was co-authored by corporate and commercial lawyer Albert Mennen.

The Potting Shed

No.4

The number of new businesses in the UK continues to grow year on year. In this series we ask entrepreneurs to describe the challenges they faced when embarking on their ventures.

Will Bees Bespoke

Starting a brand from scratch, with no outside investment was always going to be the biggest challenge. Both founders come from much bigger companies, so the immediate hands-on nature across all areas distracted us from key areas of the business that we wanted to focus on.

A major challenge was setting up the business using private funds and using only the cashflow to invest into 'growth' activity, such as marketing and product development. Fortunately we grew rapidly from day one, and the cashflow allowed for some growth activity but it was very much hand to mouth at the start. We wanted to be 100% sure we had a solid business to invest into so we knew the first few years would be run on a very tight budget.

A potential risk to our plans was the 'personalisation' concept which many peers at the time urged us to drop on the basis it might become a possible 'barrier' to customer purchase and hinder our scalability. However we persisted and now have a very quick and well run experience where the customer can have their bag personalised within 60 seconds of purchase - and it's the reaction on the customer's face when shown their bag with their name on it which is priceless and what we feel is at the heart of our brand and customer journey. We have also proved we can offer this service across all our sales channels and at the same time exceed our target sales margins. The trick is now to get this 'brand experience' onto our website which is where we believe our 2019 digital investments will deliver.

> *We have proved we can offer this service across all our channels; the trick is now to get this brand experience onto our website.*

One of the most significant challenges was keeping the back-end of our business efficient and having 24/7 financial visibility as we rapidly grew sales. At the end of 2017 we had nearly doubled our annual sales, yet our profit levels remained the same as previous years. We lost visibility of our finances, particularly margins and operating costs; the phrase 'busy fools' was used often. We soon realised we needed to invest focus, resource and effort into the back-end of the business particularly across finance and systems. Thanks to our new FD, we now have a fully integrated system in place so every part of the business communicates through one system across production, stock, finance, sales, digital and operations, resulting in a much more efficient running of the business, which immediately impacted on higher profits.

As we traded through 2018 we started to believe we have a product and business platform that was ready for growth so we recently decided to raise finance. We are paying a relatively high interest rate for this facility but for the time being we decided to borrow through a traditional loan facility rather than look for any individual or finance house that might want a percentage of our business ownership. We still believe we have a few years of growth which we can achieve with the existing set up and team before going to any second round financing house/individuals.

> ***Initial indicators from new marketing activity and product launched is looking positive.***

Our focus now is on digital marketing, now we know we have a product that sells, has further growth potential, we can scale production and have the right people in the right place to make it happen. This has primarily been achieved by working with a new Digital Director who is rapidly improving our approach and activity. The investment is also being used to launch several new ranges throughout 2019 in particular a new Luxury Bag concept which will considerably elevate our brand perception and pricing point. So far for 2019 we have achieved 80% growth online year to date, so initial indicators from new marketing activity and product launched is looking positive.

How I would do things differently

I'm often asked if we'd do things differently; our principal piece of advice would be to ensure you put one seamless system in place from the start to run your business from. Clear visibility of your finances is key in driving efficiency and profit. It's also worth remembering that your brand is key. Do not compromise your brand DNA for commercial quick gains, stick to your beliefs and treat every mistake as an opportunity to learn and change what you do for the better.

And finally....remember to breathe. It can be very stressful so make sure you enjoy the highs and crack on with the lows. Run a tight ship for the first couple of years and wait until you have a proven concept before embarking on any major growth activity and financing. Expect the journey to be a roller coaster of success and failure, however as you trade through the first couple of years and your concept proves itself, then the wins start to become more frequent. Surf more... it's great for managing stress levels.

WILL BEES BESPOKE

MAKERS OF UNIQUE BRITISH GOODS

We are a retail brand and manufacturer of Bags & Accessories based in Salcombe, Devon. We hand make in England a range of products which can be personalised with any chosen name or initials.

