JM FINN

No.45 *Winter 2023*

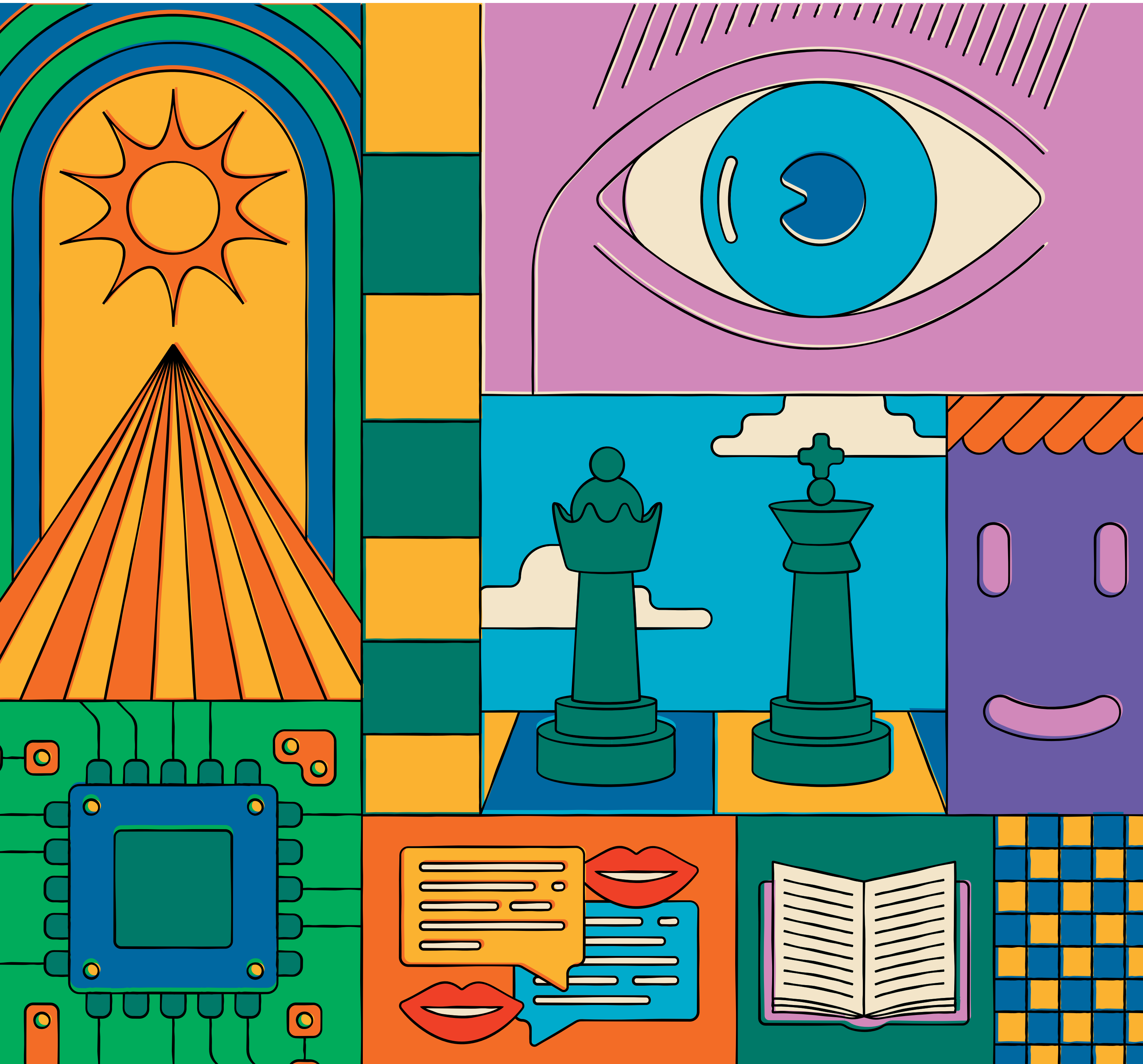
Prospects

The JM Finn Quarterly Periodical

A family affair
The influence of family ownership

All hail AI?
The boom in artificial intelligence

Demystifying annuities
Why sales are currently elevated



No.45

Winter 2023

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Important notice

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Editor
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Welcome

2023 stands out as another difficult year for investment markets and the wider economy.

