JM FINN

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Prospects

The JM Finn Quarterly Periodical

The great global vote
Half the world's population goes to the polls

Girl-powered
The landscape for female founders

School fee increases
How clever planning could help

No.46

Spring 2024



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Important notice

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Editor
Oliver Tregoning
oliver.tregoning@jmfinn.com

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Welcome

We carried out our bi-annual client survey at the end of last year and I am pleased that we are able to share some of the results in this issue of Prospects.

First, however, I'd like to pass on my personal thanks to everyone who participated in the survey; your feedback is highly valued and the insights we receive from it help us to tailor and refine our wealth proposition, ensuring that the services we offer and how we deliver them remain relevant to you and your specific financial challenges.

It is heartening to see that despite difficult markets in the last few years, the Firm continues to achieve strong client satisfaction scores across the board as it has done in previous iterations of the survey; reflecting we hope the personal service and high level of communication our Investment Managers provide.

We also learned about some of the specific areas of concern that different clients have, ranging from individual challenges, such as saving for school fees, to the more general issues posed by today's higher inflation rates. The lesson to us is that we need to cater more specifically to clients of diverse age groups, as clearly we all have different needs at different stages of our lives.

You did tell us that three core areas of wealth planning were top of your minds: retirement and pension planning, wealth succession planning and long-term care provision. We are in the process of planning a series of webinars to help inform on these topics, so please look out for these invites over the coming months or contact your Investment Manager.

Turning to this edition of Prospects, and considering the school fee challenge many parents and grandparents face, Ryan Gordon from our Wealth Planning team shares advice on the ways in which we can help to plan for and mitigate against the effects of the fee increases which may well come with a new government.

As the prospect of a UK election comes closer, we are in good company – half of the world's population will head to the polls this year. heralding a pivotal time for global democracy. In our editorial this quarter, Charles Bathurst-Norman offers his opinion on the wide-reaching implications for the investment landscape, global political relations and trade.

Much comparison has been made in recent months between the rather more buoyant results seen in US and European stock exchanges and the UK's FTSE 100 index. The latter continues to display a somewhat lacklustre performance overall, mirroring the trend seen in the last two quarters. There are undoubtedly still many excellent UK companies and our research team regularly meet with firms to critically assess their viability for investment. We continue to believe this strong emphasis on ground level due diligence puts us in the best position to discern quality companies for our Investment Managers and you, their clients. As usual, our research team highlight some of the firms they have recently interviewed in the Company Meetings section of Prospects.

Hugo

Hugo Bedford
CEO

Editorial

The great global vote

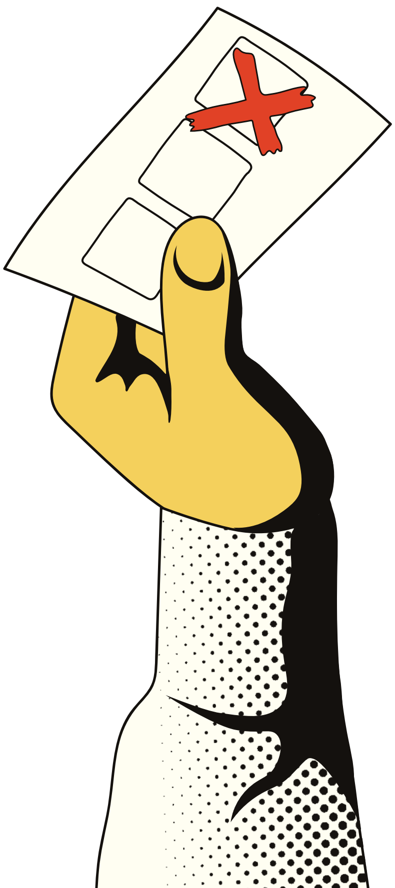
Charles Bathurst-Norman
Investment Director

As half of the world's population heads to the polls this year, Charles Bathurst-Norman analyses the potential ramifications for economies, international trade and the global investment landscape.

The 54th gathering of the World Economic Forum in January this year occurred against its most complicated geopolitical backdrop to date surrounding Ukraine, the Middle East and China. This is coupled with a challenging economic picture driven by rising global debt and the shifting tectonic plates of inflation expectations and central bank interest policy.

The standout quote for me was from the celebrated primatologist Jane Goodhall: "Half the population of the planet is going to be voting. Every vote matters, more this year than perhaps any time in history." Roughly 4 billion people will have the opportunity to vote in 2024, making it the biggest election year ever and what should be a triumphant one for democracy.

> Roughly 4 billion people will have the opportunity to vote in 2024, making it the biggest election year ever and what should be a triumphant one for democracy.



Some elections will have a disproportionate impact beyond their country's borders, and this level of political uncertainty has the potential to create short-term volatility in global markets. Voting will take place in over 70 countries including India, Pakistan, Russia, Iran, South Africa, Egypt, the UK, America and many European countries. Mexico will likely elect its first female president: both leading contenders are women and less populist than the incumbent. By far the most important contest, America's presidential election, has already cast a dark cloud over global politics. America's future direction, and with it the world order American leadership has hitherto underwritten, will be on the line.

Most ballots cast will be in Asia. Bangladesh went to the polls in January, Sheikh Hasina securing a fourth authoritarian term and with it her title as the longest-serving female head of government. The election of the Democratic Progressive Party in Taiwan in January will have lasting ramifications across the Taiwan Strait and potentially increase US-China tensions and the risk of Chinese adventurism. The Indonesian election in February could further boost sentiment in Asia and some emerging markets. Under incumbent Prime Minster Narendra Modi (a close ally of Donald Trump), India is enjoying remarkable economic growth and geopolitical success, so the most populous global election in May looks a foregone conclusion. Modi's emphasis on infrastructure and digitisation has resulted in India being a beneficiary of investor unease with China, with foreign direct investment allocating over US$20bn more to India than China.

The UK election must be held by January 2025, the first election since 2010 without the turbulence of Europe and Scotland. A Labour win is likely, but few outside Britain should notice much change. The prospect of a government spearheaded by Sir Keir Starmer is unlikely to spark the sort of flight to safety which occurred when markets were faced with the prospect of a Corbyn-led Labour administration in 2019. The difference between Labour and the Tories is largely academic on trade, foreign and defence policy and relations with China and America, so the victor will be the party that can turn the heads of the centrist voters. The state of the economy has overtaken health as voters' most important issue. Labour will inevitably focus on the cost-of-living crisis and we can expect the Tories to hammer away at voters' lingering doubts about Labour's fiscal integrity.

Limited cash remains in the Treasury coffers for either party to enact sweeping fiscal and supply side economic policy. Keir Starmer appears keen to avoid racking up spending commitments, having announced only a handful of marginal tax rises on private schools, oil and utility giants and rich foreigners to fund government policy. However, Keir Starmer knows all too well about complacent, soft and indecisive centre-left parties that throw away a winnable election before they acquire the ruthlessness to win, such as Labour losing in 1992.

Evidence suggests that the UK stock market is buoyed by change in government, rather than the incumbent winning. On average, the FTSE All-Share has recorded positive total returns in the post-election year which sees one government expelled and another party ushered into parliament. There are also greater overall average gains when a government changes following an election and the British Pound may in fact strengthen on economic policy change and renewed confidence in the economy.

Nothing, however, will compare to America's election for potential consequences. Despite a presidency that has been defined by high inflation and geopolitical turmoil abroad, President Joe Biden faces minimal opposition to stand again, notwithstanding a health event. A Democrat win would see limited industry impact and a continuation of the current policies, with more focus on renewable and clean energy and more financial regulation.

On the Republican side, Donald Trump looks on track to secure his party's nomination by 19th March. One could argue that Donald Trump's very candidacy undermines American democracy. Trump promises to increase tariffs on imports by 10%, (there is talk of a 50% tariff on goods from China) and rein in excessive government spending on foreign aid, climate subsidies and immigration. His message to voters is that his isolationist stance will save taxpayers money by, among other things, freeing the country from involvement in expensive overseas conflicts such as the war in Ukraine.