The customer personalisation experience is at the heart of our brand, as well as our Salcombe family roots. Now in our 4th year of trading we continue to grow exponentially, particularly though our digital channels, where last year we achieved over 60% growth and 2019 sees even more ambitious forecasts.

Our sales channels consist of a retail store in Salcombe (South Devon), website, consumer events, wholesale (export and UK) and corporate gifting. The main marketing activity to date has been through prestigious retail events such as RHS Chelsea Flower Show and Burghley Horse Trials where customer acquisition has been the key aim in order to funnel new traffic into our new and improved digital channel.

Wealth planning

Tax Year Planning

By Simon Wong
Chartered Financial Planner

Friday 5th April marks the end of the tax year and those intent on minimising UK tax would do well to forecast the taxable income and capital gains they expect to receive in the period. This knowledge can then be applied to optimising the various tax allowances and reliefs which may be available. Here Simon Wong highlights some of the more common issues he has dealt with during the past 12 months.

Child Benefit and Personal Allowance

The two common strategies to 'adjust' income downwards include pension contributions and gift aid payments. This adjusted net income can mean no High Income Child Benefit charge is applicable nor Personal Allowance is lost.

Incomes over £123,700

Receiving income well above £100,000, i.e. over £123,700, should not be seen negatively by tax payers. While it is true that there is a higher effective rate of tax applicable between £100,000 and £123,700, on a percentage basis, the reduction in the tax free allowance is not as bad as one might imagine.

For example: An investor receiving non-savings income of £50,000 per annum from, for example, a pension and dividends of i) £45,000 p.a., ii) £60,000 pa and iii) £85,000 pa, the tax payable would be:

Dividends	Total Income	Tax payable	Percentage Tax	Notes
£45,000	£95,000	£22,335	23.5%	Personal allowance is untouched, i.e. £11,850
£60,000	£110,000	£29,210	26.6%	Personal allowance is reduced to £6,850
£60,000	£135,000	£40,075	29.7%	Personal allowance is lost, i.e. £0

Income above £150,000

Once total gross income reaches £150,000, Additional Rate of tax is paid on this marginal income. As above, non-savings and savings income is taxed at 45% whilst dividend income is taxed at 38.1%.

Dividends

Dividends benefit from a lower rate of tax than savings and non-savings income, such as wages or pension income.

	Income from Employment, Property, Trusts, Savings, Chargeable Event Gains	Dividends from Shares
Income Tax within the Basic Rate band	20%	7.5%
Income Tax within the Higher Rate band	40%	32.5%
Income Tax within the Additional Rate band	45%	38.1%

Capital Gains Tax

Capital gains tax (CGT) is a tax charged if you sell, give away, exchange or otherwise dispose of an asset and make a profit or 'gain'. It is not the amount of money you receive for the asset but the gain you make that is taxed. Broadly, to calculate a capital gain, you compare the sales proceeds with the original cost of the asset.

However, CGT rules can be complicated and specialist advice may be required from a Tax Adviser. You may have to pay CGT when you give an asset as a gift to someone. CGT rules may vary depending on who you give the gift to and what the asset was. There are special reliefs for gifts of business assets.

There are some assets which are free of CGT. The most common examples are:

- Main residence
- Private motor cars, including vintage cars
- Gifts to UK registered charities
- Some Government securities
- Personal belongings (or 'chattels') where the sale proceeds are less than £6,000
- Prizes and betting winnings
- Cash
- Assets held in ISAs
- Foreign currency held for your own use.

Annual exemption

Each tax year, most UK residents are allowed to make a certain amount of capital gains before they have to pay CGT. This is because they are entitled to an annual tax-free allowance, called the annual exemption or annual exempt amount. For 2018/19 you may make gains of £11,700 tax free. Any unused exemption cannot be carried forward or back.

Rates of CGT

The rate of CGT you pay depends partly on what type of chargeable asset you have disposed of and partly on the tax band into which the gain falls when it is added to your other taxable income.

