JM FINN

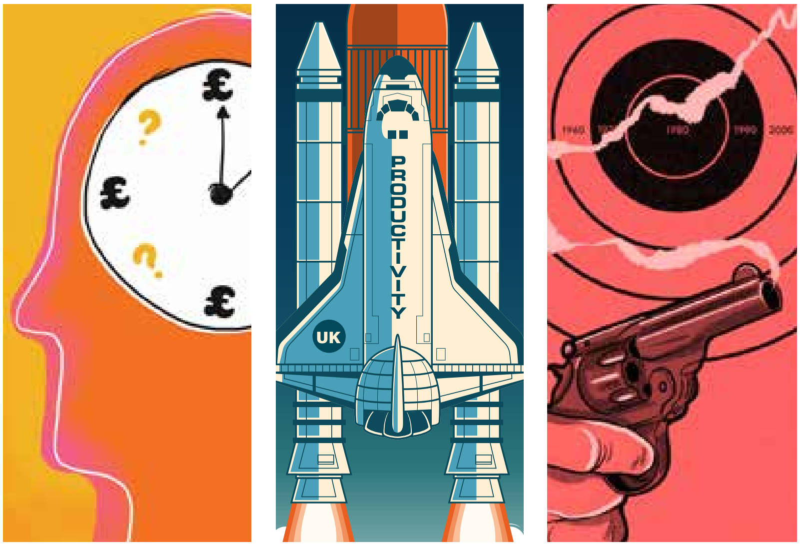
No.33 *Winter 2020*

Prospects

The JM Finn Quarterly Periodical

No.33

Winter 2020



Equity prospects
JM Finn's insights into companies 09, 13, 19, 23

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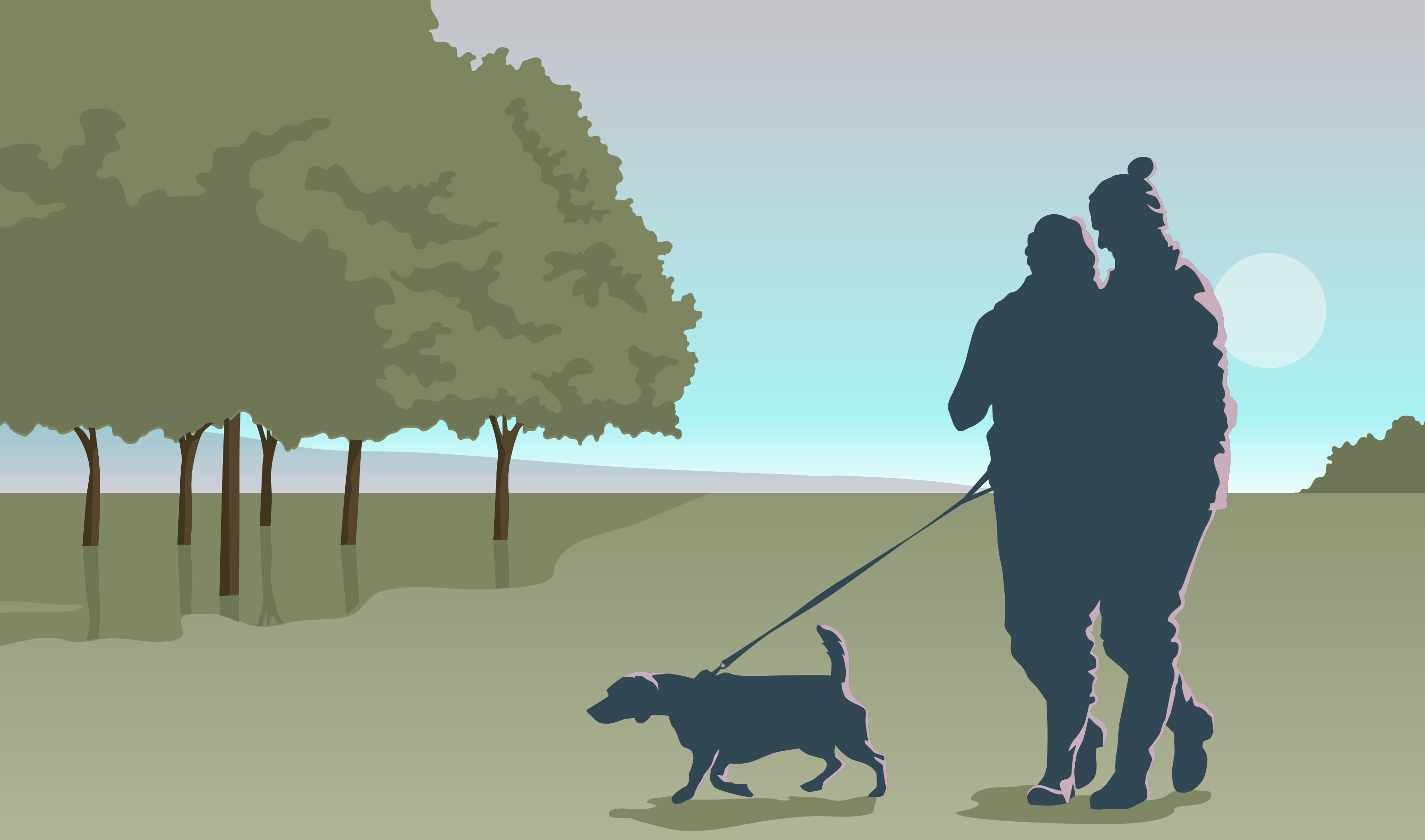
Published by JM Finn on
11th December 2020



Management changes at JM Finn

JM Finn has recently announced some changes to the board, which see a new CEO and Chairman in place. The board feels these changes represent a natural step in the firm's evolution, whilst retaining continuity within the management team. These changes are to take place from 1st January 2021 and are subject to regulatory approval.

After five years as CEO and managing partner, then managing director before that, Steven Sussman will be retiring as CEO. He will be replaced by Hugo Bedford, who has been an investment director at JM Finn since 2006 and on the management committee since 2011.

James Edgedale will be retiring as chairman of the firm, a role he has held since the firm incorporated in 2006. James will remain on the board as a non-executive director and will continue looking after his clients as an investment manager.

Steven Sussman will be appointed as non-executive chairman and will be joined on the board by Hugo and Dominic May, the firm's chief financial officer.

Welcome

COVID-19 continues to be at the forefront of all of our lives and it has undoubtedly been at the core of our investment decision making over the last quarter. The fallout differs from previous economic setbacks in many ways, but largely because it has disproportionately harmed specific industries, such as travel, hospitality and leisure, whilst many companies in services or technology-based industries have been relatively unscathed. Unfortunately, many lives, businesses and jobs have been lost and a period of uncertainty is likely to continue for some time.

The pandemic has caused significant damage to global economies, as evidenced by the UK, which recorded its sharpest ever quarterly drop in GDP in history, with the economy shrinking an estimated 20.4% from April to June. The FTSE 100 itself has been one of the worst performing major indices year to date, down around -17%. This is primarily due to the weighting that the banks, oil companies and miners have in the index, all of which face structural challenges as the world navigates the current issues.

Dividends have come under significant pressure over the last few months, with many companies slashing shareholder distributions in reaction to the fall in global demand and uncertain outlooks. We expect the overall dividend pay-out ratio to be around 10-20% below 2019. Clearly, this could make for tougher times for those clients investing for income and I would encourage anyone in this camp to discuss their specific investment needs with their investment manager.

It is at times such as these that we feel we can add value to our client relationships. By offering a personalised service, we can be extremely flexible should circumstances change, as our investment managers are not beholden to a prescriptive list of investments. Additionally, we pride ourselves on building meaningful and long-term relationships so that as and when you need to discuss your circumstances with someone, we can be there to guide you along the way. Of course, we understand not all clients require or want that regular communication and rely on reading this publication to get their updates from the firm, but we do advise periodic conversations with your managers, particularly in light of the likely impending change to capital gains tax (CGT) rates.

We have as ever tried to pull together a varied range of topics to discuss in this edition. Inflation, negative interest rates and UK residential property are all areas I would expect many clients to be interested in; we also include an interesting review of UK productivity, which highlights where we as a nation are lacking, but which goes on to suggest that a focus on digitisation and technology can be the tonic needed for the country to realise our full potential.

Many readers will be aware that we have announced a change of management to take effect from January 2021 with Hugo Bedford taking over as Chief Executive Officer from Steven Sussman. Hugo has been an investment director with the firm since 2006 and importantly, understands the needs of investors and what they expect from their wealth managers. You can read more about him and his thoughts for the new role on page 26. I will be continuing as a director and investment manager at JM Finn and very much look forward to working with Hugo to ensure the firm remains in good shape and can continue to look after today's clients, and those of future generations, by staying focused on putting our clients' interests first.

James Edgedale

James Edgedale
Chairman

Change is happening in the UK...but let's try and make it positive: how the UK can boost it's productivity

Michael Bray, CFA
Research Analyst

Illustration by Adam Mallett

The UK currently faces two seismic events – Brexit and COVID-19. Whatever your views are on how successive governments have handled these events, it is apparent that both have had, and will continue to have, a profound impact on the structure of the UK economy.

Thankfully, this appears to have been recognised across the political spectrum and there now feels like a real openness to improving upon the economic paradigm which led the UK economy out of the global financial crisis in 2008/09. The government's 'levelling up' agenda, although undeveloped at this stage, is an attestation to that. More focus is likely to be placed on driving economic growth rather than the cost cutting of austerity, and more emphasis is likely to be placed on making sure that this growth is sustainable and inclusive – regionally and by income attainment.

Improving productivity remains the key mechanism through which to bring about this positive change.

Productivity drives real wage growth

Productivity is one of the most important determinants of long-term economic growth and is the most important determinant of real wage growth (see chart 1). Driving its growth should therefore not only be viewed through an economic lens, but also a social one.

There are a number of ways to measure productivity, but we will focus our attention on labour productivity. It can be defined as a measure of output that a labour force is capable of producing given its existing resources. This output can be enhanced by improving the skillset of the labour force and by increasing investment. Investment includes both private and public sector, and in physical assets (e.g. machinery and infrastructure) and intangible assets (e.g. research & development and patents).

Improving labour skills and increasing investment sounds simple enough but the evidence suggests otherwise. UK productivity has flat-lined for more than a decade and has chronically underperformed international peers (see chart 2).

Indeed, when looking at investment levels versus 27 EU nations, only Greece spends less on investment as a percentage of GDP.

These factors suggest that some deep seated structural forces are at play.