A second Trump term would transform America into a loose cannon with isolationist tendencies at a time of geopolitical risk. The number of state-based conflicts, at over 50, is near its highest level since 1946, according to the Peace Research Institute in Oslo. America's allies, especially those that are part of NATO, could expect an assessment of the extent to which they "freeload" off America, for example by running a trade imbalance with it or spending paltry amounts on their armed forces. This will ultimately drive higher domestic government spending for all Western countries, increasing budget expenditure on defence and the onshoring of energy and industrial supply chains.

Votes this year could mean changes to some of the most important economic, environmental and geopolitical issues impacting the world.

Taiwan runs a large trade surplus with America and it relies on an American military presence to deter a possible invasion by China. Trump's likely failure to defend Taiwan would set a precedent for other Asian allies and frustrate regional defence plans. Trump may see the war in Ukraine as a drain on valuable American resources and try to push Ukraine into a peace deal with Russia. Betraying Ukraine would leave both Russia and its leader, Vladimir Putin, in strengthened positions and Trump's boast to end the Russia-Ukraine conflict in 24 hours would be at Ukraine's expense. Israel could expect further support and the dismissal of Palestinian aspirations for their own state.

Trump has reportedly said that America would not come to Europe's aid if the continent came under attack, threatening NATO's Article 5: that an armed attack on one member shall be considered an attack against them all. The consequences could be catastrophic for global stability, democracy and detrimental to the already fragile economies of Europe. Under his administration, unrestrained spending and tax cuts and his refusal to touch Social Security and Medicare would drive inflation expectations up and bond prices down. There would be uncertainty surrounding follow-through on the Inflation Reduction Act, a lack of support for electric vehicles and clean energy and an increase in permit grants for US oil and natural gas drilling.

Pressure on the US Federal Reserve to cut interest rates would resume if Trump is re-elected, with his intention to boost the domestic economy and weaken the dollar. Policymakers have signalled that rates may come down before the end of 2024, but policy will remain restrictive for some time. Some clients will recall the phrase coined by James Carville during the Clinton campaign of 1992: "It's the economy, stupid." This is perhaps the important point to note: the forward path for the economy and the outcome of the Federal Reserve's effort to tame inflation through its rate hiking campaign is more consequential to investors than the eventual constellation of White House, Senate, and House of Representatives political control.

To conclude, votes this year could mean developments on, or changes to, some of the most important economic, environmental and geopolitical issues impacting the world. A new landscape of greater geopolitical risk will mean volatile inflation and bigger budget deficits. In the biggest election year ever, it would be foolish to ignore this risk within client portfolios. I would reiterate the importance of well-diversified multi-asset portfolios and to avoid concentration risk in any one asset class, sector or stock. I firmly believe that holdings in soundly financed companies with genuine pricing power still offer the best opportunity to protect portfolios from heightened geopolitical risk, inflation and the impact of higher rates globally.

Please read the important notice on page 1.

Guest Editorial

Girl-powered: the landscape for female business founders

Chloe Vernon-Shore
Partner at Michelmores LLP

There has been significant progress in levelling the financial landscape for women over the last 50 years. Businesses, particularly in their infancy, rely on debt, and so it would have been near impossible for a woman to have started her own business prior to 1975 when she could not access credit or open a bank account in her own name. Times have changed and a record high of new businesses are now led by women (20%), but women need continued support to ensure their businesses thrive.

As a Partner in Michelmores' Commercial team, I regularly advise innovative and disruptive businesses at all stages of their business lifecycle on their key legal needs. I am also the co-lead of MAINstream, a network of angel investors who deploy capital to early stage and growth businesses. While we see a reasonably even split of male and female founders that are looking to raise capital and bring on board angel investors, MAINstream is (much like the rest of this country) still dominated by white, male, middle-aged investors. The UK Business Angels Association reports that just 14% of all angel investors are women, and the gender composition of MAINstream is broadly in line with this national average. It is important to address this discrepancy because women are likelier to invest in women[1]. Female entrepreneurs identify market gaps and opportunities that their male counterparts may miss, and female investors are more likely to recognise, understand and see the growth potential of those opportunities. In 2018, the Rose Review identified the potential to contribute £250 billion to the UK economy by supporting female entrepreneurs and providing access to resources that female entrepreneurs were being denied. Different people move in different communities and have diverse lived experiences – bringing unique ideas to the table as a result.

[1]https://www.kauffmanfellows.org/journal/women-vcs-invest-in-up-to-2x-more-female-founders

Female entrepreneurs identify market gaps and opportunities that their male counterparts may miss.

The number one challenge for female founders is access to funding. According to the British Business Bank, for every £1 of equity investment that was made in the UK in 2021, all-female founded teams received just 2p, while all male-led teams secured 84p in every £1 (more than female and mixed gender teams combined)[2]. This discrepancy is remarkable and it cannot, unfortunately, be explained away without reference to some form of bias (whether that is unconscious, societal, or otherwise).

Another challenge to face female founders is a shortage of female role models and an absence of a support network that has trodden the path of female entrepreneurship. Female-founded businesses are on the rise now, but they have a huge amount of catching up to do when compared to their male counterparts. When women were granted the right to access credit and open a bank account in 1975, Companies House was already 130 years old![3] There is a shortage of female entrepreneurs demonstrating their success to the next generation of female business owners. That will change over time provided we support the growth and success of the current generation of female founders.

The lack of transparency and accessibility of finance presents another challenge. The language that we use in the financial industry is exclusive and excluding. Financial terms are kept for those in the know (and those in the know have, historically, always been men). Another curveball for female founders is approaching in the form of a government proposal to raise the investment threshold to qualify as a sophisticated investor - it is estimated that this could result in a 70% reduction in female angel investors. As women invest in women, this could ultimately hit investment in female-founded companies. In my top tips below, I touch upon the importance of choosing the right team, and that should include advisors who never make you feel insecure about your knowledge (or lack of it).

Here are my top tips for success:

1. Focus

Founders perform a number of roles, and they rarely have the luxury of unlimited time or resources. You will have an abundance of information being presented to you, and it can be easy to become overwhelmed. The core focus of any entrepreneur must be the establishment and growth of a unique and investible business. The items on your 'to-do list' should always drive towards and further that aim.

2. Simplicity

Entrepreneurs are often creative thinkers with a host of ideas for their nascent business. While this is perfect for problem solving, the market will be less knowledgeable than you. Drill down to your core market. This will prevent you from spreading yourself and your business too thinly and should negate any confusion among potential investors and customers. Simplicity in your presentation of the problem and your solution will help you to deliver a clear pitch and bring in early investors.

[2] https://www.british-business-bank.co.uk/wp-content/uploads/2022/06/small-business-equity-tracker-2022.pdf

[3] The 1844 Act established the UK's first registrar of companies, which is known as Companies House today.

3. Choose the right team

It is important that you surround yourself with a team of professional advisers that understand how your business works and that you want to work with – find advisers that ask questions, listen to you and understand your unique business needs.

4. Present a united front

Prospective investors will always be interested not only in the business but also the people behind it. Make sure any co-founders are aligned and each understand their respective responsibilities and contributions to the business. This will include formalising how shares are allocated using a shareholder agreement and potentially putting in place directors' service agreements.

5. Protect intellectual property

Establishing clear ownership of intellectual property assets will show investors that your business already has value in those assets – and increases the chances of securing investment. Where possible, register patents, trademarks and/or designs. Ensure that proprietary "know how" and other confidential information is appropriately secured and make sure all agreements with third parties are in writing.

6. Choose a distinct brand

Your business name and logo should stand out and be a unique representation of the business and its identity. You will need to grow that reputation and the goodwill associated with the business name and brand. Instruct lawyers or trademark agents to conduct searches to check no one is using your preferred name or brand and then have them register trademarks. You want to avoid any costly re-brand at a later stage.

7. Ensure commercial relationships are covered by contracts

Customer terms and conditions are one of the important documents that you will need to develop at the appropriate time as they will ensure cash flow into your business and help to manage the exposure of your business to risks and liability. Consumer contracts should be drafted carefully to ensure they are fair and reasonable and meet the necessary legal standards. Finally, do not neglect supplier contracts; they secure the timely supply of key services and components for your business.

8. Be adaptable, resilient and persevere

The path to success is rarely straight and can feel steep and challenging. Unforeseen obstacles will inevitably arise and you may need to pivot your proposition at times. Be adaptable to market and societal demands and stay resilient.