Since our last edition of Prospects, markets have continued to display the kind of volatility that has typified the rest of the year. Rising wages and overheads mean companies are having to pass on costs to consumers, dampening spending in some discretionary sectors in the UK. Against this backdrop of turbulence in markets and the wider economy, our investment approach remains steadfastly the same: to invest for the long term in good companies with solid balance sheets. Despite the gloomy conditions, there are some positive signs: energy prices and inflation are gradually waning, potentially leading to falling interest rates in the new year.

Many of our clients may have had a number of jobs throughout their working lives, all with separate pensions. It can be very difficult to keep track of all the schemes currently held, let alone monitor their performance. A solution to this problem can be to consolidate pensions, which has been a key area of focus for our wealth planning team this year as more and more clients choose to take advantage of the simplicity and flexibility afforded to them by consolidating their individual pots into a SIPP. Full details of the process and what to expect are on page 26. For those approaching retirement, there can be a dizzying array of options. Annuities are often a source of confusion, yet they have become potentially more interesting in recent times due to the correlation between annuity rates and interest rates. Michael Law of our Wealth Planning team explores the topic on page 16.

Many of our readers will have recently received a link to our biennial client survey. This affords us a huge opportunity to gain insight into how we are perceived by our clients and what you, our clients, need from us to help you meet your financial challenges. In addition, our industry regulator has let it be known that they are looking to become increasingly data driven and direct client feedback is one area they are looking to focus on. I hope you found the survey a chance to share your views and thank you to those who took the time to respond.

Thank you also to those who participated in the Prospects survey that we included with the summer edition of the magazine; your response is invaluable in helping us to shape Prospects and other communications to your needs and I am delighted we got such positive feedback. Details of the survey results can be seen on page 18.

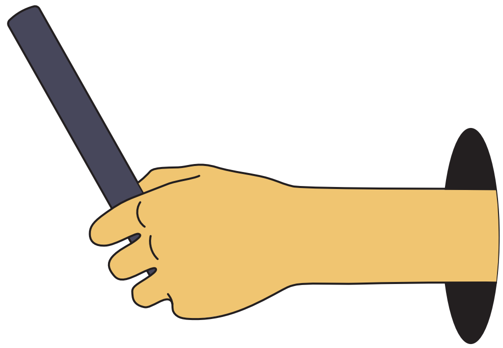
2024 will undoubtedly be an interesting year for investors, with elections in the US, for the European Parliament and, most likely, in the UK. With polls predicting a change of government here, it could well be a year of substantial change. We don't anticipate too much concern in the markets but changes to personal taxation levels could well be on the cards, so it might be prudent to run a health check on your finances ahead of time, which we would be happy to assist with.

Finally, I announce that our Chairman Steven Sussman is retiring after many years at JM Finn. Steven has led the firm in various capacities for over 25 years, for which we are incredibly grateful. He will be replaced as Chairman by Luc Bertrand, who has been a non-executive director of JM Finn since 2011. I would like to personally thank Steven for his outstanding contribution to the firm, more of which can be read about on page 30.

Hugo

Hugo Bedford
CEO

A family affair



Nina Etherton
Assistant Fund Manager

Despite ostensible issues with governance, capital allocation and succession planning, many public family owned companies surpass the average performance of their respective industries, writes Nina Etherton, Assistant Fund Manager.

It may come as a surprise that many listed companies are still under the influence of their founding family or a significant long-term shareholder.