From April 2017, CGT is charged at the rate of 10% (or 18% on residential property) for gains falling in the Basic Rate band. For gains falling into the Higher Rate band or Additional Rate band, the rate is 20% (or 28% on residential property). For example, if you are normally a Basic Rate taxpayer but when you add the gain to your other taxable income you are pushed into the Higher Rate threshold, then you will pay some CGT at both rates. There is a special rate of 10% (entrepreneurs' relief) that applies on the sale of certain business assets.

Spouses and civil partners could transfer investments to the lower taxpaying spouse, so that when they are eventually sold part of the gain may be charged at 10% and not 20%. This could be combined with an income tax election if one spouse wished to receive and be taxed on most of the income. They would also be taxed on part of the gains, which might be useful in ensuring their annual CGT exemption is not wasted.

The historically low CGT rates may provide an opportunity for investors who have undiversified portfolios to reduce stocks they have proportionately too much of. This could be particularly pertinent in light of the current uncertainty in British politics as a new government could be inclined to increase CGT rates. A balanced, well diversified portfolio will help minimise the risk of loss. For example, if one investment performs poorly over a certain period, other investments may perform better over the same period.

Pension planning

As discussed above, individuals may be able to recover part of the income tax paid through tax-efficient pension planning.

— Pension contributions are paid net of 20% tax, meaning for each £80 paid to the scheme HMRC matches that with a £20 rebate to the pension company, topping the investment up to £100. Higher Rate and Additional Rate taxpayers can claim tax rebates at their marginal rates. However, the maximum annual allowance for pension contributions is £40,000. This is gradually tapered down to a minimum of £10,000 once a person's gross income reaches £210,000.

Share investors

Where dividends are received, either through traditional investments or a family company, there are a number of options available for shareholders:

— Spouses and civil partners can transfer investments between each other free of CGT. The transferee is taxable on dividends declared after the transfer. The transfer will be in the form of a gift.

— Where investments are owned jointly by spouses or civil partners, for income tax purposes they are taxed equally on the income irrespective of their underlying interest in the investments. Often, equal taxation is acceptable, but in cases where one partner wishes to transfer income to another who pays tax at a lower rate there must be a genuine transfer of the underlying capital. It is then necessary to make a formal election on HMRC Form 17 to be taxed on the new unequal basis.

Property investors

Landlords can enjoy similar flexibility with land ownership that investors do with shares.

Spouses and civil partners can hold the land in unequal shares and can therefore share rental profits in unequal proportions to benefit partners with unused lower tax bands. Again, HMRC have to be notified and there should be a Declaration of Trust to confirm this ownership which will be as 'tenants-in-common'.

Individual Savings Accounts (ISAs)

It is always worth mentioning ISAs (including Junior ISAs and Lifetime ISAs) as we approach the end of the tax year. The standard ISA allowance for 2018-19 is £20,000 per adult. The gains on which are tax-free – and income is also exempt from income tax.

Parents and even grandparents can fund Junior ISAs on behalf of younger generations. The annual subscription limit for Junior ISAs for 2018/19 is £4,260. From age 16, a child can also have an adult cash ISA alongside their Junior ISA. They can still only save £4,260 per tax year in the Junior ISA, but they could also save up to £20,000 extra in an adult cash ISA between age 16 and 18.

The Lifetime ISA (LISA) can be used to fund the purchase of a first home or save for later life. Investors must be 18 or over but under 40 to open a Lifetime ISA. LISA holders can put in up to £4,000 each year, until their 50th birthday. The government will add a 25% bonus to your savings, up to a maximum of £1,000 per year.

ISAs provide a good opportunity to create tax-free capital gains by setting aside relatively modest sums. If it is the older generation in a family that has the money, funding these investments out of surplus income or capital has useful inheritance tax benefits.

Inheritance tax

Inheritance tax is paid on death and occasionally on gifts into trust where the value exceeds £325,000. The rate of tax applicable is 40%. There are a number of things that individuals can do on an annual basis when looking to reduce the amount of tax HMRC may be due on death.

— Regularly update values of assets and consider if there is any scope to give away surplus assets based on reasonable life expectancies. This avoids surplus wealth continuing to accumulate unnecessarily and being exposed to the 40% charge on death.