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All views expressed are those of the author and are presented for information purposes only. The information provided in this article is of a general nature and is not a substitute for specific advice with regard to your own circumstances. You are recommended to obtain specific advice from a qualified professional before you take any action or refrain from any action.

Company Meetings

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

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

Henry Birt, *Assistant Research Analyst* (Esker)
William McCubbin, *Assistant Research Analyst* (LSEG)
Sir John Royden, *Head of Research* (Prudential)

CONSUMER DISCRETIONARY
Tesla, B&M

CONSUMER STAPLES
Barry Callebaut, Unilever

ENERGY
Shell

FINANCIALS
HSBC, Prudential, LSEG, Aviva

HEALTH CARE
Novo Nordisk, AstraZeneca, Genus

INDUSTRIALS
DiscoverIE, Experian

INFORMATION TECHNOLOGY
Darktrace, Esker

MATERIALS
Anglo American, Rio Tinto

REAL ESTATE
Tritax EuroBox, LondonMetric, SEGRO

1.

Esker

Equity Market Cap (M) **€979**

Information technology
Emmanuel Olivier, COO

Esker is a French document process automation software developer. Its software is primarily used to automate its clients' accounts receivable and accounts payable functions and Esker has been a beneficiary from the ongoing automation of back office processes. Emmanuel explained how the back office digital transformation has lagged other business functions, thus providing a long growth runway. Put simply, Esker aims to streamline the process of paying suppliers and getting paid by customers, all while making sure regulations are complied with. I was surprised to hear that even in accounts payable, the most digitised segment of Esker's target market, c. 40% of processes are still manual with no form of automation. Beyond just the size of the opportunity, Emmanuel flagged additional regulatory tailwinds in France, where legislation is being brought in to reduce VAT fraud by digitising processes – something that seems likely to be replicated elsewhere.

Our focus turned to competitors, which Emmanuel noted are mostly of a similar size to Esker. Esker's point of difference is that it covers all four processes of accounts receivable, accounts payable, order management and purchasing. Given the investment needed to overhaul back-office processes, client loyalty is typically high and churn is very low at 1-2% annually. This provides high barriers to entry for any company wanting to compete with Esker from scratch.

Esker aims to grow its sales c.15% organically and is targeting a 14% operating margin. Near-term margins have been guided lower however, as Esker hasn't been able to pass all costs on to customers. Going forward, Esker will need to maintain its mid-teens growth profile and see margins recover if it is to justify its premium valuation.

2.

London Stock Exchange Group

Equity Market Cap (M) **£48,795**

Financials

Peregrine Rivière, Group Head of Investor Relations.

London Stock Exchange Group (LSEG) is a leading global provider in financial market infrastructure and data, shifting focus in 2007 to become an information services business and over-the-counter (OTC) derivatives clearinghouse. This transformation enabled LSEG to lead trends in finance, including exchange-traded fund (ETF) adoption, OTC clearing, risk management and quantitative funds.

LSEG's competitive moat is sourced from its unparalleled leadership in real-time data and extensive global connectivity to 540 exchanges. Additionally, LSEG holds a distinctive edge with the longest running tick-by-tick trading history, dating back to 1996 – particularly significant in major securities, especially within the fixed-income market.

During the meeting, we explored the establishment of a 10-year strategic partnership with Microsoft, which places LSEG at the forefront of leveraging next-generation data and analytics, coupled with cutting-edge cloud infrastructure solutions. A minimum of £2.3bn over the partnership was jointly agreed to develop new products and services. This collaboration involved a substantial move, as Microsoft acquired a 4% stake in LSEG, securing a board seat. The partnership is set to facilitate the development of tailor-made generative artificial intelligence (AI) models, propelling growth in AI-related products. The partnership should flow through to increase existing user consumption from the widespread reach of Microsoft products, creating new revenue streams.

LSEG's commitment to the financial data business is shown through the acquisition of Refinitiv for US$27 billion and additional bolt-on acquisitions like TORA and MayStreet. These acquisitions distinguish LSEG from cyclical global exchange peers, with 1/3 of revenue now originating from information services. Despite this, LSEG currently trades at a price earnings (P/E) discount, with 1 year forward P/E at 27x, compared to MSCI at 38x, Moody's Corporation at 34x, and S&P Global at 30x.

3.

Prudential

Equity Market Cap (M) **£21,513**

Financials

William Elderkin, Head of Investor Relations

Prudential sells savings products, life and health insurance into Asia. China and Hong Kong account for a combined 30% of its business, Singapore 16%, Malaysia and Indonesia each at about 9% and the rest from other Asian countries.

The company has been a disappointing underperformer this year and is down 32% vs the FTSE100. It's hard to pinpoint one specific point that has driven the share price down: Prudential has not had a catastrophic failure in one country or with one large insurance product and the business is ostensibly ticking on as it should be.

William reminded us of the strong metrics for growth guidance. Prudential aims to grow new business profit at 15% to 20% per annum and see double digit capital generation growth. This implies a capital expenditure and regulatory capital drag of perhaps 5%, which in our view is reasonable.

General anti-Chinese sentiment may play a role in its underperformance, according to William. Although China is only c.30% of the overall group, we were told that "Nobody wants to own anything to do with China right now, especially so in the USA". That's a not unreasonable assumption as both Prudential and AIA, Prudential's closest Hong-Kong-listed competitor, have followed the Hong Kong market down. Both companies have slightly underperformed the local market over the last year but Hong Kong's Hang Seng Index is down 28% vs the FTSE100, so that makes for Prudential having a 4% local underperformance.

Back in February last year Prudential was trading at £14 per share. It's now at £8, which is below the £9 lowest broker/investment bank valuation that we can find. It's also below the median broker/investment bank valuation of £13. Perhaps China's woes will turn out to justify this valuation.

Please read the important notice on page 1.

JM Finn *News*

Exploring our 2023 client survey results

Carrie Lennard
Marketing Manager

The results of our bi-annual client survey are in: thank you to the many of you who responded to tell us your thoughts – your feedback is important to help us continue to refine our services and ensure that we meet your needs.

Continuity of satisfaction

One of the main areas we seek to measure in the survey is our clients' satisfaction with different elements of our service. The results tell us that a large majority of clients are satisfied with their Investment Manager (96%), and an equally high proportion report satisfaction with the quality and responsiveness of the wider team (94%), reflecting the high level of personal service that all our investment professionals work to offer.

High levels of trust

As a business founded on trust, we also use the survey to test the extent to which our clients have confidence in our services. We are pleased that 95% say they have trust and confidence in their Investment Manager at JM Finn, mirroring the figure for the firm overall. 97% indicated that they are satisfied they have a personal relationship with someone they trust at JM Finn.

Clear and timely communication

JM Finn's scores are also high for the various aspects of communication tested in the survey: 94% are satisfied with communications from JM Finn. 96% indicated that their investments are easy to understand, while 94% agree that the firm communicates and engages with them in a timely manner.

Wealth Planning service

Our Wealth Planning service is very highly rated among clients who have used it – 98% are satisfied with the team's retirement planning advice, 97% wealth structuring, 96% with advice on passing wealth on to loved ones and 94% with advice on funding long-term care.

The survey also highlighted that there is low awareness of our Wealth Planning service, but that there is potentially a high demand for them to assist in different areas of financial planning: 70% indicated that they may use our advice on funding long-term care, 3 in 5 our estate planning services and over half may consider using wealth structuring services. The Wealth Planning team will run a series of webinars in the coming months to share their knowledge on the many areas where they can offer advice.

Strong propensity to recommend

The combination of good communication with high levels of trust and satisfaction mean that our clients are happy to recommend us to their friends and family: 3 in 5 have done so during their tenure as a client, including 1 in 4 within the past 12 months, which we see as the ultimate testament to our enduring high levels of client service.

SERVICE SATISFACTION

How satisfied are clients with JM Finn's service?

96%

are satisfied with their JM Finn Investment Manager.

94%

satisfaction with the quality/ responsiveness of the wider team at JM Finn.

TRUST AND CONFIDENCE

Do our clients trust us?