Innovative but not productive

The UK's relative productivity performance is puzzling, given our status as a global innovation hub. The UK has consistently ranked within the top 5 of the global innovation index, ahead of the similar sized economies of France and Germany. It also scores highly on research and development (R&D) and start-ups. Five of the world's top 20 universities are from the UK, it ranks first globally in categories such as citable scientific publications, and leads in many e-commerce and Information and Communications Technology (ICT) markets. Moreover, it remains the largest market for tech talent within Europe.

Digging deeper, the UK's productivity issues are more apparent when looking at the dispersion of productivity across the best performing and worst performing businesses.

According to the Bank of England's (BoE) 2018 report on the UK's productivity problem, the UK has a small set of world leading businesses which have an excellent track record of delivering productivity growth but a long tail of stagnant businesses which are acting as a drag on overall productivity growth.

Another way of viewing this divergence is through R&D expenditure. Three-quarters of the UK's private R&D spending - which at 1.7% of GDP is already more than one percentage point below our main competitors - is concentrated in only 400 companies, less than 0.01% of the UK's business population.

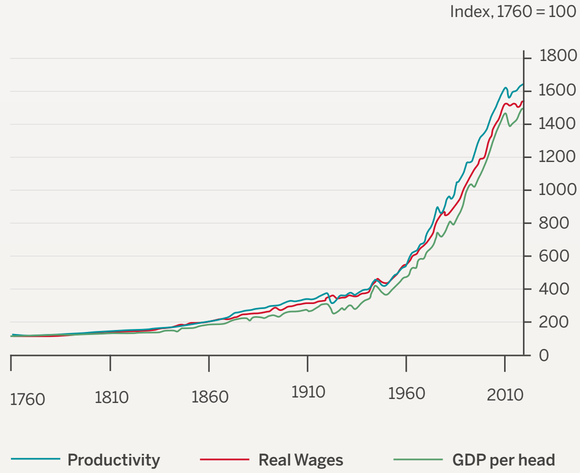
Knowledge diffusion is key

So, what explains why the UK is poor at disseminating the innovation, which it has a strong track record in producing, throughout its economy? The heart of the problem comes down to weak knowledge diffusion. A useful way to analyse the UK's knowledge diffusion is through the technology diffusion framework created by economists Diego Comin and Marti Mestieri. They highlight four structural factors:

External openness

This represents the openness to cross-border flows of goods and services, capital, people and information. The UK scores highly on all external openness metrics so this isn't the issue.

Chart 1: UK productivity, real wages and GDP per head

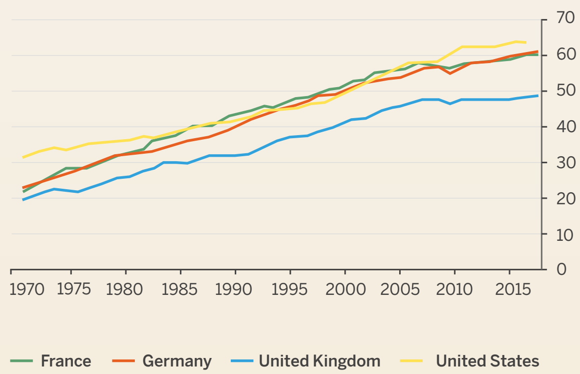


Source: Bank of England

Notes: Labour productivity per head uses GDP at factor cost. Real wages defined as nominal wage divided by GDP deflator at factor cost.

> Productivity is one of the most important determinants of long-term economic growth and is the most important determinant of real wage growth.

Chart 2: Level of productivity



Sources: Bank of England

Technology transfer

The rate of technology transfer is dictated by 1) adoption - the time it takes new technology to first reach a country or company and 2) penetration – the extent to which this technology then reshapes processes and products. Both these aspects contribute to the long tail of unproductive companies in the UK.

On adoption, although somewhat a dated statistic, the BoE estimated that by 2015 fewer than 10% of UK companies were using four or more technologies: of 1) mobile access to email, 2) documents and software, 3) websites with online ordering, 4) fast broadband access and 5) electronic interchange sales. On technology penetration it's a similar story. In 2015, the BoE estimated only 20% of UK businesses had 50% or more of their employees using a portable device with internet access.

Recent McKinsey research found that three-year revenue growth for the most proactive digital movers was over twelve percent, nearly twice that of companies playing it safe. A lack of awareness of new technologies and how best to use them is a key issue for many UK small and medium enterprises (SMEs).

Institutional infrastructure

Countries with high-quality institutions typically grow more rapidly and have higher levels of productivity and living standards.

The UK fares well internationally in regards to rule of law and property rights, which support investment and innovation, but fares poorly on its diffusion and financial infrastructure. The BoE's 2018 comparison of UK and German institutional infrastructure reveals why.

Germany has a long-established support infrastructure to diffuse knowledge and technical know-how to its companies. Its Fraunhofer institutes were established in 1948 to rebuild the German corporate sector and now cover all sectors and regions.

Dimension	UK Catapults	German Fraunhofer
Age	7 years (from 2011)	69 years (1949)
Number of centres	10	72
Industry projects per year	600	6,000 - 8,000
Annual budget	£0.3bn	€2.3 billion
Annual budget (% of nominal GDP)	0.01%	0.07%
Employees	>1,400	24,500

Source: Bank of England

Secondly, Germany's Steinbeis system, established in 1971, provides a network of 6,000 technical professionals whose skills and experience can be drawn upon.

Thirdly, Germany has multiple layers of financing, which operate at local and national levels, and serve both small and large businesses.

Turning to the UK's equivalent institutional infrastructure, we either have such institutions but they lack scale and scope, or we are missing them entirely. The UK's Catapult Centres, established in 2011 are modelled on Germany's Fraunhofer institutes, but lack their presence. Furthermore, the UK has nothing like the Steinbeis system for disseminating technical expertise and know-how between companies.

On financing infrastructure, although big corporates are served well by the UK's large and liquid corporate bond market, smaller UK businesses have to seek financing from banks where options are more limited; lending to the corporate sector by UK banks represents just 6% of their assets compared to 18% for German banks.

Human Capital

People are unsurprisingly a key mechanism through which ideas and innovations are diffused. As workers transition between companies, their expertise and experience is transferred with them.

Historically, UK firms have performed worse on measures of good business practices, such as lean operations, performance monitoring, and aspects of talent management, versus firms in competitor nations such as Germany and the United States.

Again, the UK also exhibits a greater degree of dispersion of management skills when compared to competitor countries. Mckinsey estimate that when comparing UK businesses in the top decile of management performance scores versus those in the bottom decile, they are nearly three times more productive, grow revenue c.25% faster per annum, and invest ten times more in R&D. Moreover, poor management practices make it less likely that a firm will invest in and adopt ICT and digital technology effectively.

This has been amplified by around a 20% reduction in employment churn compared to before the 2008/2009 financial crisis and by the fact that the most skilled workers are increasingly staying within the top performing productivity companies, limiting knowledge and technological trickle-down.

What can be done?

With the bad news out of the way, let's focus on what is being done and what more can be done to improve the UK's diffusion structure.

Supply chains, universities and financing

Large, global companies are already playing a crucial role. These businesses are typically more productive than smaller, locally focused firms and are helping to drive adoption of productivity boosting technologies and industry practices within their supply chains. These supply chains are typically made up of thousands of large and small businesses and provide a natural diffusion structure which can be harnessed.

A national set of structured projects are currently underway, co-ordinated by the Government established 'Be the Business' advisory body, which aim to use supply chain infrastructure to disseminate knowledge and best practices across companies. The UK needs to double down on such efforts.

Outside of supply chains, more hands-on guidance is required to implement new technology. The UK's catapult network are already doing this, but as discussed, the scale and scope lack that of Germany's Fraunhofer system and other international peers. A relatively quick way to boost such capabilities could be through the UK's world class university network. The UK's top-ranked universities are already playing a crucial role in establishing the UK as an international innovation hub through their business parks. They are an important reason why the UK ranks so highly on innovation and start-ups. Many UK universities do not however have such close interactions with local businesses. Building these links out could help diffuse innovation more broadly across sectors and regions.

Many SMEs also need enhanced incentives and access to finance to adopt what may seem risky new assets and technologies. For example, the German government's Digitisation and Innovation Loan provides businesses, even those with weak credit ratings, with funding to invest in new technologies. There is no reason the UK couldn't do the same.

Disseminating and Investing in skills

A way to solve the UK's diffusion of human capital is through mentoring or twinning between firms of different levels of skills and experience.

'Be the Business' is already engaged in a sequence of pilot mentoring schemes between companies. They have also created programmes to develop management and technical skills with "mini-MBAs" and provide online tools for businesses to benchmark their practices against and receive actionable advice.

However, the most proven methods for enhancing managerial practices tend to involve relatively intense, on-the-job support, which combines classroom based instruction with experiential learning. The same is true for increasing management's capacity to adopt and implement new technologies. This suggests a more formal national network for knowledge-exchange, along the lines of the German Steinbeis system, is worth considering.

Aside from improving management skills, more needs to be done at scale to improve foundational skills for workers; Denmark's flexicurity model provides a guide. It brings together trade unions, the government, and businesses to maintain a flexible labour market while also supporting

workers in finding new employment opportunities. The model incentivises continuous learning and retraining, and provides a generous social welfare programme that helps unemployed workers retrain whilst looking for a new role. It is estimated that Denmark spends 1.5% of its GDP on offering job guidance or education to the unemployed, compared to just 0.2% of GDP spent in the UK on Jobseeker's Allowance on average between 2010–11 and 2015–16.

Establishing national skills training for both managers and workers would go some way in helping alleviate the productivity gap between firms, but crucially regions as well. Worthy of deeper analysis in its own right, the productivity by region mirrors that by company – the UK is overly reliant on London and the South East to drive productivity.

The OECD estimate that c.60% of the variation in productivity across UK cities are driven by age, education or experience. A lack of skills thus perpetuates this regional divide. Devolving more power over adult skills budgets to regional administrations could help fit workers to available jobs better; the current patchwork of government grants targeted at skills training often fits awkwardly with local skills gaps. This is highlighted by Manchester's Working Well programme, which has a better record than national schemes at getting people working after long periods of unemployment.