— Divestment can take many forms, but usually capital gifts are made either outright to individuals or into a family trust. The latter is useful if the intention is to build up some wealth in a trust that can be responsive to the needs of younger individuals such as assistance with education of adult children, house purchases or funding their early careers or business start-ups.

— An annual review of wealth and income, particularly for those aged over 60, can indicate whether a range of different types of gift can take place. Normally, a donor has to survive seven years before the gift is treated as being outside of their estate. However, the following are never included once made:

— Annual gifts of £3,000 in total per donor. The annual gift exemption can be carried forward one year if not used, so in appropriate cases there may be a £3,000 allowance from 2017-18 and also an allowance of £3,000 from 2018-19.

— Small gifts of £250 to any number of individuals. This relief is to ensure that on death, modest gifts such as birthday presents do not have to be accounted to HMRC. However, the relief cannot be used in conjunction with another gift – i.e. it is not possible to make a gift of £3,250 to one individual and on death claim both the annual gift exemption and the small gift exemption, if the donor dies within seven years.

— Gifts made out of 'normal income' can avoid double taxation. Suppose a person's net annual income from pensions, work and investments were £48,000 a year but they only needed £36,000 to live on, year in year out, and this could be demonstrated by looking at current account statements each year. If the surplus income of £12,000 were accumulated into savings there would be double taxation because that net income having suffered income tax at rates as high as 45% is then exposed to a further 40% inheritance tax on death. The combined effective tax rate could be as high as 67%. By arranging and documenting regular gifts of this surplus income to family beneficiaries or their executors (of their estate), and proving that it was genuinely not needed each year, the gifts will not count as capital on death. Gifts of surplus income can be made to beneficiaries outright or into a wider family trust.

— In addition to the above annual gift reliefs, a donor may wish to make ad-hoc larger capital gifts. These are called 'potentially exempt transfers', which means they gain full exemption only when the donor survives seven years. They are one of the most common form of gifts, used in addition to the annual gifts referred to above, and when integrated into other forms of tax planning can be quite powerful.

— Relatively modest amounts can therefore be transferred away, which combined with other tax-efficient savings investments, can produce material returns and make a difference for the younger generations.

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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. You are recommended to obtain professional advice from a professional accountant or solicitor before you take any action or refrain from action.

To meet one of our Chartered Financial Planners to discuss tax and estate planning, please contact your investment manager who will be happy to arrange a meeting.

GIVAUDAN

John Royden
Head of Research

PRICE
CHF 2,497

52 WEEK HIGH-LOW
CHF 2,520—CHF 2,098

NET YIELD
2.4%

HIST/PROS PER
34.9—27.9

EQUITY MARKET CAP (M)
CHF 23,185

You probably don't know this but the probability that you have a Givaudan product in most of your domestic consumables is very high.

Givaudan is based in Switzerland and makes fragrances and flavours. They are the essence of rose in your soap, the wafts of lavender as your laundry comes out of the tumble dryer as well as the vanilla in your ice-cream and the magic bag of ingredients that turns pork meat into the finest of salamis.

Whilst Givaudan uses both synthetics as well as naturally derived ingredients, they are able to ride the re-formulation trend for anti-fat, anti-salt and pro-natural flavours.

Additionally, they could benefit from the emerging market urbanisation trend which, mostly in Asia, seems to be driving consumers to buy more processed food and less raw food from market stalls. 50% of Givaudan's sales are currently to emerging markets and if this urbanisation trend continues that percentage could grow over time.

Please read the important notice on page 1.

JM Finn News

Wealth across the generations

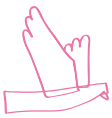
We know that wealth means different things to different people and it appears that there is little commonality in what determines wealth. Typically the different attitudes can be attributed to different age groups; conveniently, the generations are now labelled, giving the media ample opportunity to make sweeping generalisations about different age cohorts in today's world of bite-sized media consumption.

It is generally accepted that there are differing attitudes towards all manner of financial aspects, not just money and wealth, across the ages. These changes are attributed to three key facets: economics, technology and attitudes to parenting.