95%

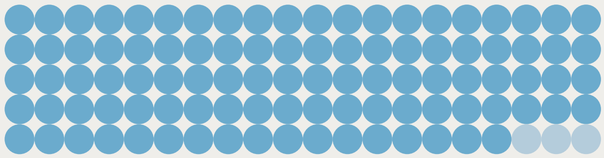
say they have trust and confidence in their Investment Manager at JM Finn.

COMMUNICATIONS

High standards in client communication

96%

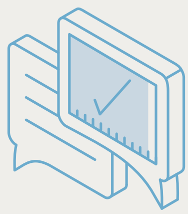
Satisfaction rate with Investment Manager communications.



97%

of clients are satisfied with the timeliness and accuracy of administration.

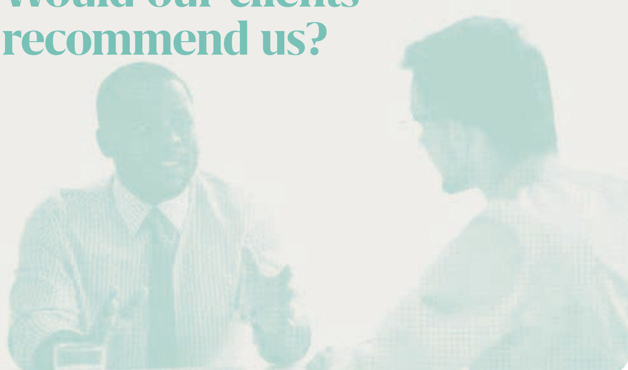
94%



are satisfied with communications from JM Finn.

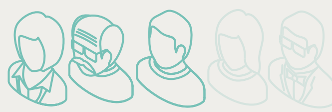
SERVICE SATISFACTION

Would our clients recommend us?



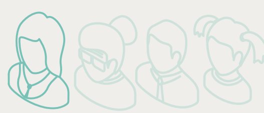
Nearly

3 in 5



clients have recommended us to family or friends, including nearly

1 in 4



in the last 12 months.

Wealth Planning in focus

Paving the path to success: school fee planning

Ryan Gordon
Paraplanner

With the next general election around the corner and the Labour party currently leading the polls, there is a strong likelihood we will witness a change of government this year. Labour have reiterated their 2019 manifesto pledge to remove the VAT exemption on private school fees, which would increase the cost of school fees by 20%.

Regardless of the colour of government, school fees already come at a significant cost. The Institute for Fiscal Studies (IFS) found the average private school fees across the UK in 2022-23 were £15,200 per annum (net of bursaries and scholarships), in today's prices, and higher still for boarders.

The report refers to a 20% increase in the cost of school fees between 2010 and 2022-23, and a 55% increase since 2003. Additionally, there is a plethora of associated costs: school trips, uniforms, meals, and after school clubs, to name but a few. Most parents pay the school fees from taxed income so the real cost is even higher. To pay school fees of £15,000 you would need gross earnings of £25,000 – assuming 40% tax is deducted. It is therefore important for families to start school fee planning as early as possible. This planning involves estimating the total amount of fees you will need to pay, saving and investing wisely, and finding ways to reduce the tax burden.

> During times when markets are particularly volatile, it may be wise to retain a few years' worth of school fees.

Early planning and maximising your investment potential

The first step is to estimate how much you will need to pay over the course of your children's education. It is important to consider how many children you are likely to be paying school fees for, when the fees will begin and end, your income and assets, possible inheritances, as well as an estimate of the level of fees and future increases. Consider too whether you will be utilising an existing lump sum, and/or building up a pot through regular investment. Cashflow modelling can also help here.

The second step is to start saving and investing as early as possible. The sooner you start, the more time you have to benefit from 'compounded growth' (i.e., where income is generated both on an original investment and on returns previously generated). The best option for you will depend on your risk appetite, time horizon, and tax position.
The third step is to utilise tax reliefs, allowances, and exemptions to reduce your tax burden. Where possible, use tax-efficient structures such as Individual Savings Accounts (ISAs), which allow every individual to commit up to £20,000 each year tax free. Where appropriate, investment bonds might also be a sensible, tax-deferred option.

While there are more attractive interest rates available for cash deposits in current times, long-term, investment into the stock market has historically been proven to offer the best chance of long-term growth. Nevertheless, it is important to maintain a healthy cash balance for emergencies. During times when markets are particularly volatile, it may be wise to retain a few years' worth of school fees, to mitigate the potential pitfall of having to realise investments standing at a loss.

Tax-efficient strategies for grandparents

For some, there is also the possibility of financial assistance coming from the bank of Grandma and Grandad. School fee assistance can be a rewarding way for grandparents to provide financial support, while simultaneously reducing their own Inheritance Tax (IHT) liability. There are several strategies they can adopt here:

— Grandparents, like anyone, can gift capital lump sums away. This is a simple and effective way of potentially reducing the size of their estate. Usually, larger direct gifts will be exempt from IHT, provided the individual making the gift survives for seven years after doing so. Each individual is also entitled to give away up to £3,000 each year immediately free of IHT.

— To the extent that an individual has surplus income after tax to support this, and providing they maintain a pattern of regular gifting, gifts out of surplus income fall outside of scope for IHT calculation purposes. Gifting out of excess income ensures that capital does not continue to accrue, thus capping the potential growth of the estate.

— Trust planning can help grandparents with school fee planning, in tandem with IHT planning. This allows them to retain an element of control over the asset, including how it is invested, as well as its distribution.

— Commonly, a 'bare trust' (a trust created to give assets to a named beneficiary where the beneficiary cannot be changed) might be utilised, as these are among the most straightforward to set up and administer. The funds can be used for the maintenance and education of beneficiaries throughout the trust's existence. The tax treatment of this type of trust is favourable, as it allows the beneficiaries' own tax allowances to be used. It is not advisable for a parent to set up such an arrangement, as parental settlement rules mean that if income generated from the trust exceeds £100 per annum, all income would be taxed as though belonging to the parent. At age 18 (16 in Scotland), the beneficiary(ies), become legally entitled to their share of any residual funds.

— For added flexibility and additional control, discretionary trusts may be a consideration. The tax treatment of this form of trust is more complex: there is additional ongoing administration, potential tax and associated costs. Under the right circumstances, these are however, a useful planning tool.

— An option for parents and grandparents to consider to help fund university fees is Junior ISAs (JISAs). £9,000 can be subscribed each year, and the fund grows free of any tax. A potential downside is that the funds belong to the child and they can access the funds at age 18 to spend as they wish.