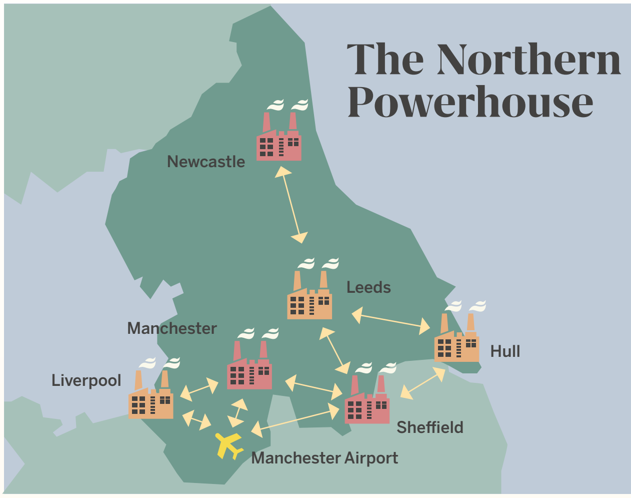
Promoting investment in infrastructure

A more obvious way to boost the diffusion structure of the UK is to improve its transportation infrastructure. UK infrastructure investment has lagged for some time, and overall public and private infrastructure investment as a share of GDP only rose above pre-crisis levels in 2017.

Large and dense cities are best suited to support knowledge diffusion due to the concentration of workers and firms. Improving inter and intra connectivity between large cities, and their suburbs, can thus help with knowledge diffusion.

Again, UK regional disparities can be seen with London and the South East having relatively good transportation infrastructure compared to cities in the North, which do not offer the same density networks. The "Northern Powerhouse" project which was touted by George Osborne during his tenure as Chancellor of the Exchequer aimed to better connect six Northern cities and their combined 15 million population. For example, lowering travel times from Leeds to Manchester and Sheffield to 30 minutes is estimated to lift productivity in the city by more than 10 percent.

Administration change in Westminster has meant the Northern Powerhouse proposals have not garnered steam.



The current government's 'levelling up' agenda looks to do a similar thing, but lacks detail at this stage. Again, devolution of powers and finances could help by bringing a longer-term focus to regional infrastructure planning.

Why has change not been forthcoming?

There is no mystery around what is required to boost UK productivity. History tells us that improving productivity is the surest way to drive sustainable and inclusive real wage growth. However, what has been absent is consistent enthusiasm from central government, across the political divide, to implement the necessary policies because they are slow to take effect. I am hopeful that the economic shocks of Brexit and the COVID-19 pandemic – which has already forced many businesses to hasten digitisation - will provide renewed impetus for a sustained commitment by government and business to accelerate efforts to increase productivity, and help the UK realise its full potential.

Understanding Finance

NEGATIVE INTEREST RATES

Rheanna Filmer
Research Assistant

When Interest Rates (IR) are high (i.e. borrowing is expensive) consumers pay more for their mortgages, loans and credit, so have less disposable income and spend less…inflation goes down. When IRs are low (i.e. borrowing is cheap) consumers can spend more… inflation goes up. In consumer driven economies, rate moves are very significant to economic performance. But when referring to 'high' and 'low' IR, this has traditionally meant above the zero bound.

Negative IR reverse this premise of borrowing. Instead, the lender pays the borrower for keeping/using their money. For example, a consumer with a deposit in a bank, pays the bank to hold their money. This should encourage consumers to save less and spend more rather than letting their money sit idle in the bank and incur fees.

The same relationship between consumer and bank also applies between a bank and its respective central bank. Thus negative IR should encourage banks to lend more like it encourages consumers to spend more.

Similar actions can however cause different reactions. Whilst commercial banks have accepted negative IR from central banks, they have not passed negative IR to customers, in fear of losing business. This leads to a cut to their own profits and so reduces their inclination to lend. The exact opposite to the effect intended.

The fact that the extreme option of negative IR are being considered, indicates that interest rates are not as powerful in steering the economy as previously considered. Post pandemic, more will be needed to boost the economy than a few tenths of a percentage point below zero.

•

LONDON STOCK EXCHANGE GROUP ("LSE")

John Royden, CFA
Head of Research

PRICE
£79.20

52 WEEK HIGH-LOW
£92.64—£53

NET YIELD
0.91%

HIST/PROS PER
71—39

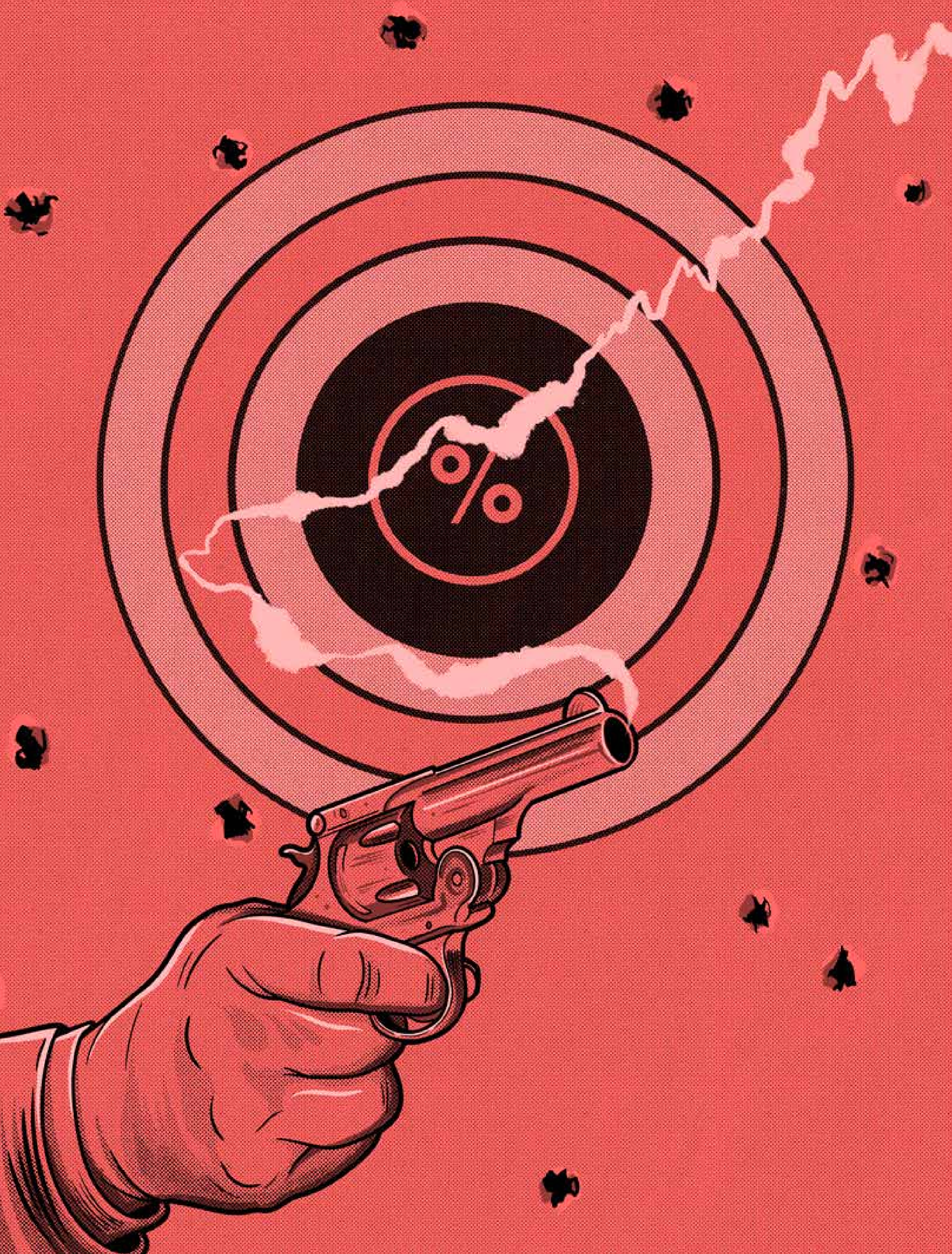
EQUITY MARKET CAP (M)
£28,361

The London Stock Exchange Group, an exchange where shares and bonds are traded, also incorporates a range of clearing and settlement business as well as price information and index sales. The LSE sits in their Capital Markets division together with Borsa Italiana (Italian stock exchange) although it looks as if Borsa Italiana is about to get sold as part of the Refinitiv deal.

Refinitiv will boost the data and intellectual property sales that LSE gets from price information and indices. If you launch a FTSE100 Exchange Traded Fund (ETF) then you have to pay LSE a licence fee for including "FTSE100" in the name and you have to pay LSE to get price data to allow you to manage your ETF.

Data sales is a great business. If you own the price data then it is often next to impossible for somebody to replicate it. Once you have created an index, then you can sell the same data set over and over again for next to nil marginal cost. Companies like LSE end up with a near monopoly over mission critical inputs for their clients, which gives them great pricing power. Refinitiv brings more of this to LSE. The danger is that price increases of the last decade push customers to give up on paying LSE to display the FTSE100 as a performance benchmark and move to a lesser-known index like the UK100.

Please read the important notice on page 1.



The Inevitability of Inflation

By Anthony Hilton
Columnist of the Evening Standard

Illustration by Asa Taulbut

By the end of the Second World War Britain's debt ratio to Gross Domestic Product (GDP) was 250%. By the end of the 1970s - 35 years later - the debt was down to below 40%.

The Attlee Government of the late 1940s practised a measure of austerity - they had little choice - but from the 1950s onwards the economy gradually did better but still did not make much dent in the debt. What did make a difference was inflation. Following the war it was regularly running up to 3% a year, which meant that the debt would be halved in 25 years. Then in the 1970s inflation really took off following the quadrupling of the price of oil in 1973. Indeed it touched around 20% for a couple of years but thanks to this inflation, debt fell below 40%.

Nor was this the only time. After the Napoleonic Wars in 1815 we also had debt of 250%. Britain industrialised in the Victorian era, but governments did not borrow much. With little or no inflation it took much longer to bring the ratio down below 40% - to the eve of the First World War in fact.

In current times, governments and central banks have focussed on keeping inflation dormant and with some success - though not as much perhaps as they think. While the price of goods has been subdued, asset prices have not. Houses, art, luxury goods, classic cars, the stock market - all have rocketed. Inflation by conventional indices may not be a problem but this lifestyle inflation is.

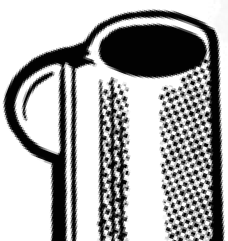
> After the Napoleonic Wars in 1815 we also had debt of
> **250%**

At the same time, services which used to be free to the public, have either been withdrawn or now cost. Central and local governments used to cover these through taxation, but no more. University student fees used to be free but now cost £7,000 per year. Car parking costs, especially with hospital visits, are extortionate, libraries have been closed, welfare benefits have been cut back, defined benefit pension schemes are largely gone in the private sector and governments now extract fees for essential services, which again used to be free, or virtually so. Much of this is blamed on austerity, but making people poorer is inflation too. It is just not measured as such.