As well as retaining a material proportion of the shares, they may control the votes, have seats on the board or hold management positions. Some of the most well-known companies on the stock market fall into these categories, spanning all geographies and sectors: from Tesla to H&M, Samsung Electronics to Berkshire Hathaway, LVMH to Softbank.

Interestingly, those companies where the founding family or long term shareholder retain a significant influence appear to outperform the wider market. A study by Credit Suisse which tracked the share price performance of a group of 1,000 companies with family ownership since 2006 claims this outperformance is as much as 3% on average every year.

The irony is that there are many potential problems that come with this continued influence. The three most obvious are succession, capital allocation and corporate governance. So what is it about family influence that can, in some cases, overcome these challenges and drive superior financial performance?

Succession

The principal impediment to the long-term success of family owned businesses is succession. For example, who inherits ownership and control when the founder retires or dies? Elon Musk, an early investor in Tesla who is now CEO and has the controlling shareholding, was mindful of this when he announced that his eleven children will not inherit his Tesla shares upon his death. Instead, Musk suggested the shares be passed to an educational institution, clearly feeling this would result in more reliable stewardship of his innovative company than his burgeoning brood. Should future generations retain an influence in the company, the danger is that they are not as capable as their predecessors and the company could deteriorate over time. Similarly, another risk to us as investors is the possibility that a family member could sell down their stake after it is inherited. In this scenario, our investment might suffer from downward pressure on the share price.

Brown-Forman, the US drinks company whose portfolio of global brands includes Jack Daniels, has been very successful at avoiding these pitfalls to ensure the smooth transition of responsibility between generations of the founding Brown family (they still retain a 51% stake, having listed the remainder on the stock market after the end of Prohibition). As an example, in 2021, the previous Chairman, George Garvin Brown IV, retired and was replaced by his brother, Campbell P. Brown, without any operational issues. Importantly, the selection process to work at the 153-year-old company is more stringent for family members than for normal employees. There is a 'Next Generation Committee' which aims to engage and inspire the sixth generation, from which future leaders will likely be picked. This emphasis on meritocracy rather than entitlement is a key ingredient to a fruitful partnership between external investors and a founding dynasty. The benefits are clear at Brown-Forman where the shares have delivered an average growth rate of 11% per annum over the last fifty years, which is as far as our data goes back.

The principal impediment to the long-term success of family owned businesses is succession.