Financial protection

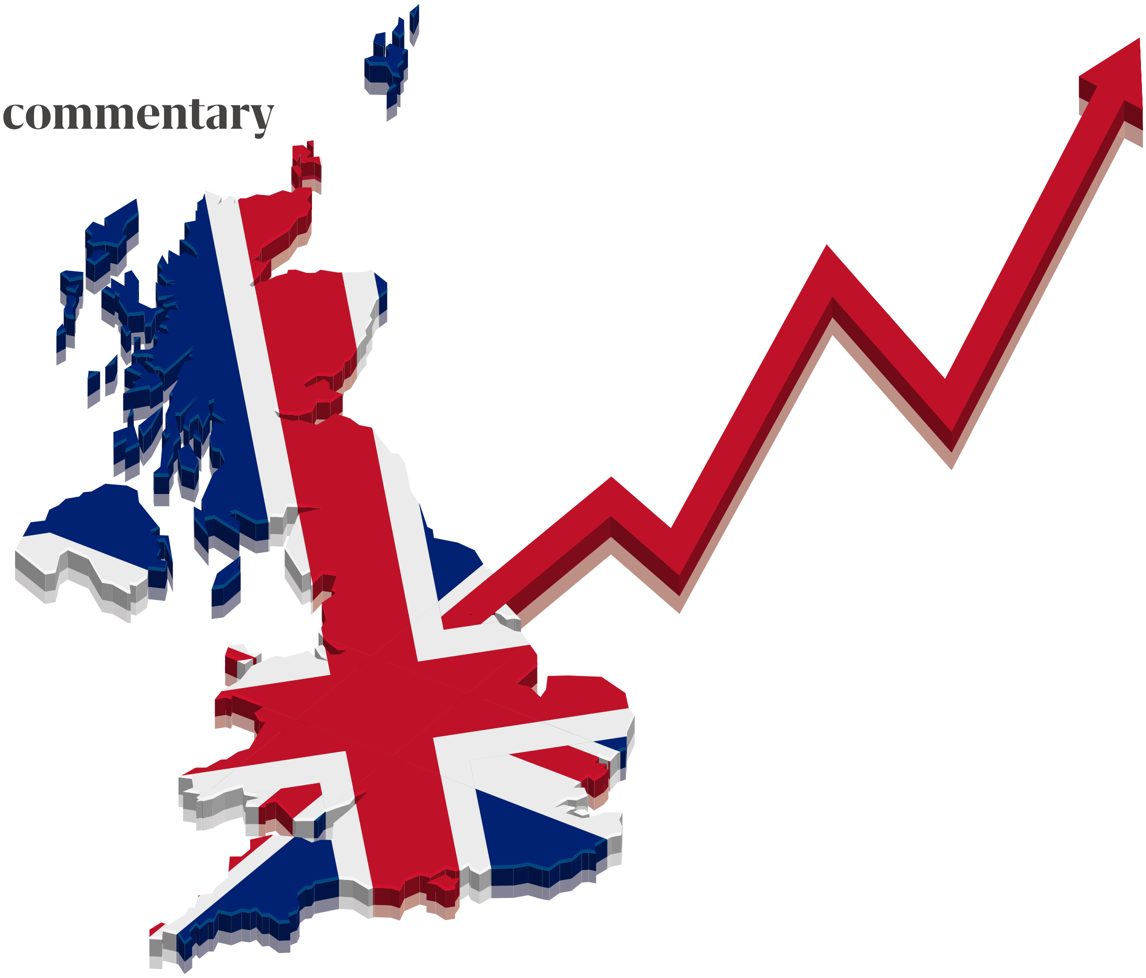
This area of planning is often overlooked but is particularly important to consider if you will have to fund school fees out of earnings on a 'pay as you go' basis. Products such as life assurance, critical illness cover, and income protection can all serve to protect the means through which school fees are met, should the worst happen. Many workplaces offer such benefits to a degree, and it is wise to consider whether that level of cover is sufficient, noting too, that should you move employment, that cover provided by the employer would cease. The JM Finn Wealth Planning team can help you ascertain which insurance products are most appropriate for your circumstances, as well as a suitable level of cover.

A final step is to check if your child or grandchild qualifies for any financial assistance such as bursaries or scholarships. Schools will be able to provide you with information on eligibility.

The above is not exhaustive, and there is no one-size-fits-all solution to such planning. If this is an area for you or your family to consider and you would like guidance or advice, please speak to your Investment Manager to arrange a meeting with one of our Wealth Planners.

The information provided in this article is of a general nature and is not a substitute for specific advice with regard to your own circumstances. You are recommended to obtain specific advice from a qualified professional before you take any action or refrain from action.

Collectives commentary



Rule Britannia?

Guy Anderson
Portfolio Manager at The Mercantile Investment Trust plc.

Buoyant consumer confidence, falling inflation and attractive opportunities in mid and small-cap companies all point to a far more resilient UK economy than common consensus would indicate, writes Guy Anderson, Portfolio Manager at The Mercantile Investment Trust.

The prevailing narrative surrounding the UK and its economic performance has been almost uniformly negative, and this, alongside various external factors, has been weighing on investor sentiment and pushing UK valuations to very low levels.

Forecasters entered 2023 expecting a recession, but those expectations were gradually revised up over the year as it became clear that the domestic economy was proving to be more resilient than had been presumed. The improvement in the economic outlook is beginning to be reflected in corporate outlooks – the December composite Purchasing Manager's Index, which measures changing conditions in the goods manufacturing industry sector, registered a seven-month high at 52.5, with the service sector particularly strong at 53.8 – both indicating economic growth.

Looking forward, there are several reasons to be optimistic. UK inflation, which for a period appeared to have become 'stickier' (i.e. where prices do not quickly adjust to fluctuations in supply and demand) in comparison to other advanced economies, has reverted down to the G20 average. Meanwhile, consumer confidence has been recovering strongly and real wages have shown positive year-on-year growth since May 2023, after 13 consecutive months of negative growth. A sharp decline in gas prices and expectations for this to feed through to lower household energy costs, as well as the expected tailwind from the increase in living wages, pensions and benefits from April 2024, bode well for the domestic consumer.

Our view is that now is an opportune moment to be investing, and in the mid and small-cap part of the market we are finding many attractive opportunities that we expect to deliver over the long term. This part of the market has suffered a drastic valuation de-rating (i.e., a downward adjustment in a company's valuation multiples) in recent years – if we look back at the period between December 2019 and December 2023, the forward price/earnings (P/E) ratio on the FTSE 250 excluding investment trusts has declined from 15x to 11x. For context, the forward P/E on the S&P 500 has increased from 18x to 20x over the same period. Moreover, the FTSE 250 now trades on the same rating as the FTSE 100, in contrast to the significant premium observed historically, which has broadened the investment universe for Mercantile.

Of course, we cannot say for certain how far this elastic band can stretch, but the de-rating cannot continue ad infinitum – and could ultimately reverse. Smaller companies tend to have higher domestic exposure than larger companies, and we expect that as we enter the initial stages of a possible monetary policy easing cycle, the prevailing narrative will begin to change positively, which would favour these companies. Many corporate buyers seem to agree with our view, given the recent number of acquisitions of UK companies, and the sheer volume of share buybacks currently being undertaken across the UK market.

> "Consumer confidence has been recovering strongly and real wages have shown positive year-on-year growth since May 2023.

We are currently particularly excited about some of the consumer-facing sectors, as sentiment remains negative and valuations are low, while prospects may in fact be improving – with the UK consumer in aggregate experiencing sustained real wage growth again and consumer confidence picking up. Within this area we absolutely prefer those companies that have more levers under their own control and can benefit from market share gains. We also continue to see attractive opportunities in the technology sector, given strong corporate appetite to invest in IT and its increasing importance to economic activity.

In the near term, we expect that financial markets will continue to be heavily influenced by the inter-connected forces of inflation, monetary policy, and the impact of these upon economic growth expectations. As we look ahead, while the risks cannot be ignored, particularly from inflation (which may be influenced by supply chain disruptions and energy price fluctuations associated with escalating conflict in the Middle East) and tighter financial conditions, this is more than reflected and priced into many UK stocks. We remain optimistic given the improving domestic economic outlook and the opportunity to invest in high-quality, resilient companies that can invest capital at high returns to drive long-term earnings growth. As an indication of our positive view, the Trust is currently deploying gearing of c.13% well above the historical average.

The Mercantile Investment Trust plc. Registered office: 60 Victoria Embankment, London EC4Y 0JP. Company registration number: 20537

Please read the important notice on page 1.

Stock in focus

Deere & Company

Jack Summers
Research Assistant

'Nothing runs like a Deere' so the saying goes, an almost unavoidable phrase in the world of agriculture.

Even those less involved with the sector are often familiar with the iconic green and yellow John Deere livery – and for good reason. Deere & Company ('Deere'), selling under the John Deere brand is the world's leading manufacturer of agricultural and turf equipment alongside its offerings in construction and forestry, with a weighted average market share of 25%.

In 1837, blacksmith John Deere designed and made the first self-scouring steel plough out of a broken saw blade. The revolutionary design proved hugely popular and so Deere & Company was incorporated in 1866 as an implement manufacturer, before entering the tractor market with the 'Waterloo Boy' in 1918. Fast forward 100 or so years, the Deere tractor offering comprises numerous models, from ride-on lawn mowers through to the range-topping articulated 9RX 640 tractor, which boasts a 690 horsepower rating.

The business is split into three main segments: Production and Precision Agriculture produces large and mid-sized scale tractors, cultivators, planters, harvesters, and crop care equipment and has the highest margin. Small Agriculture and Turf comprises products associated with livestock farming, high value crops and turf and utility users. Its third division, Construction and Forestry, produces equipment for all aspects of earthmoving, forestry and roadbuilding.