> University student fees used to be free but now cost
> **£7,000**
> per year

Of course many analysts are still singing from the old hymn sheet talking about inflation in terms of food, energy, clothes, furniture and transport and seeing no sign of it - quite the opposite in fact.

Perhaps the most significant challenge to this consensus comes from Charles Goodhart, a former Bank of England man, now Emeritus Professor at the London School of Economics. Back in 2015 he wrote a paper - which was expanded into a book published in October this year with fellow economist Manjoy Pradhan - in which he said that inflation was largely caused by demographics.



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Globalisation is stalling because of trade wars and the world is growing old, even in China where the one child policy means a whole swathe is reaching retirement.

The suppression of inflation from the late 1990s onwards was not primarily the result of central banks' actions, as is witnessed by the same central banks' failure to hit their target since 2008. Rather it was because China shifted millions of agricultural workers into manufacturing as part of its industrialisation in the 1990s, and the collapse of the Berlin Wall, which brought millions of skilled Eastern Europeans into the world economy for the first time. This doubled the labour supply of the industrial world.

The result was lower prices for Chinese exports, manufacturing relocating to China to take advantage of its lower wages and globalisation taking a hold. These factors caused the deflation.

But now the world is turning. Globalisation is stalling because of trade wars and the world is growing old, even in China where the one child policy means a whole swathe is reaching retirement. That means prices will go up. At the same time an increase in the elderly at the expense of those of working age, implies an increase in social care which is bad for the economy, as more care workers have to be hired and the public sector will have to raise taxes to pay for them. Those of working age with skills will have much greater bargaining power.

The pandemic has added to this. Governments have increased their deficits to make up for lost output and it is likely that this increase will not be reversed any time soon. All these factors will cause inflation.

Immigration is too toxic to change fundamental demographics, while countries like India and some in Africa and South America have the populations, but lack the institutions to deliver huge growth. They will of course develop but they will not be another China - and anyway according to the authors, we need three Chinas to make a difference.

> **Given they have not hit a target for 12 years, do you really want to bet on this?**

In sum, says Goodhart, we are likely to see 4% to 5% inflation for the next 20 years, starting probably in about 2025, when Covid should be behind us and demographics really take hold. The central bank's job will be to try to keep it at that level, so it does not explode to 20% or more, like in the 1970s. But given they have not hit a target for 12 years, do you really want to bet on this?

Author, broadcaster, journalist and lecturer, Anthony Hilton joined Fleet Street in 1968 as a trainee on The Guardian. He was City Editor of The Times (1981 to 1983), City Editor of The Evening Standard (1984 to 1989) and in 1989 became Managing Director of The Evening Standard. He held that post for six years before returning to the City Office as Editor in 1996. He has also worked for The Observer, The Daily Mail and The Sunday Express and for three years he was based in New York as Business Correspondent for the Sunday Times.

MARKETAXESS

John Royden, CFA
Head of Research

PRICE
$533.89

52 WEEK HIGH-LOW
$606.45—$275.50

NET YIELD
0.45%

HIST/PROS PER
74—69

EQUITY MARKET CAP (M)
$20,268

MarketAxess is where most corporate bonds get traded, particularly American ones and in the smaller deal size (below $5 million). The way of trading is a bit different as, to trade a share you look at market-makers' bid/offer spread on a screen but at MarketAxess you request a price (anonymously) from others. Being anonymous, MarketAxess carries the settlement risk; every contract has MarketAxess as the counter-party. One tenth of the income comes from settlement with the rest from volume-based fees.

MarketAxess has been clever (or lucky) enough to get the lion's share of volume which is a great entry barrier to others via the 'network effect' – as a virtuous cycle of more traders using the platform brings more trading volumes. Would-be competitors could replicate the technology but if nobody uses another platform then it does not make economic sense. MarketAxess are also proud of their electronic plumbing, which routes trades directly into users' back office systems.

Whilst strong revenue growth and margin progression have been the net result of current business credentials and are expected to continue, we have to caution that a forward Price/Earnings ratio of 71x does feel expensive.

Please read the important notice on page 1.

Company Meetings

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

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

John Royden
Head of Research

James Ayling, CFA
Research Analyst

Michael Bray, CFA
Research Analyst

COMMUNICATION SERVICES
BT Group

CONSUMER DISCRETIONARY
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CONSUMER STAPLES
Diageo

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INDUSTRIALS
Spirax-Sarco Engineering , BAE Sytems, Bunzl, RELX, Ricardo, Ceres Power Holdings, Alpha Financial Markets Consulting, Diploma

INFORMATION TECHNOLOGY
Learning Technologies Group, Microsoft Corporation, Halma

MATERIALS
Victrex, BASF, Croda International, Hill & Smith Holdings, Mondi

REAL ESTATE
SEGRO, Shaftsbury, Derwent London

1.

HSBC

Price **£4.04**
52 week high-low **£6.02 – £2.81**
Net Yield **0%**
Hist/Pros PER **NA – 20**
Equity Market Cap (M) **£80,726**

Financials
Ewen Stevenson (CFO) and
Neil Sankoff (Head of Equity Investor Relations)

Aside from provisions, HSBC is taking hits from low interest rates, lower customer activity and from lower wealth product sales. Asian product sales have been hampered by fewer mainland Chinese visiting Hong Kong to buy insurance.

Ewen said that Anglo-Saxon banks were relative newcomers to low interest rates. European banks have had time to realise that the remedies were reduced costs and moving to fee income, rather than net interest income by building wealth management sales.

Cost reduction is part of HSBC’s solution and costs were 7% down at the Q2; driven, in part, by less travel. Some of those savings will persist into a post COVID-19 world. More than half was internal travel and that won't be allowed again in the future, but external travel will be allowed again. More desk sharing has the potential to cut their $3 billion property cost, which is 10% of their total cost base.

HSBC are aiming for 2.5 days in office vs 2.5 days at home on average. Perhaps they will sublet half of Canary Wharf? The problems of home working are technological failure, not training juniors properly, mental health issues and an inability to judge performance so well. Ewen said that job mobility had fallen as well and they have not been able to replicate the operational efficiency of having 15 programmers in a room working around a white board and table to solve IT issues.

2.

Persimmon

Price **£26.96**
52 week high-low **£33.28 – £13.67**
Net Yield **3.94%**
Hist/Pros PER **13 – 12**
Equity Market Cap (M) **£8,630**

Consumer Discretionary
Dave Jenkinson (CEO), and
Mike Killoran (Finance Director)

Persimmon is a leading UK house builder that aims to produce quality housing at affordable price points. Since the Help to Buy scheme announcement in 2013, Persimmon has been a beneficiary given that c.50% of their homes are sold to first time buyers; strong demand allowed volumes to rise and profitability to expand. With the scheme extended to 2023, for first time buyers only, Persimmon should have a relatively longer period of government support than some peers. This support could prove even more valuable in a cyclically sensitive sector as the UK economy seeks recovery from the pandemic.

Unlike other house builders, Persimmon took steps recently to broaden its vertical integration strategy to ensure critical material supply. By way of example, their brick manufacturing factory in South Yorkshire is capable of producing eighty million bricks per year. This production volume covers two thirds of Persimmon's annual brick build requirement. Whilst ownership of a brick production site might seem uninspiring, it provides a competitive advantage by ensuring Persimmon can complete the core structure of each home it builds. Building material supply disruption was an early worry in the pandemic. We think Persimmon's internal supply capabilities may have helped it push forward with construction whilst peers took a more cautious stance. This would partly explain their relative market share gains earlier this year.

Dave Jenkinson passes the CEO post to Dean Finch, an experienced leader in the transport sector, but a relative outsider for the house building sector. It will be interesting to observe whether Persimmon's well-trodden strategy endures or changes are afoot.

3.

Microsoft

Price **$215.23**
52 week high-low **$232.86 – $132.52**
Net Yield **0.98%**
Hist/Pros PER **34 – 32**
Equity Market Cap (M) **$1,618,475**

Information Technology
Kyle Vikström (Investor Relations Director)

Microsoft is in the minority of businesses which have financially benefitted from the COVID-19 pandemic - FY20 Q3 revenue and operating profit grew by +12% and +25% respectively. Lock-down restrictions have forced white-collar workers to work from home and pushed businesses to digitise work flows to remain operational. This has increased demand for a range of Microsoft products/services, particularly its cloud platform Azure.

Microsoft note that this enhanced cloud demand isn't different from that of the past, but marks an acceleration in what was already a structural shift from on-premise to cloud computing. Nonetheless, the company is keen to stress that they still see this shift in its "early innings". They define the transition to the cloud as a two staged process: 1) migration, which involves packaging data so that it is suitable for cloud use and; 2) innovation, where this data can be used in more advanced analytics such as artificial intelligence. Microsoft continue to not provide any exact commentary around where their overall customer base sits within these phases, but have said that around 20% of its customers are at the innovation stage in some shape or form. They view the consumption curve within the innovation stage as being like a 'hockey stick' and believe that many of their customers are just at the beginning of it.

Microsoft are however finding it challenging to convince new customers to begin their transition to the cloud in the midst of a pandemic. Additionally, revenue from LinkedIn has declined due to the collapse in the jobs' market and Windows operating system sales have fallen as enterprises rein in hardware spend. Although Microsoft has benefitted from the pandemic so far, the business cannot insulate itself from the wider macroeconomic environment forever.

Please read the important notice on page 1.

Economic Focus

Crouching Tiger, Hidden Dragon

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Jordan Atkinson

They say that a week is a long time in politics. It is turning out to be a positive age in markets. Overall, markets have held up relatively well in the unprecedented conditions that the have been created by the pandemic.

Some have even hit new highs, with the expectation of workable coronavirus vaccines encouraging investors to believe that a return to some sort of normality could be not too far away. But conflicting news is seeing greater volatility and a widening disparity between the performance of individual markets.

One area that does seem to be in the vanguard of the anticipated recovery is Asia Pacific, or more precisely, China. The second largest economy in the world looks set to post a positive set of GDP numbers for 2020 as a whole, while most developed economies are unlikely to avoid a recession as a consequence of the coronavirus pandemic. For the nine months to September this year the Chinese economy grew by 0.7%, helped in no small measure by its export trade. This is way below the numbers we have become used to in recent years but, in the circumstances, it is an impressive performance.