Economics and technology are obvious areas of difference – if we think of the contrast between our parents' and our children's economic situation and use of technology, it's clear that these could influence our outlook on life. Differences in parenting is most likely a combination of the two.

No.26
Spring 2019

To highlight the different viewpoints we have produced a report in which we have identified some of the wealth challenges that may exist specifically for the different generations. With individual case studies alongside some suggestions at specific areas we hope this report might spark some intra-family conversations. Also included is a look at what women would tell their younger selves when it comes to looking after their finances as well as an overview of the changes in parenting styles across the ages.



> ***It is generally accepted that there are differing attitudes towards all manner of financial aspects.***

Request a copy

To order your copy of the report, please contact your investment manager or email us at marketing@jmfinn.com

ILLUMINA

Michael Bray
Research Analyst

PRICE
$321.18

52 WEEK HIGH-LOW
$372.61—$225.82

NET YIELD
0.0%

HIST/PROS PER
58.0—49.3

EQUITY MARKET CAP (M)
£47,213

Illumina is one of the few companies which is at the cutting edge of improving our quality of life. It develops highly complex machines which sequence or 'read' genomes. Genomes contain our complete set of DNA and include all genes.

By sequencing and deciphering our genomes, it is hoped that we can understand what parts of our DNA make us more susceptible to certain conditions and what treatments will work best to combat them. The end goal being the use of more targeted therapies and better patient outcomes. Many medical breakthroughs have already occurred as a result, particularly in the field of oncology (cancer).

Illumina say just 0.01% of all species have had their DNA sequenced, less than 0.02% of humans have and that 99% of the variants discovered in the genome are not understood. The potential for the business is truly astounding.

But with such exciting prospects comes a hefty valuation, shares trade on 54x last year's earning, meaning that operational execution will need to be flawless. Additionally, genome sequencing is still a nascent industry which is experiencing rapid technology advancement. Whether Illumina continues to lead it, is not a foregone conclusion

Please read the important notice on page 1.

JM Finn News

JM Finn conference

Personal security

Personal security is becoming an increasing worry across the UK, with two thirds of us more concerned about crime today than we were five years ago. The top two issues raised as causing the most concern were cybercrime and terrorism.[1]

With political uncertainty, more personal data online and increasingly sophisticated tactics of today's criminals national, corporate and personal security is at the top of many of our agendas.

Our Spring conference in May will focus on security with a range of speakers discussing the threats and how we can help keep ourselves safe. Leading the panel of speakers is BBC security correspondent, Frank Gardner who will discuss the UK's national security in a post-Brexit world.

Date: Tuesday 21st May

Venue: The Royal College of Physicians, 11 St Andrews Place, Regent's Park, London

Timings: 6.00pm – 7.30pm followed by drinks

To register your attendance at our conference please contact your investment manager or email us at marketing@jmfinn.com. Please feel free to extend this invitation to your friends and family.

[1] The BRE National Security Survey (www.bregroup.com)

Asset Allocation 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 sectorial basis.

The Asset Allocation Committee, which consists of three members of our research team and a number of investment managers, aims to provide a view on the asset allocation that seems most suitable in current macro conditions. The output of the monthly meetings remains a suggested stance and it is important to note, that the views expressed are not those of the firm but rather those of the committee and that the views expressed may not necessarily be those of your individual investment manager.

Here we present a snapshot of the current views.