The lesser-known part of Deere is its Financial Services segment, which provides financing to both buyers of its machinery and Deere's dealer network, which it uses to maintain inventory levels. While this does expose the business to added credit default and interest rate risk, it makes for a much more streamlined customer purchasing experience and dealer network.

There is no escaping that Deere is a cyclical business given its exposure to the equipment replacement cycle, and that makes for inconsistent growth. Despite this it has achieved a 10-year revenue growth rate of +5.3%. The cycle for agricultural and forestry machinery is dictated by the prices of soft commodities (i.e. commodities that are grown rather than mined), while the construction machinery cycle is determined by construction levels. Poor soft commodity prices or construction levels typically lead to equipment owners delaying the replacement of machines in their fleet and vice versa.

Deere is the world's leading manufacturer of agricultural and turf equipment alongside its offerings in construction and forestry.

Equity market capitalisation (m)
US$102,394

52 week high-low
US$450 - US$346

Net dividend yield
1.60%

Price/earnings ratio
11

Evidence of cyclicality is clear in Deere's revenue growth. In the years 2021-23, revenue grew at +27.1%, +20.6% and +15.8% respectively. This correlates with strong corn and soybean prices in the period and represented the start of a new cycle after six years of historic underinvestment. Now, with grain prices cooling into 2024 and construction output hampered by the effects of higher interest rates, consensus expects -14.3% and 0% growth in 2024 and 2025, which we would associate with mid-cycle performance.

Global food production is at an interesting inflection point: it is estimated that by 2050, global food demand will have risen by 59%. While bringing more land into production is the most obvious answer, it often comes at the cost of rainforests and also impacts water supply. The alternative is to address the global 'yield gap' (the difference between actual farm output and the yield potential) by unlocking the true yield potential of currently cultivated land through more efficient farming. At the same time, the agriculture industry is coming under increasing pressure to reduce its emissions and reliance on pesticides and inorganic fertilisers, in order to be less impactful on the planet.

These drivers, coupled with skilled labour shortages have led Deere to add increasingly sophisticated technology to its machinery offering. The cloud-based JD CommandCenter coupled with GreenStar GPS steering creates fleet integration from cultivation through to harvest, enabling yield mapping to dictate variable rate seed, fertiliser, and pesticide applications. These capabilities create a competitive advantage for Deere over rivals in two ways; a) incentivising owners of multi-brand fleets to consolidate into John Deere only fleets across machine types, and b) making it very difficult for owners of John Deere only fleets to justify trying competitor alternatives for particular machine types.

In 2017 Deere acquired AI-based Blue River Technology, a developer of 'See and Spray' technology for US$305m. See and Spray technology uses cameras to continuously photograph the crop as the sprayer moves across a field. The photographs are computer analysed to identify weeds, diseases, and pests. Once identified, an instruction is sent to turn on the respective spray nozzle as it passes over the target area and then to turn it off once the sprayer has passed the target area. In field trials the technology has proven to reduce herbicide use by 77%, and while still in its infancy, there is a highly compelling use case for farmers seeking to reduce pesticide usage from a cost, resistance and pollution perspective.

Please read the important notice on page 1.

Bond Focus

Inflation-linked bonds

Sir John Royden
Head of Research

Sir John Royden explains why, perhaps counterintuitively amid current high inflation rates, now may be an opportune time to invest in inflation-linked bonds.

Inflation-linked bonds, often called 'linkers' are so called because their capital and coupon payments are linked to the Retail Price Index or (RPI), which is a measure of consumer inflation. This linkage is calculated by dividing the RPI at the date of the creation of the linker into the RPI, typically three months before the linker expires on its 'maturity' date.

A first read of that paragraph might have you thinking that if inflation goes up then so should the price of linkers. History will show you that this is not always the case. And that's because getting linkers right as an investor is all about understanding what inflation expectations are baked into the price. The crux of why linkers are currently potentially attractive is because their prices are based on what expectations about inflation are today, rather than the most recent inflation rate.

For example, if a linker is predicting inflation to be 5% for the next ten years, then that linker will do well or badly relative to conventional gilts (government bonds), depending upon whether inflation is above or below that 5% that's baked into its price. That assumes that all other factors like interest rates stay unchanged. So for example, if inflation turns out to be 7%, the linker will perform well. But if inflation turns out to be 4% (albeit still a high rate of inflation) then the linker will disappoint.

Over the past two years linkers have underperformed conventional gilts by 13%.That's a consequence both of interest rates going up but also of inflation expectations falling. The five-year / five-year inflation swap ("5Y5Y") allows professionals to trade inflation expectations. The name means inflation for five years in five years' time. It's a good measure of long-term inflationary expectations which is what drives the prices of linkers.

A bond's 'duration' is its average life measured in years. As an asset class, linkers have a longer duration than conventional gilts and this makes them more sensitive to interest rates. When interest rates go up, bonds fall and bonds with longer durations fall most. The reverse happens when rates fall.

"As an asset class, linkers have a longer duration than conventional gilts and this makes them more sensitive to interest rates.

That 5Y5Y swap is now trading at 3.3% which is lower than where it was a few months ago. That said, please bear in mind that in 2030, the calculation methodology for RPI will change from arithmetic to geometric. The effect of this is that RPI is expected to be 0.7% lower than it would have been otherwise. After 2030, RPI and CPI should have roughly the same long-term rates of inflation, which is not the case right now.

Even with the recent underperformance of gilts in mind, I am drawn to the view that the time has come to start looking at linkers again because the lower levels of expected inflation start to make them look attractive. If inflation starts being sticky at current levels, then this could well prompt a rise in inflation expectations and that would drive outperformance in linkers on a relative basis.

We are at a point in the economic cycle where linkers should once again be considered. We see comments from leading economists along the lines that they are worried that the Fed may turn too 'dovish' (i.e. favouring lower rates) too soon, allowing inflation to stop falling. Inflationary geopolitical risks abound. Forcing shipping to dodge the Red Sea is inflationary. Unexpectedly strong wage inflation and low rates of unemployment are also inflationary, as are the excess savings built up during Covid. There are good reasons to expect inflation to become more range bound in the future.

Please read the important notice on page 1.

Independent View

Thomas Ward
Private Client Director at Hampden Agencies

30 years of change at Lloyd's

Thomas Ward, Private Client Director at Hampden Agencies explains why he believes the changes Lloyd's has undergone have resulted in the best investing conditions for a generation.

Lloyd's has overcome many challenges since the first deals were struck in Edward Lloyd's coffee shop in the late 1600s, and the last, most infamous of these was in the late 1980s.

Fast forward 30 years and following a complete reconstruction of the market, 2024 sees us entering the sixth year of continual rate rises and the current market figures look extremely promising, with 2021 at 12%, 2022 at 18% and 2023 currently forecast for a 23% return on capital[1]. In the three decades since Lloyd's worst years, the market has undergone a major transformation, leaving it in a much stronger position today than at any other point in history.

To understand how these changes have advanced the world's leading insurance and reinsurance market to put us in the position we are now, we can't overlook the past, so let's start some 50 years ago. During the 1970s and into the 1980s, liability claims arising from asbestos and corporate environmental claims in the litigious United States were followed by the unrelated but parallel insured tragedies of Piper Alpha and Exxon Valdez. They put huge pressure on what was then a less regulated and still less well-run Lloyd's market.

This series of liability and catastrophe claims unearthed what was a critical vulnerability of the Lloyd's market. Many syndicates who underwrote the risks brought to Lloyd's had participated in so-called 'excess of loss' reinsurance, which covered losses of other Lloyd's syndicates over a certain level. This type of reinsurance had worked well for decades and the London Market Excess of Loss (LMX) product was popular for syndicates and members because it was initially profitable for most. The profits, however, hid the true issue, in that no one knew just how interconnected the LMX had become until it was too late. At that time, private investors at Lloyd's (known as Lloyd's Names), who provided capital to the syndicates, had unlimited liability and the combination of structural and operational factors reached unsustainable levels for many of these individuals.

Lloyd's had no choice but to change. So, throughout the 1990s, Lloyd's looked to rebuild itself. New capital rules were introduced, along with more oversight and professionalisation.

Under the leadership of a new CEO, David Rowland, Lloyd's recognised the need to reform and the new Lloyd's Market Board (LMB) replaced the old Committee of Lloyd's. A new Lloyd's Regulatory Board (LRB) was also set up to better regulate the market.