Bear in mind that during the five years to the end of 2018, China contributed around 28% of global economic growth. This is twice that of the United States, still the world's largest economy, but one cannot help but wonder for how much longer. Recent other statistics coming out from the world's most populous nation include retail sales rising at a rate of 4.3% - a distinct improvement on the previous set of numbers – and industrial production up by nearly 7%. The Chinese juggernaut continues to roll on.

> For the nine months to September this year the Chinese economy grew by
> **0.7%**

Then there is the trade deal that China has brokered, bringing together 15 nations in the Pacific region which together account for nearly one third of global economic output. Included in the countries that will form part of this Regional Comprehensive Economic Partnership (RCEP), as it is known, are Japan and Australia. Neither India nor the US have been invited to join, but then President Trump did take America out of the earlier free trade deal – the Trans Pacific Partnership – shortly after taking office.

> **Joe Biden is well known to the Chinese leadership and, as a mature and experienced politician, is likely to enjoy greater respect than his predecessor.**

Might the new occupant of the White House take a difference stance over China? On the face of it this seems unlikely as, amongst other concerns, human rights are likely to loom large in the Democratic agenda. But that is not to say that some easing of the tension between these two powerful nations could not take place. Joe Biden is well known to the Chinese leadership and, as a mature and experienced politician, is likely to enjoy greater respect than his predecessor, who's lack of predictability will have been a source of great annoyance to Beijing.

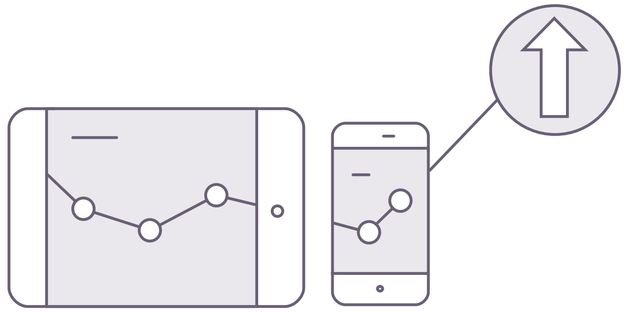
The RCEP will undoubtedly enhance China's position as a mover and shaker on the world economic scene. First into the pandemic, they are clearly the first to emerge - and in better shape than many could have predicted. Of course, they did have the advantage of being led by a regime that governs by dictat, so were able to clamp down on their population when fighting the pandemic in a way denied to Western democracies. Even so, the way in which they have emerged from this particular crisis is truly remarkable.

China has not always been an easy country in which to invest. In the early days of their industrial and technological revolution, corporate governance was all too often a misunderstood concept amongst the entrepreneurs that were jumping on the capitalist bandwagon. Even now there are issues that need to be taken into account when assessing the investment opportunities that certainly exist there. The role of the State is just one such concern.

This has led to the exclusion of some Chinese companies from important infrastructure contracts in the West. Huawei has been denied involvement in further developments of the mobile telephone network here in Britain, despite being a cheaper provider, while the US has demanded a change of ownership for the TikTok operation there. And we saw Jack Ma having to withdraw the public listing of his Ant Group payments giant following pressure from the government and regulators.

China, starting from a much lower base than the developed West, has managed to leapfrog other economies in technological terms, with tech giants there now threatening the hitherto dominance of west coast America. It all adds to up to an exciting prospect for investors, but not one without risk. The risks are not confined to investment decision taking. The Chinese state is acquiring data at an alarming rate – arguably part of the reason behind their failure to support Jack Ma in launching the world's biggest IPO. We ignore China at our peril, but need to be vigilant both in investment selection and in how we treat this emerging Leviathan.

App update



The lack of face-to-face contact this year has brought the full benefits of our client portal to the fore. Being able to access a valuation of your portfolio(s) at the touch of a button, access all your confidential account paperwork and send secure messages to your investment manager are all essential aspects of managing our clients' wealth today.

As pioneers in developing a proprietary online tool for clients, we have continued to invest in and evolve the digital side of our services with ease of use and security of data as the focal points. To this end, we have recently upgraded our App.

The new version of the app, which is available for both iPhone and Android device users provides enhanced security and the ability to rotate the screen from vertical to horizontal, thus providing additional features. As well as improved functionality, the new App appears cleaner on the screen, aligning to the existing, award-winning Client Portal.

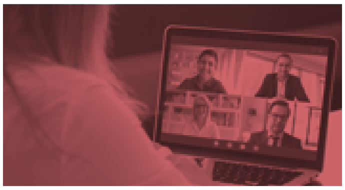
The biggest development however, is the upcoming ability for the App to interact with a smart phone, and to alert Clients to new messages or documents. This is similar to the alerts one may receive for WhatsApp or SMS and are completely user controllable.

The App can vastly simplify the log-in process and is significantly more secure. By simply downloading the App from the Apple or Android App Stores and then use biometric access, such as face recognition or fingerprint access – no password or pin is required. We would encourage those regular users of our portal to download the app and make the most of the built-in security features on their devices.

App features

- Available from Google Play or the App Store
- View the current value of your portfolio
- Notifications when new documents are posted to your document library
- Secure log-in from your smart phone or tablet (if available) via biometric identity check
- Access the transaction history and cash statement
- One-touch Fraud Alert in the event your emails have been compromised
- Send and receive secure messages to your investment management team

Training doesn't stop



Of the many challenges presented to firms by remote working, one is how younger members of staff can continue to learn from their colleagues.

We have ensured that the level of Training given to younger members of staff has been maintained and we were delighted that a large number have recently passed a range of exams, all of which are noted below. Congratulations to all.

CISI Level 7 Chartered Wealth Manager Qualification (CWMQ)

Congratulations to Laura Langton and Samantha Goodson, who both achieved a first time pass in the Portfolio Construction Theory. Congratulations also to Ben Hudson, Charlie Croggon and Edward Robinson – who all passed the Financial Markets paper.

CFA UK Level 4 Investment Management Certificate (IMC)

Well done to Rheanna Filmer, who completed both the Investment Environment and Investment Practice papers to achieve the IMC.

CISI Level 4 Investment Advice Diploma

Congratulations to India Turnbull, who completed the Regulatory, Investment Risk & Taxation and Securities papers to complete the CISI IAD.

CISI Level 3 Investment Operations Certificate

Well done to Kyle Price, who passed the Introduction, Financial Regulation and Asset Servicing modules to pass the full CISI IOC.

TESCO

Rheanna Filmer
Research Assistant

PRICE
£2.28

52 WEEK HIGH-LOW
£2.60—£2.02

NET YIELD
4.28%

HIST/PROS PER
22—16

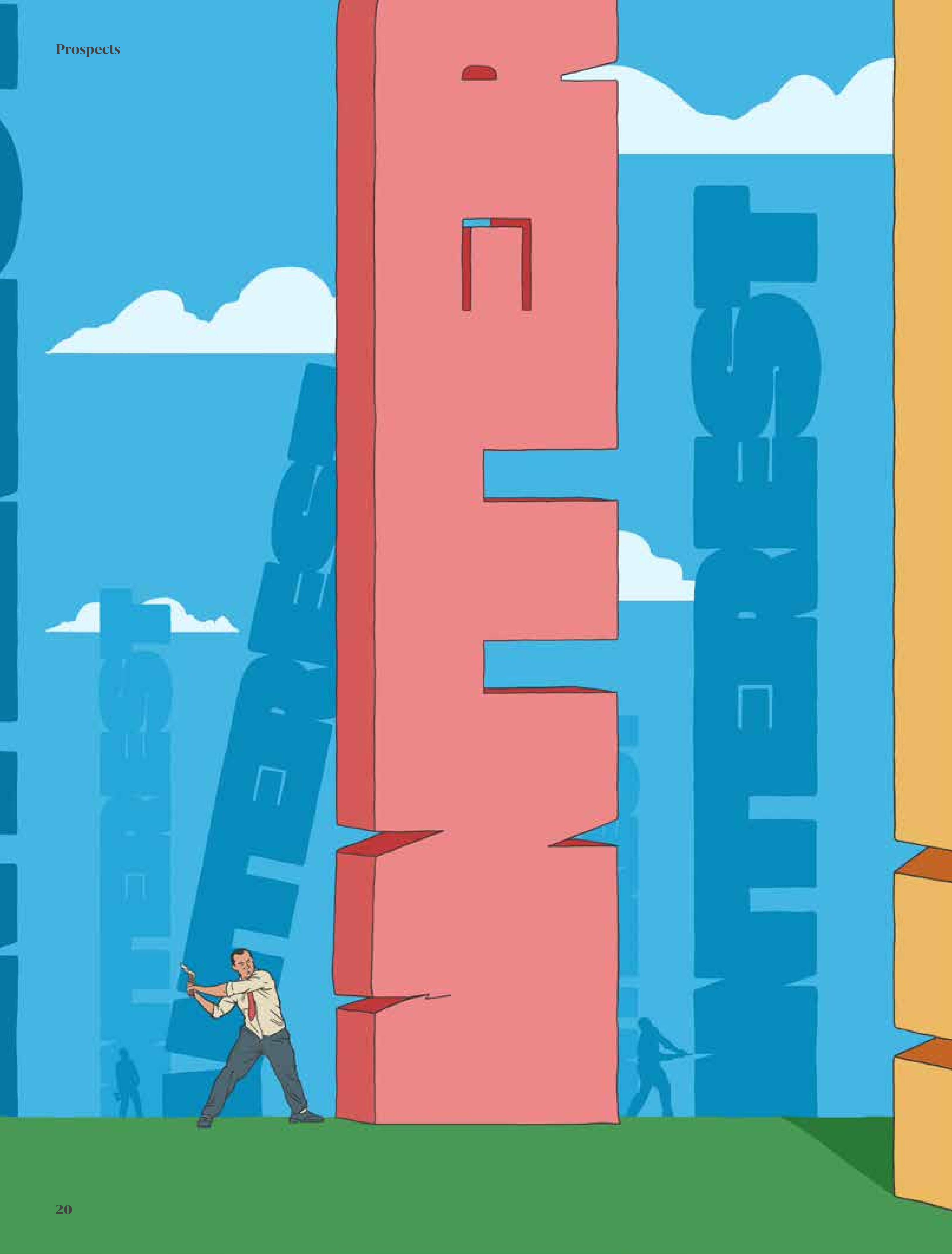
EQUITY MARKET CAP (M)
£22,221

Tesco needs little introduction - it's one of the UK's top retailers in groceries and merchandise and has a market capitalisation of £20bn. The COVID-19 pandemic accelerated the trend towards e-commerce that Tesco had to work hard to capture. The proportion of online sales grew from 9% to 16% of total UK sales by the end of the half year.