Positive Neutral Negative

FIXED INCOME		
UK Government Bonds - conventional gilts	Negative	With inflation risk and possible interest rate hikes later this year we see significant duration risk and would remain short dated.
UK Corporate Bonds	Negative	Given the uncertain economic outlook, we see current spreads as offering little value with little downside protection.
UK Government Bonds – index linked gilts	Positive	We have a preference for the protection from inflation afforded by index linked gilts.
EQUITIES		
Materials	Positive	We see Chinese stimulus during 2019 as likely. Commodity markets could be a key beneficiary and rally this year. Dividend attractions also support our positive stance.
Consumer Staples	Positive	We like this sector for its defensive qualities, with some valuations now offering buying opportunities.
Consumer Discretionary	Neutral	Focus on the disrupting companies and high quality brands. Structural growth and rising wages should support the sector. Note Amazon represents 15% of this sector.
Financials – ex Banks, Insurance & Property	Neutral	This includes a broad range of stocks which are generally geared to investment markets, such as exchanges. Valuations now reflect the cautious lower growth outlook.
Banks	Neutral	Prefer globally exposed banks to domestic, look for beneficiaries of rising rates.
UK Property	Neutral	Some discounts in the UK are at historically wide levels however caution on Brexit uncertainty and structural trends impacting High Street.
Life insurance	Neutral	Supportive demographics, particularly internationally, however the sector is vulnerable to set backs to investment markets.
Health care	Positive	Growth and defensive attributes and global demographic tailwind. Distinguish between pharma/healthcare/biotech sub sectors. Key theme for medium term.
Industrials	Neutral	Valuations starting to look more reasonable following the correction but watch out for value traps eg. low PE cyclicals.
Energy	Positive	Demand/supply dynamics should become more favourable as year progresses. Dividends sustainable with oil at current levels and valuations appear attractive.
Information Technology	Neutral	Traditional tech firms - Apple, Microsoft (make up 24%) with Visa, Intel, Cisco - be selective.
Communication Services	Neutral	New restructured sector - Alphabet, Facebook, Netflix, Tencent (make up 30%) included with Verizon, AT&T, Disney and Comcast - be selective.
Utilities	Neutral	Valuations now reflecting political uncertainty in UK. UK interest rates unlikley to move considerably from current level. Upgraded to neutral.
ALTERNATIVES		
Absolute Return	Neutral	The sector may provide downside protection but this can come with high fees and little transparency.

Meet the manager

Paul Tyndall

Senior Investment Manager, London

Lives Rural Essex on a tiny part of the estate once owned by the first governor of the Bank of England

Family Married with 2 children + cat, dog and hamster (until such time that the former eats the latter)

Education Mostly 'on the job' so to speak. Left school at 16 and started as a messenger boy at Spencer Thornton Stockbrokers. Professional exams were completed aged 20 and I became one of the youngest members of the Stock Exchange

Started at JM Finn October 2006; just 7 days after the birth of my daughter (still married, see above)

Next holiday Barbados (to celebrate a birthday ending with a zero)

Charity supported Kidasha, an amazing Nepalese children's charity

Favourite Song Chasing Cars by Snow Patrol

Who you'd most like to meet Warren Buffett

As you know we've recently been awarded the Gold Standard award for our discretionary services. What do you think specifically helps us stand out from our clients' perspective?

I'm often asked that question, particularly by people considering becoming a client of JM Finn and I have always answered in the same manner; we genuinely care about our clients' wealth which makes the job we do much more than just a job for many of us here. The fact that we don't separate the role of relationship management and stock picking means the buck stops with each individual investment manager, as there's no front person to hide behind if and when we get it wrong. I really feel clients value this direct approach and it is becoming more and more of a differentiator as our peers move down a more centralised route.

How did your newest client find their way to you?

Most of my clients come by way of referral from existing clients. Most recently I hosted a lunch at our London offices for a longstanding couple for whom I act. They brought along two friends and a decent rapport was quickly established and they soon became clients. There's no doubt that the personal referral made the difference, ably assisted by the wonderful in-house catering we offer.

What's the key in your view to a successful client / investment management partnership?

I remember discussing this question with one of my clients who is a heart surgeon where the relationship between medical expert and patient is even more important. He mentioned the 3 As: ability, affability and availability and I've followed this mantra since and in my opinion anyone looking to build a professional relationship would be wise to follow suit.

You have long been an investor in some of the leading US tech names. What's your view of corporate America today from the perspective of a long term investor?

America tends to exhibit both the worst and the best of capitalism. As an investor I don't think any economy comes close to the opportunities and sheer optimism of the US. In terms of where to invest, in America, I think exposure to their world beating technology companies could be the defining decision of any long term portfolio.

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The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested.

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