In 1996 Lloyd's published its 'Reconstruction and Renewal' plan, which introduced a wide range of market reforms. As part of these changes, Lloyd's no longer permitted new members to have unlimited liability, but insisted that new members join through limited liability companies. This was later widened to include partnerships (LLVs). When structured as a partnership or shareholding of a limited liability company, the risk of unlimited liability that Names had dealt with for generations was removed, ensuring that only those assets used to underwrite at Lloyd's could ever be at risk. This also provided investors with financial certainty.

[1](figures from Hampden Underwriting Research (HUR) team based on Lloyd's 2023 Q3 syndicate forecasts and spot estimates released to HUR by syndicates in Q4 2023).

A key pillar of this plan removed historical liabilities, making the market more attractive for new members and corporate capital. The plan also helped clarify to all stakeholders that Lloyd's was finally drawing a clear line under its past mistakes. The result of a decade of work in improving the market came to the fore in 2002, when authority was given to Lloyd's for the creation of a Franchise Board and Franchise Performance Directorate. Starting on 1st Jan 2003 it brought about a tougher, more coherently managed market, wielding executive control of syndicates' business plans, setting risk guidelines and targeting the poorer-performing classes of business and syndicates.

A good illustration of the impact of these changes was during the hurricane years of 2004 and 2005 when the US was hit by a series of major hurricanes, culminating in Hurricane Katrina. Katrina remains the most expensive single storm for the insurance industry of all time, at US$150bn. In comparison, the 30-year average annual loss for all types of natural disasters is US$56bn.Even so, Lloyd's remained profitable over this period, indeed investors through Hampden on average made 13.9% on their capital deployed (5.6% on capacity underwritten). This was due to a hard market, with high insurance rates ensuring a very profitable period that lasted until 2017. Higher than expected claims in 2017 and 2018 and Covid losses affecting 2019 and 2020 have pushed insurance rates back up to the highest seen for a generation.

With a healthy change to the market's operations since 1996 and AA ratings from S&P and Fitch, Lloyd's is looking in good shape. One of the reasons syndicates like private capital to support their underwriting is that it is 'sticky' – in other words, loyal over a length of time, and the market improvements made in the past two decades have helped enforce that thought. Over the same period, investors via Hampden have recorded an average annual internal rate of return[2] of 17% per year.

> One of the reasons syndicates like private capital to support their underwriting is that it is 'sticky'.

Investors can use existing assets such as equities and bonds as their funds lodged at Lloyds (known as FAL), and can continue to receive the income from these assets while also generating insurance returns. It is this double use of assets and the potential for double profits from them, that really enhance the appeal of Lloyd's.

For UK taxpayers there are additional potential inheritance tax benefits and business reliefs, which can fit into, and work well with, a family financial structure and family succession planning.

www.hampdenagencies.co.uk

Hampden Agencies is authorised by The Financial Conduct Authority and regulated by The Financial Conduct Authority and Corporation of Lloyd's.

Please read the important notice on page 1.

[2](IRR is based on the subset of clients continually investing via Hampden between 2003-2022)

Understanding Finance

Understanding the insurance market's Solvency II regulation

Sir John Royden
Head of Research

Solvency II is an EU directive that has survived Brexit in the UK. The legislation is the regulator's attempt to make sure that insurance companies have enough capital to cope with underlying risks to their businesses. It is an attempt to ensure, for example, that you get paid from an insurance policy if your house burns down.

The aim of Solvency II at implementation was to harmonise insurance regulations across the EU by replacing 14 existing directives with a single set of rules to create a level playing field for insurers in different member states. It requires insurers to hold capital proportionate to the risks they underwrite, leading to more efficient use of resources.

There are three distinct pillars of Solvency II: Quantitative, Qualitative and Reporting. 'Quantitative' governs the rules for calculating Solvency Capital Requirements (SCR) and Minimum Capital Requirements (MCR). SCR reflect the potential financial losses an insurer might face under various stress scenarios, while MCR set minimum levels of capital that insurers must hold as a buffer against unforeseen events.

'Qualitative' focuses on internal risk management and governance. Insurers must have robust systems and processes in place to identify, assess, and manage risks effectively. This includes the Own Risk and Solvency Assessment (ORSA), where insurers assess their own specific risks and demonstrate their capital adequacy.

'Reporting' states that insurers must publicly disclose information about their financial position, risks, and ORSA results. This allows regulators and policyholders to assess an insurer's solvency and make informed decisions.

Solvency II is far from perfect: it's very complex and there's an endless debate about the degree to which subjective judgement should be allowed. The UK government is in the process of reforming the regulation in order to improve it.

Glossary of key terms

Derivatives – Financial contracts where the value is based on performance of an underlying asset.

Exchange-traded funds (ETFs) – Funds that can be bought and sold (i.e. traded) on exchanges.

Gearing – The extent to which a company uses debt relative to equity in its capital structure. The greater the reliance on debt, the greater the gearing. Gearing can contribute to increased return on equity but also increases the financial risk to the business.

Hard/soft landing – A 'hard' landing refers to a period of economic slowdown caused by central bank tightening that triggers a recession. In a 'soft landing' despite tightening, recession is either mild or avoided.

Headwinds/ tailwinds – Headwinds are factors likely to negatively affect a company, tailwinds on the other hand are likely to have a positive impact.

Maturity of a bond/ gilt – The date at which a debt instrument ends, at which point the borrower must pay back the principal value of the debt in full to the bondholder.

Price / earnings ratio – A ratio derived by dividing a company's share price by its earnings per share. It is a relative valuation measure to determine if a company's share price could be over or undervalued relative to its earnings.

The Purchasing Managers' Index – A survey-based measure of sentiment around current and future business conditions in the service and manufacturing sectors. A number greater than 50 indicates sequential improvement in conditions whilst below 50 signals sequential deterioration in conditions.

'Sticky' inflation – Persistently elevated levels of inflation within an economy, typically associated with core measures (inflation excluding food and energy) where prices do not adjust as quickly to supply and demand changes.

Asset allocation and sector focus

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

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

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

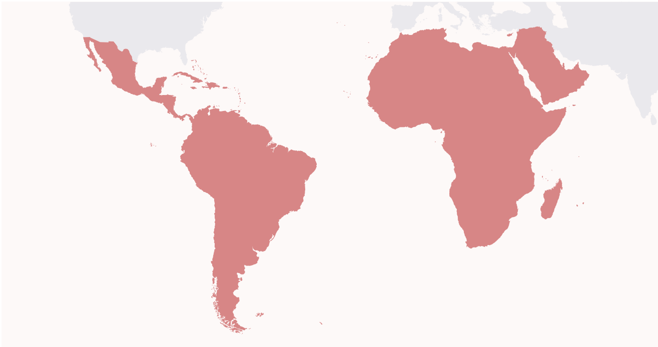
Here we present a snapshot of the current views.

Asset Allocation

Overweight Neutral Underweight

North America

The Magnificent Seven tech companies have been joined by added breadth in the rally which saw the S&P500 reach a new all-time high. Traders scaled back rate cut expectations after US inflation cooled by less than expected to 3.1% in January, with cuts now expected by the summer. Nevertheless, GDP and unemployment data continues to be supportive of a 'soft-landing', a potential positive for corporate earnings in the region.



Emerging Markets

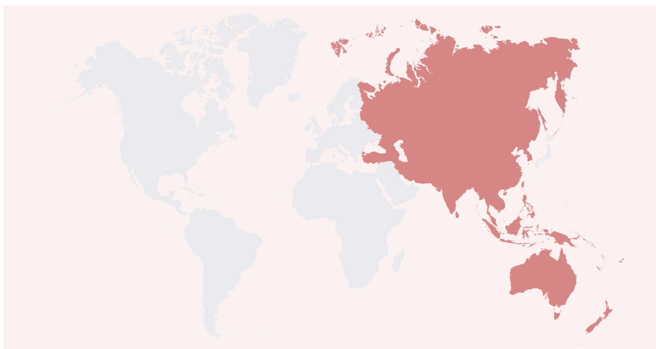
A weakening dollar when US interest rates are eventually cut should be a tailwind to dollar-exposed emerging markets, though ongoing weakness in the Chinese Renminbi will be a drag on this benefit. We have started to see interest rate cuts in emerging markets, though hotspots of inflation and political risk in the region lead us to take a cautious view.