The major shift to e-commerce came with c.£533m of extra costs, which includes for more staff in stores and facilitating online orders. The supermarket business is labour heavy, and Tesco warned that the additional costs would be high. Fortunately, further restrictions on pub and restaurant attendance boosted food sales and Tesco benefited from the business rates holiday introduced by the government. Retail operating profit margin therefore held up, increasing by 0.19% year-on-year.

Three quarters of the group's operating profit are from the UK and Republic of Ireland. Tesco have benefited from the expected spike in food sales brought on by the second lockdown without quite as much of a shock to their cost base.

Please read the important notice on page 1.



Wealth planning in focus

Interest cuts

Clare Julian
Wealth Planner

Illustration by Adi Kuznicki

National Savings & Investments, (NS&I) has for long been a favourite of UK savers wishing to see some return on their cash savings.

We have lived in an age of historically low interest rates for some years now, and this appears to show no signs of abating any time soon. Whilst this may be good news for borrowers, for those wishing to save, this poses quite a predicament.

Of course one of the basic tenets in Wealth Planning is to ensure that you have a contingency fund readily available in cash should this be required in short order. However, in a time when interest rates offered by banks and building societies are so low, by holding cash long term, you are effectively seeing your savings eroded, as inflation outstrips the rates of interest enjoyed by most.

This is where NS&I have been a shining beacon of light. By placing cash with NS&I, you are effectively lending money to the Government to support their finances, and the security of knowing that one's cash is held within as secure an institution as this, coupled with their more competitive, market leading savings rates, has meant NS&I have enjoyed huge popularity over the years.

However, at the time of writing, NS&I are due to cut the rates on its savings products and Premium Bond prizes. As Covid-19 loomed, the Treasury increased the cap on what NS&I were permitted to take in, and as the stock markets were plummeting earlier in the year, NS&I were inundated with people rushing for a cash safe haven.

It is important that we strike a balance between the interests of savers, taxpayers and the broader financial services sector

Ian Ackerley (NS&I Chief Executive)

NS&I Savings Rates

Account	Current Rate	Rate from 24th November 2020
Direct Saver	1.00%	0.15%
Investment Account	0.80%	0.01%
Income Bonds	1.15%	0.01%
Direct ISA	0.90%	0.10%
Junior ISA	3.25%	1.50%

NS&I Premium Bonds From December 2020 Draw

Current Prize Fund Rate	Current Odds	New Prize Fund Rate	New Odds
1.40%	24,500 to 1	1.00%	34,500 to 1

Having reached their fund raising cap for this year of £35bn, this led to the need to reduce rates to cope with the cost of such huge new demand. In the words of NS&I Chief Executive, Ian Ackerley, "It is important that we strike a balance between the interests of savers, taxpayers and the broader financial services sector; and it is time for NS&I to return to a more normal competitive position for our products."

Instead of opting for a more stealthy reduction over time, they have opted for quite a drastic reduction. Changes to savings rates took place from 24th November 2020, whilst the premium bond fund prize rate of interest reduction will take place with effect from their December prize draw, and the odds of winning will become less likely too.

So where does this leave savers? For starters, it is important not to be complacent. Do shop around for the best cash savings rate. With regards the rates changes to NS&I products, the cuts are dramatic and instantaneous. Moving to capture even a modest rate may be better than staying put and watching the rates of interest on your cash decrease, and in tandem with that, the spending power of your cash. There are various online comparison sites which allow you to compare bank interest rates.

In times of market turbulence, it is natural that the more cautious side of us takes over, and it is tempting to wish to remove risk from our hard earned savings and avoid or withdraw from investments, but cash risk is very real too, and the announcement of the NS&I rates reductions serves as a bold reminder of this. With the current rate of inflation as at September 2020 running at 0.70%, it is easy to see that by accepting a deposit account earning anything below this, you are compromising the spending power of your cash over the long term. Indeed, the rate of inflation on other items for example that of transport, of school fees, the list goes on, is considerably more.

There are various online comparison sites which allow you to compare bank interest rates.

As I mentioned earlier, it is important to retain some cash readily available to meet any unexpected costs, but think carefully about how much you really need immediately to hand. Circa six months' worth of cash is a good rule of thumb, but everyone is different.

By investing the balance, you should, over time, enjoy growth in excess of inflation. Although there will always be bumps along the way, it is important to view any investments as being for the medium or long term, and this is usually the best way to protect and grow your capital. You only need look at how the stock market has performed over the very long term to see this having played out, and with professional investment management, one cannot be better placed. However, it is always wise to remember that past performance is not an indicator of future results.

To arrange to speak with one of our Chartered Financial Planners, please contact your investment manager.

The information provided in this article is of a general nature. It is not a substitute for specific advice with regard to your own circumstances.

SEGRO

Rheanna Filmer
Research Assistant

PRICE
£9.01

52 WEEK HIGH-LOW
£9.96—£6.41

NET YIELD
2.31%

HIST/PROS PER
104—35

EQUITY MARKET CAP (M)
£10,962

Segro is a real estate investment trust (REIT) that specialises in owning and developing warehouses, data centres and logistics sites in the UK, focussing on 'edge-of-town' spaces. Urban warehouses account for two thirds of Segro's portfolio.

Segro received a boost from the COVID-19 pandemic restrictions. There were two main drivers for Segro's outperformance: stronger demand for data centres and e-commerce.

Large data centres were needed to support working from home and video streaming. At the height of lockdown restrictions, only essential shops were open. All other retailers had to rapidly move online and required the warehouses and logistics capabilities that Segro offered. Segro is taking advantage of its time in the sun and raised capital this year to further invest in the "last mile" strategy of providing easy access into large cities.

Although Segro has many tail winds, its fortunes are still tied to the performance of the online retail sector. This pandemic has far reaching consequences including a likely hit to consumers' disposable income which, in turn, could render Segro's tenants less able to pay rents.

Please read the important notice on page 1.

Stock in Focus

Starbucks

James Ayling, CFA
Research Analyst

Illustration by Adam Mallett

Starbucks started life in Seattle in 1971, not as a coffeehouse serving brewed coffee, but as a retail store that sold premium coffee beans and roasting equipment to consumers and businesses.

In 1982, Howard Schultz joined the business to expand sales and marketing. In 1983, Schultz travelled to Italy to learn more about European coffee culture where he was impressed by the popularity of Italian coffeehouses serving freshly brewed caffé latte to consumers.

Upon his US return, Schultz convinced Starbucks' original founders to trial the concept but they lacked conviction in his idea. Undeterred, Schultz left Starbucks to create 'Il Giornale', a speciality coffeehouse making fresh coffee beverages for consumers using Starbucks' coffee. By 1987, Schultz's determination had paid off and 'Il Giornale' had acquired Starbucks to create the modern day Starbucks Corporation.

Since then, Starbucks has expanded rapidly across the US, aiming to be the 'third space' – a safe and welcoming coffeehouse outside the home or workplace where consumers can relax and socialise whilst soaking up freshly brewed coffee aromas.

This approach has resulted in Starbucks being recognised as a leading direct to consumer (on-trade) premium coffee brand operating in over 80 markets globally with a significant store estate, c.31,000 coffeehouses. This on-trade segment is crucial for Starbucks' success, accounting for over 90% of its revenue.

This store estate is split fairly equally between company owned stores and company licensed stores. It is worth highlighting that Starbucks, unlike peers, prefers to own its stores and doesn't like to franchise its store portfolio. Instead, it prefers to license out a collection of stores or even an entire regional market to a single large operator.

> In the US, coffee culture is well established. Consumers are estimated to drink **c.300** cups of coffee per year

Whilst the difference may appear subtle, in practice, we think this approach helps to ensure higher quality standards and consistency for Starbucks' stores across the world and is part of the reason Starbucks has built and maintained a high customer service rating whilst expanding rapidly.

Since 2018, we have seen Starbucks increasingly licence out its European store estate. This appears to reflect the more competitive coffeehouse market on the continent. European consumers are more selective and opinionated towards their coffee preferences meaning larger chains find it harder to resonate. With higher wages, less flexible labour markets and higher rents, the store operating profitability in Europe is less favourable than other markets.

PRICE
$98.66

52 WEEK HIGH-LOW
$99.32—$50.02

NET YIELD
1.70%

HIST/PROS PER
86—35

EQUITY MARKET CAP (M)
$115,797

In contrast, Starbucks are much more excited about the growth prospects and attractiveness of the US and Chinese coffee markets. To monetise the scale and growth opportunities in these regions, management try where possible to fully own coffeehouses here. This approach is more capital intensive and means Starbucks' financial results are more exposed. Yet cutting out a third party leaves Starbucks with a larger share of the profit pie, if the stores are successful. This disciplined approach to regional dynamics demonstrates the quality of management – focus on areas of competitive advantage and strongest growth!

In the US, coffee culture is well established. Consumers are estimated to drink c.300 cups of coffee per year, yet this is still below coffee consumption in some European countries. Prior to COVID-19, Starbucks identified that c.80% of American customer orders represented 'on the go' transactions – consumers increasingly want to grab a takeaway beverage rather than drink in-store. This has implications for Starbucks' store estate particularly in busy urban centres. Over time, management need to reduce the number of larger 'third space' stores with lots of seating and instead offer smaller format operations. If done right, this newer model could deliver higher order throughput with lower staff and rental costs which could prove margin accretive.

Meanwhile, in China, coffee culture remains in its infancy. Consumers in China's most developed cities consume just 30 cups of coffee per year, suggesting considerable potential growth runway ahead. If, as we suspect, household wealth increases and China's middle class expands, Starbucks' customer base could swell too. This should give the business considerable runway to build out its traditional 'third space' stores alongside efficient 'on the go' formats.

Complementing its stores, Starbucks boasts powerful digital capabilities that we think are underappreciated by investors and help strengthen brand affinity and boost sales. For example, its app learns from customer orders to develop increasingly personalised recommendations. Moreover, its Mobile Order and Pay offering cleverly links up to its store order management system to fulfil remote orders in a timely fashion.

Outside its popular coffeehouses, Starbucks also has an off-trade business where its branded coffee beans, pods and ready-to-drink products are supplied into supermarkets and convenience stores. While off-trade is relatively small, c.8% of 2019 revenue, it expands Starbucks' traditional reach into 'on the go' and in home consumption - acting as a profitable brand extension play.