UK

The UK market continues to look cheap relative to the US and Europe, albeit with lower earnings growth expectations. Inflation at 4% is getting closer to the Bank of England's target of 2%, supporting the market's expectations of rate cuts in the summer. With the economy in a technical recession, a key focus of the next government needs to be generating better GDP growth amidst challenging economic conditions.

Japan

Inflation unexpectedly slowed into the end of 2023, whilst GDP contracted for a second consecutive quarter in Q4 2023, putting Japan in a technical recession. These data points raise questions as to whether central bankers will be able to switch from controlling interest rates along the yield curve to rate hikes in order to shore up a weak Yen. Despite this, Japanese equities continue to perform well, with the Nikkei225 at a 34-year high.



Europe

The earnings of European equities have delivered encouragingly against expectations in the recent reporting cycle. With inflation moderating, the expectation is that the European Central Bank will be the first major central bank to start cutting rates. Generally, key EU nations, including France and Spain look well positioned economically as we enter the rate cutting cycle. The exception is Germany, where conditions appear more challenging.

Asia Pacific

Asia Pacific mostly revolves around China. The Chinese economy is still growing but does appear to be slowing from previous levels, with lesser contributions from global exports and the troubled real estate sector. Domestic markets continue to see international outflows and volatility on the back of seemingly sporadic regulatory crackdowns by the ruling Chinese Communist Party. Trade tariffs mooted by Trump should he re-enter the White House make for potential added complexity for investing in the region.

Please read the important notice on page 1.

Sector Focus

Overweight Neutral Underweight

Communications

The telecoms sector has benefitted from above-inflation price rises as many contracts are structured to account for inflation increases, yet this will abate now as global inflation rates are falling. Rising debt costs remain a headwind as companies are forced to refinance at higher levels. Areas of the sector more exposed to consumer discretionary spending can struggle in a recession. We are also concerned about the direction of advertising spend in this environment.

Consumer Discretionary

Inflation has been falling, but the performance of the sector is likely to continue to be driven by macro considerations, as the sector remains pinned to the economic cycle. The non-essential element of discretionary products/services makes them less resilient to a downswing. Since the pandemic, businesses have been supported by excess consumer savings. With savings now depleted, the risk of higher rates for longer looms over the sector and underpins our underweight stance.

Consumer Staples

Economic growth in 2024 will likely be slower than 2023 and tighten the purse strings of consumers. Input costs have been a headwind for the sector, however pricing power has been resilient. As consumers are more wary of budgets, growth will likely be suppressed. It is reasonable to expect 2025 to provide a rebound in growth and it would remain wise to focus on the longer term.

Energy

Last quarter we saw oil majors move a touch higher on the back of stronger oil prices. In December Brent bottomed at US$75 per barrel and is now at US$82. At low oil prices Shell and BP are highly correlated with the oil price. But above US$90 the relationship progressively breaks down because the share price starts to anticipate demand destruction from higher costs. Share prices are discounting expectations for weaker GDP growth and lower demand.

Financials - Banks

US banks have outperformed those in the UK, which was linked to the prospect of fines and restitution from the unfair pricing of car loans. Pressure from credit losses and an end to net interest margin growth persists. Prudential continues to suffer from woes emanating from slowing in China whilst Legal & General and Aviva climb higher on expensive insurance premiums. Given the sector weighting to banks we conclude with underweight.

Health Care

Multiple profit warnings in the sector have dampened sentiment. A combination of continued disruption to procedures, funding issues in biopharma, and concerns about a regulatory crackdown in China have impacted the short-term outlook for the sector. Longer-term demand remains resilient and the structural drivers associated with an ageing population are unchanged. The pressure in the sector makes valuations more attractive. Healthcare can also be expected to perform well in a recessionary environment.

Industrials

Whilst industrial indicators weakened in the back end of 2023, a soft landing appears increasingly likely. Industrial valuations generally look reasonable and at discounts to longer-term averages. If the soft landing happens, we expect industrial indicators to be around trough levels, at which point economic theory suggests is the time to buy industrials. In this instance we would expect interest rate cuts and GDP growth to be supportive of earnings growth later in 2024.

Information Technology

Sector performance has been strong as hope relating to the potential of AI has driven share prices and valuations. The sector is interest rate exposed though, so passing the peak of the rate hiking cycle should be a positive for valuations. Debate remains around whether the sector's demand can be considered discretionary and demand may be affected if we enter a recession. The lack of margin for error provided by valuations drives our neutral rating.

Materials

China is still the largest single driver of the sector and Chinese economic data has consistently underperformed. The economy is now in deflation as the country tries to export its way out of trouble. Longer term, supply/demand dynamics in metals look attractive and demand from the metal intensive energy transition remains. Company balance sheets remain strong, however we still expect underperformance in a recession. Our neutral rating is driven by the uncertain macroeconomic outlook.

Real Estate

2023 was a challenging year, due to persistent inflation and a 15-year high in interest rates. High rates saw commercial real estate transactions plummet, as valuations fell with heightened borrowing costs. 2024 could see rate reductions kick in and stimulate activity, helping investors to reduce their 'risk off position'. The market remains fragile, but we believe an uptick in the real estate sector is due because of easy comparatives and an improving economic landscape.

Utilities

Index-linked regulatory earnings models continue to offer protection to utilities companies even amid slowing inflation. A key component of the UK's energy transition will be reform of energy infrastructure, which should aid earnings growth for UK power transmission names. In water, proposed allowed investment returns are relatively unattractive and we expect heightened environmental regulatory scrutiny going forwards. We prefer power utilities, which currently have a more attractive regulated earnings profile and operating environment than water.

Please read the important notice on page 1.

Meet the manager

Simon Wong

Senior Wealth Planner, London

Lives Kingston upon Thames, Greater London

Family Married, with one daughter and two rescue cats

Started at JM Finn 2016

Pastime Attempting running, cycling and swimming challenges, and training for such challenges

Next challenge Snowdonia Marathon Eryri in October 2024

All time favourite film Willy Wonka & the Chocolate Factory

Current favourite fictional character Rumpole of the Bailey

Current favourite TV show The Traitors

Please could you tell us about the Wealth Planning team and how they work in tandem with the Investment Managers to support clients?

The Wealth Planning team aims to provide clients of our Investment Management service with assistance in making important financial decisions. JM Finn's Wealth Planners are highly qualified Chartered Financial Planners with experience in helping clients structure their wealth, with a view to preserving it, building it, or transferring it to loved ones.

What have been the standout highlights of your career at JM Finn?

Helping the Wealth Planning team grow from three members to eleven since inception, acting as Deputy Head of Wealth Planning, achieving Fellowship in my profession, and receiving a mention in Charles Beck's book about JM Finn: 'The second J. M. Finn & Co.'

What does the Wealth Planning team hope to achieve in 2024?

The team hopes to continue providing a high-quality service to clients, by maintaining and enhancing our knowledge through continuing professional development and by team members undertaking professional examinations.

Excitingly, we are also in the process of growing the team by recruiting two new Wealth Planners. We look forward to introducing new team members to colleagues and clients from Q2 onwards.

What does a typical working day look like for you?

My alarm goes off at 6am. I usually cycle to the office to counteract a day of sedentary office work, and it's a convenient way to fit in some training. I'm at my desk by 8am, after showering and changing in the office.

I'll spend the first 30 minutes planning my day, eating breakfast and chatting to colleagues. I normally have a client meeting either in the morning, afternoon or both. Between meetings, you'll most likely find me either typing an email, prepping for meetings, reviewing reports, speaking to someone on the phone, at a colleague's desk discussing an enquiry, eating a sandwich at my desk, enjoying a tea/coffee break, reading some study material, or wondering where the day has gone as it's 5pm and I need to cycle home.

My preference is to be in the office as I enjoy interacting with colleagues and clients in person, although I do work from home at least one day a week. This gives me a less hectic 'catch-up' day, and is a much needed change of pace for a busy working week.

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