However, for Starbucks, an important structural risk to consider is whether the COVID-19 pandemic accelerates the 'working from home' trend. If working from home becomes more permanent, Starbucks' on-trade business could suffer less footfall and with limited off-trade exposure, the overall business may require a meaningful restructure.

Please read the important notice on page 1.

A change at the top keeps the focus on clients

Illustration by Sir Radar Drench

On 30th September, JM Finn announced a series of changes to the leadership team, which sees the chief executive role taken up by Hugo Bedford as of 1st January 2021, subject to regulatory approval. We asked Hugo to outline some of his goals, and the challenges that he expects the firm to face in the future.

“I would like to begin by saying how extremely honoured I am to be taking up the role of CEO at JM Finn. Whilst there does not seem much to do on the face of it, the wealth management industry is incredibly competitive and constantly changing, so we need to ensure the business continues to develop and evolve.

What I do know, having been an investment manager at the company since 2006, is that our focus on delivering a highly personalised client service, where investment managers are accountable for all aspects of the client relationship, means we are best placed to give our clients the service that they need. As a firm, we have long committed to this view and unlike much of the industry today, we stand by this approach.

Looking ahead, one of our big focuses for the future, is Wealth Planning – helping our existing clients with their wealth transfer challenges and pension planning. As we enter a period of likely higher tax levels, subdued growth and low interest rates, planning and wealth structuring will be key to long term financial security. Rather than operating as a separate division, this is something that we offer to our clients as complementary to their investment management. Built in the JMF mould of being ‘needs driven’ rather than ‘product driven’, this service is becoming a fundamental part of our offering. The next step for us will be looking to introduce more access to wealth planning in the branch offices.

Another aspect of investment that is becoming increasingly important is the need for more responsible asset management. There has been a tremendous amount of news coverage on Environmental, Social and Governance (ESG) investing, particularly in light of the pandemic. At present, the debate is weighed down by a plethora of often diverging definitions, expectations and considerations but I believe we need to make more ground here, not just for future investors but for our investors of today. From an investment point of view, the most successful companies of the future will be able to demonstrate their purpose, what they contribute to society as well as their impact on the environment so we need to deepen our engagement with these companies in order to unearth the best investment opportunities.

New business is often viewed as a dirty phrase, but the fact remains, firms like ours have to grow to continue to be able to invest back into the business and remain in a strong position to weather uncertain economic and regulatory times ahead.

We are not looking to double in size overnight but rather to continue to increase funds organically and by bringing in the right managers who fit our culture. The business is in strong financial health and this allows us to grow without compromising the level of service we offer clients today. We will continue to invest in our partnerships, such as the Royal Academy and Surrey County Cricket Club, both to continue building our presence but also to enable us to meet our clients and their friends in less formal surroundings – it can be times such as these where understanding and trust develop, both important aspects of a successful relationship.

> One of our big focuses is helping our existing clients with their wealth transfer challenges and pension planning.

It would be remiss of me not to mention Steven Sussman and James Edgedale who as CEO and Chairman respectively have skilfully guided the firm through a difficult period that has seen, amongst other things, the financial crisis of 2008, a change of ownership in 2011, and more recently the pandemic, all the while evolving the business from our more traditional stockbroking roots to the more comprehensive wealth management business that it is today.

I am looking forward to the challenge of continuing their good work and to meeting more clients of JM Finn in the New Year. In the meantime, we encourage all our clients to stay in touch with their investment managers and we hope to be able to meet again in person in the not too distant future.

Hugo joined JM Finn in 2006 from HSBC where he ran the High Net Worth Desk in the Investment Management Division.

He has 28 years of investment experience and has worked in Private Client Management all his working life, starting his career at James Capel in 1992. Hugo has always maintained a flexible approach to managing clients' assets and believes the key to successful wealth management relationships is trust and he cites listening to a client's needs as another key driver of successful wealth management relationships.

As well as looking after clients directly, Hugo currently has oversight for nineteen investment managers in his role as one of three "Area Heads" across the firm.

He is a chartered member of the Chartered Institute for Securities & Investment having achieved the Securities Institute Diploma with papers on institutional investment advice, private client investment advice and regulation & compliance and he holds a 2:1 degree in Economics and Politics from Durham University.

Hugo was recommended as a High Net Worth Manager in The Spear's 500 2019 & 2020 editions and named "outstanding in field" in the former and a "distinguished individual" in the latter.

Married to Charlotte, they have twin boys and a daughter and live in North Hampshire. He is an avid fisherman, enjoys walking and has recently taken up open water swimming. He also plays cricket and still turns out for JM Finn's Stockbroker Cup eleven as well as his local village side.

Collectives Commentary

Is it different this time?

Sam Perry
Senior Investment Manager,
Pictet Asset Management Ltd

Illustration by Jordan Atikinson

With a new prime minister in place, we asked Sam Perry, an investment manager at Pictet Asset Management, to share his thoughts on Japan's fortunes.

Just as we are absorbed by politics today, so were we eight years ago. However, we were not focused on the US, where a second term for President Obama offered continuity. Rather our attention was on that rarest of events, something interesting happening in Japanese politics.

Ever since Junichiro Koizumi left office in 2006, Japan had had a fairground carousel of Prime Ministers who lasted barely a year before being ousted. Eight years ago, however, Shinzo Abe returned to the office of Prime Minister. He had held the office before in 2006, but lasted just a year before stepping down due to ill health. However, by 2012 he recovered, won the LDP leadership in September and then a general election in December.

Abe campaigned on the economy - monetary easing, fiscal spending, and reform – the policies that became known as Abenomics. In fact, this was not his original plan. He had wanted to run on a platform of constitutional change but was persuaded to focus on reforming the economy first and then the constitution by the man who now succeeds him as Prime Minister, Yoshihide Suga. Suga spent the entirety of Abe's second term in office as his Chief Cabinet Secretary. In Japan, this is a ministerial position – not that of a civil servant. As such, its role is rather different from its UK equivalent – sometimes it is more like the Chief Whip, sometimes more like chief advisor and manager, sometimes more like a policy guru. Suga seems to have handled all these roles adroitly. While Abe handled diplomacy, Suga focused on domestic policy. It is not too much of a stretch to state that Abenomics was in fact Suganomics.

So, this year, politics are mirrored versus 2012: there is continuity in Japan while there is change in the US. However, one thing remains the same: foreign investors are uninterested in Japan. It is generally recognised that in 2012 foreign investors had their lowest exposure to Japanese equities since the Bubble. Then in 2013, the combination of Abe's accession to Prime Minister, the promise of Abenomics, and the appointment of Haruhiko Kuroda as Governor of the Bank of Japan (and his implementation of QQE, or Quantitative and Qualitative Easing) brought a surge of investment by foreigners.

However, in 2020 foreigners have once again relapsed into their old indifference. Allocation to Japan is – if anything – even lower than it was in 2012. Partly this may stem from a feeling of ennui that structural reform is still tomorrow's news, and partly it may be that while Japan may be the Land of the Rising Sun, it is not the Land of the Rising Unicorn. An international market that is obsessed with mega-cap software companies, content providers and social media growth stocks in the US finds comparatively slim pickings in Japan.

> While Japan may be the Land of the Rising Sun, it is not the Land of the Rising Unicorn.

That is not to say that Japan has been immune to the siren call of growth. Just as elsewhere, value and cyclical stocks have languished while growth stocks now carry a premium. However, Japan is nothing like as dominated by those growth stocks as the US, where five stocks – Apple, Microsoft, Amazon, Facebook and Google – are now more than 20% of the S&P500, and neither are Japanese valuations as stretched. Indeed, Japan has not rerated at all since 2012 – despite the Nikkei tripling from those 2012 lows to reach 29 year highs in November.

However, while it is hard to find any Rising Mega-Unicorns to tempt the foreign investor, their ennui over structural reform is unjustified. A focus of the Abe administration was to drive growth by getting idle assets back to work. Corporate sector balance sheets were woefully inefficient with net cash and liquid assets equivalent to two thirds of GDP. This made some sense in a period of deflation as the cash could give you a real return risk free. However, it reinforced the deflationary spiral – keep hoarding the cash, keep clipping the coupons, don't invest ... that leads to further deflation etc, which is why Abe introduced the Corporate Governance Code, the Stewardship Code, and a focus on engagement by the huge public pension funds.

The results for investors have been dramatic. Dividend yields have been increasing every year until this year. Buy backs have been steadily increasing. While this year dividends are likely to be slightly down (¥14tn vs ¥14.2tn last year – in 2012 only ¥6.6tn of dividends were paid), TOPIX still offers a higher yield than the S&P500. It is true that cash levels remain high despite rising investment – but only because free cash flow has accelerated even faster than payouts. Corporate restructuring continues apace, and the threat of action from activist investors and hostile acquirers is real.

That last comment may prompt a raised eyebrow – after all, isn't Japan famous for its lack of hostile M&A? Until last year, there had only been 16 completed hostile takeovers since 2000 and the total value of those deals was just a few billion Yen. To be fair, while RJR Nabisco lives long in memory, US doesn't really see very much hostile M&A activity either ... though, admittedly, it has at least had some (somewhat under 0.1% of all M&A deals over the last 5 years, according to Bloomberg M&A database). However, Japan has seen a flurry of deals in the last 18 months notable not only for their size, but also for involving blue-chip listed companies and the participation of blue-chip brokers. No longer can a company shelter behind a web of relationships and cross-shareholdings.

I am always wary of declaring that "This time is different", but there really are some dramatic differences from the start of Abe's administration in 2012, most notably that those cash rich corporate balance sheets are being invested, are being paid out and are under threat. On the other hand, the start of Suga's administration is also very like 2012: a new Prime Minister; a focus on domestic reform; cheap valuations; cash rich balance sheets; and barely a foreign investor to be seen.

Views and opinions have been arrived at by the author and should not be considered a recommendation. Please read the important notice on page 1.

Independent view

Unprecedented

We asked George Burnand of JMChase Property Search to give us his views of the residential property market in the shadows of an extraordinary year.

George Burnand
Partner – JMChase Property Search

Illustration by Adi Kuznicki

Who could have predicted the happenings of 2020? It was all set up to be a fantastic year, the General Election had delivered a confidence boosting result and the previous years of Brexit uncertainty were nearing an end.

The property market was set for some plain sailing, with a lot of buyers frustrated with the lack of good properties coming for sale through 2018 and 2019. The pent-up demand was building.

COVID-19 and the first lockdown was a nerve-racking period as the industry sat on its hands waiting to see what would happen. Very few predicted that after a 30% stock market crash and a likely global recession that the market would bounce back by 10% when it reopened in May. A series of high value properties sold in competition through June and July as the most financially mobile buyers moved ahead of the rush.

Buyers in the more mainstream market now focused on more square footage, green space and the ability to work from home. Upsizing for more bedroom space, a balcony to a garden, a move from London to the Country, without the shackles of the daily commute are all fuelled by record low interest rates and a stamp duty holiday.

Transactions at the lower end have followed suit and while the conveyancing process has proved slow and the mortgage industry has struggled to keep up, the demand still remains. As we entered our second lockdown some of the selling agents are reporting record years and upward pressure on prices.

As an industry we are now looking ahead to 2021. A vaccine has been announced, creating a huge amount of positivity. There is no doubt that the property market is driven by sentiment. When the vaccine is distributed, there is hope that life could return to normal. We are confident that a lack of supply and an enduring demand will keep prices at least at the level they are today.

There are threats to this activity, including the wider damage to the economy, specifically the hospitality and travel sectors, with the inevitable ensuing unemployment. Removing the plaster of the furlough schemes and of course the end of the stamp duty holiday will also hurt. However, an active property market is good for the economy and the exchequer, so we are expecting some continued support from Rishi's financial stimuli, to keep the market active, particularly focused on the lower end.

We are expecting some continued support from Rishi's financial stimuli, to keep the market active, particularly focused on the lower end.

At the top end, both Savills and Knight Frank are reporting strong activity at the Super Prime end of the market, with a number of deals going through between £20-40 million. These transactions are without the added demand from foreign buyers who could add another layer, as and when they can visit the UK.

As a business, we are receiving an unprecedented level of enquiries from potential clients looking to move both within London and out to the countryside. All strong signs that the market will remain active in early 2021.

For those thinking of selling, doing so early in the new year would be a good time. Our advice is to speak to two or three selling agents over the next few weeks to understand how best to proceed in the new year and how to reach all the buyers still actively looking.

For buyers we suggested getting all your ducks in a row so you can hit the ground running and get ahead of the competition in early 2021. Do your homework on your ideal area of search, be decisive on schooling if that's important to you, engage with a good mortgage broker so you have confidence on your budget and, if you want early access to the best properties, engage the services of a property buying agent.

George is a partner with JMChase Property Search, a private client property advisor. He is a qualified Chartered Surveyor and his property career spans 20 years mainly as a Partner with Strutt & Parker in Newbury, Winchester and London. George joined JMChase to head up the Country House team working across Hampshire, West Berkshire and Wiltshire.

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Short term thinking

John Royden, CFA
Head of Research

Illustration by Adam Mallett

On the 19th of March 2020 the plague reached the Bank of England and it cut its base rate to 0.1%. With a somewhat slower response time, the government's National Savings and Investments (NS&I) is now cutting its rates as well.

So that begs the question … "what to do with short term cash?" In our experience, clients have often tended to invest "rainy day" funds with NS&I. Sometimes we have seen clients explain significant cash deposits, as a much need safety net, as discussed by Clare Julian in our Wealth Planning article. We expect the drop in rates may well be matched by a resignation that at least the cash is safe. At the same time, we suspect that many will be exasperated by the effectively zero returns which, by the way, are negative after inflation.

Can we do better? With ten years gilts paying 0.2%, you could buy those and take the upside if rates go lower. Recently members of the Bank of England's Monetary Committee have all been publically airing their thoughts about negative rates. Gilt prices should climb higher on negative base rates, but then you carry the risk of rates increasing and effectively locking in 0.2% per annum when, by waiting, you could have got more.

> With ten years gilts paying
> **0.2%**
> you could buy those and take the upside if rates go lower.

Index-linked gilts might help, particularly for higher rate tax payers. If, as we expect, we get a weak central bank response to inflation then the net of higher inflation boosting returns and lower than expected interest rates could provide a platform of support. The risk, as I see it, is that quite high retail price index (RPI) expectations of c.3% are implied by the current prices.

Some argue that high inflation expectations of 3% are driven by very high demand for index-linked gilts from pension funds, in their efforts to hedge out inflation risk.

> The date of RPI reform has been confirmed as
> **2030**

Now that the date of RPI reform has been confirmed as 2030, it is possible to more confidently buy index-linked gilts beyond 2025 without the fear that the Chancellor might advance the likely date of reform from 2030 to 2035 and expropriate tens of billions of pounds from investors for the benefit of the UK's public accounts.

The alternative for cash seeking a short-term home is to allow us to suggest a combination of asset classes that typically display less volatility than equities, namely government and corporate issued debt, multi-asset and total return funds and other alternative asset classes, such as infrastructure, property and commodities, such as physical gold. The allocations would be determined by each individual's risk appetite and other factors, such as the investor's investment time horizon. Additionally there is scope for optimising net-of-tax returns with capital gains in excess of the annual allowance being taxed at lower rates than income tax.

Asset allocation and sector focus

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

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

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

Here we present a snapshot of the current views.

Sector Views

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

Asset Allocation

Overweight (+) Neutral (/) Underweight (−)

UK EQUITIES		
UK	−	We acknowledge that Brexit risk could still yet rear its head and drive a run on the pound that would make overseas investment more attractive. The cyclical rally in financials, banks and oils is now playing out, but longer term, we want to see the UK's larger service sector return to growth before being more positive.
INTERNATIONAL EQUITIES		
North America	/	Whilst we remain over-weight non-UK equites, we downgraded North America to neutral during the quarter. The election result has been positive for investors with expectations of smaller fiscal stimulus more than balanced by expectations that the Fed will keep rates lower for longer. Expectations of a Republican Senate mean that left wing shareholder value-destroying legislation is unlikely. We expect more upside but there is now potential for non-tech and non-US universes to catch up. We don't see North America out-performing as it has done in the past.
Europe	/	We upgraded Europe to neutral following their EUR 750 billion support package, although the approval process is being slowed by Austria and Poland. Public pressure is driving corporates to focus on sustainability, which could increase the cost of capital and lower returns. If the next round of Chinese stimulus is more focussed on domestic consumer demand, rather than infrastructure spending, then this could dent expectations for an export led recovery.
Japan	/	We upgraded to neutral as Japan has been out of the trade war news and the yen has the potential for reverting to safe harbour mode if vaccines disappoint. We hope for corporate reforms delivering on their promises and driving higher returns. More share buy backs will also help. We also think valuations will deter international sales of Japanese equities as will Suga's continuation of Abenomics.
Asia Pacific	+	China is not imploding under a debt burden as many once feared. Instead, leverage is supporting the economy in a co-ordinated way which we expect to be supportive for Asia Pacific equities. China was first into the COVID 19 pandemic and should be first out in a way that leads the region. Recent data has been encouraging and we expect prospects to improve further.
Emerging Markets	/	Extreme USD strength is obviously no longer a concern and a gradual improvement in commodity prices, linked to a Chinese infrastructure stimulus, could help those emerging markets more sensitive to commodity exports. Argentinean contagion is a worry and raises the risk premium. Ongoing tensions between India and China should not be forgotten and remain a risk.
BONDS		
Conventional	−	We have reached the stage with conventional gilts that they are now being described as return free risk. Ten year gilt yields are now at 0.32%. We don't see ten year rates going negative and if interest rates climb from these levels there is greater downside risk.
Index Linked	+	Linkers are a good hedge against the low probability event of higher than expected inflation. It is not beyond the realms of possibility that the recent strong money creation could drive inflation above current expectations.
Coporate bonds	−	Given our overweight equity position we would prefer to be underweight corporate bonds. There is a possibility that corporate spreads could reduce further but we think the upside from spread contraction has probably reached its limit.
CASH		
Cash	+	We went to neutral cash before the US election and will look to deploy the cash on any pull-back.
PROPERTY		
Property	−	We weigh up many factors including Brexit risk, valuation and weak interest rates helping demand. Overall the commercial slant of most listed property assets leads us to dislike the sector for the time being.
ALTERNATIVES		
Alternatives	+	We have been favourable towards gold and infrastructure within this sector and remain so.

Meet the manager
Antonia Consett
Senior Investment Manager, Leeds

Lives Thirsk, North Yorkshire

Family Married with two children

Started at JM Finn 2007

Favourite Film Top Gun (so many memorable songs on the soundtrack)

Charities I am involved with York Minster, the NSPCC and Art for Youth Charities

Dreaming of Life before Covid

Passion Tennis and lately baking

Tell us a bit about how you have kept in contact with your clients in recent months, given you have not been allowed to meet with them physically?

As our IT department did such an excellent job in setting us all up to work remotely as soon as the lockdown came in March, I have been able to keep in touch with clients by email, telephone and indeed video calls. It has been great to see some of my clients virtually, which has compensated for not being able to see them in person. Our research team have also been producing regular updates so that we, as investment managers can send relevant information to clients to keep them up to date with our thinking.

Market volatility aside, what do you see as the biggest challenges for investors?

For clients who need income, maintaining dividends in order to cover their income requirements is a major area of focus for us. We have seen a number of companies that have cut dividends and our challenge has been to ensure clients do not see an interruption in their income payments. Even if some investors do not need income, the power of compounding reinvested dividends helps to achieve wealth accrual. In addition, how to protect wealth and pass it efficiently down through the generations is a growing challenge given the funding that the government has injected into the economy in order to support the country this year. Will they tinker with capital gains tax, inheritance tax, pensions etc.? Thankfully, we have an excellent wealth planning team to help with any tax or pension planning needed by our clients.

What advice would you give your younger self when trying to break into the wealth management industry?

If possible, study subjects at university or college that are finance or economics based. In any branch of finance, you need to do professional exams, including in wealth management, so becoming familiar with financial terms and concepts before starting a career will be invaluable when needing to do the exams. Brush up those communication skills; a large part of our job is investing in our relationship with clients and helping them understand our thinking and navigate the jargon, and take any work experience offer you can find to gain that crucial on-the-job experience.

Finally, which areas of the market most excite you in terms of investment performance over the next few years?

I think technology will continue to be a theme. There may be some concern over regulation, but the tech companies are revolutionising how we live now and regulators will hopefully recognise this. The emergence of 5G, Artificial Intelligence and Robotics will evolve and we need well-capitalised tech companies to drive this forward. Healthcare will also be key as we live longer and the opportunities in evolving our healthcare move on, whether it be DNA testing, robots carrying out operations or gene therapy. Otherwise, the continued evolution of on-line shopping and the digitalisation of our lives. Finally, geopolitics will certainly shape our future, particularly between the US and Asia so investors will probably need a foot in both camps should these two regions continue to tussle.

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