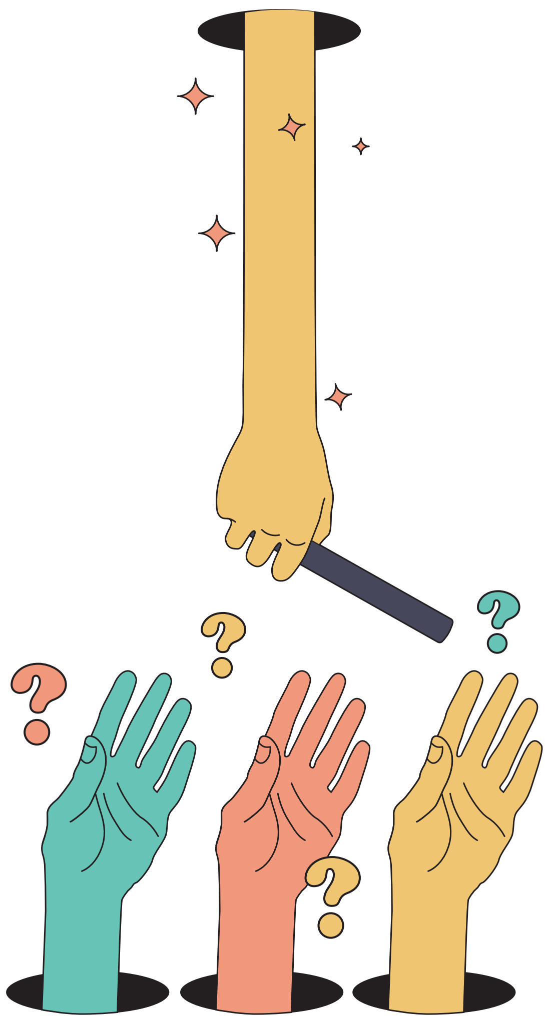
Capital allocation

The second problem with some family companies is that – particularly as they mature and are passed down between generations – they err on the side of caution when it comes to spending the company's capital. Family owned companies tend to spend a lower proportion of revenue on research and development (R&D) compared to their non-family peers. The paradox is that despite this frugality, their revenue and profit growth often outpace those of the wider market. This is because limitless R&D budgets do not necessarily equal financial success. The cautious influence of a long-term family shareholder can help avoid expensive vanity projects, focus more on practicalities such as routes to market and develop more efficient decision-making processes. In other words, they get more bang for their buck. Financial caution also results in a reluctance to take on leverage, or borrowing, to fund growth and a propensity to avoid large acquisitions. Leverage and acquisitions are both standard levers management can pull to fuel growth. The key is to use them with prudence.

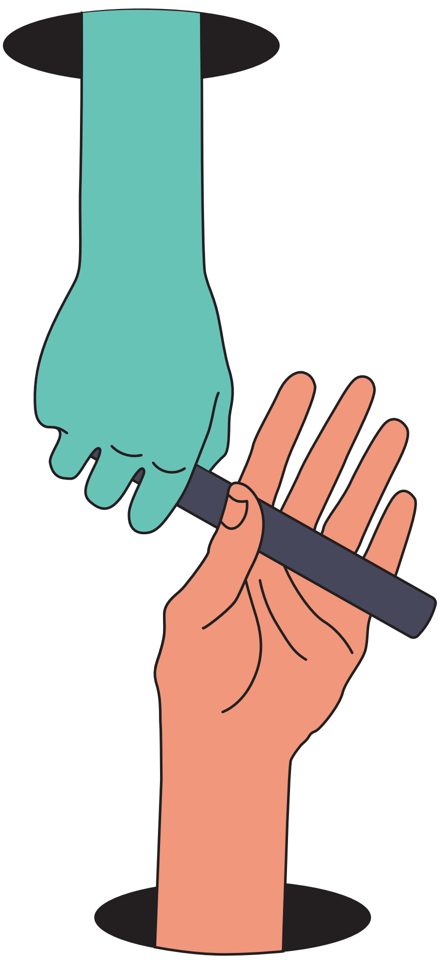
Lifco, a listed Swedish holdings company majority owned by Swedish investor Carl Bennet, exemplifies restrained but highly effective capital allocation. Its business model is to acquire small companies in the dental, sustainability and demolition markets. The common thread linking these seemingly incongruous sectors is that Lifco finds them to be fertile hunting grounds for niche businesses with attractive financial characteristics such as high revenue growth and high margins. Bennet's desire for a reliable and growing income means that 30-50% of profits are paid out in dividends. This imparts a sense of responsibility in management who reinvest the remaining profits selectively into new acquisitions. Importantly, they avoid large-scale deals which are usually more expensive and likely to add less value. Although additional debt will sometimes be taken on to fund particularly attractive deals, the majority are funded with cash. This controlled approach to mergers and acquisitions (M&A) has allowed Lifco to grow its dividend at an average annual rate of 17% since the 2014 Initial Public Offering (IPO).

Another example of the long-term benefits of cautious capital allocation is Robertet, a French flavouring and fragrance company based in Grasse, France. Founded in 1850, it is now under the influence of the fifth generation of the Maubert family who have a significant stake and management positions. A comparison between Robertet and its larger French competitor Givaudan reveals that, while both spend similar proportional amounts on research and development (R&D), completely opposing emphases are taken in terms of balance sheet strength. Over the last five years, Givaudan has taken on 33 times more debt than Robertet. So far, Givaudan and Robertet continue to grow at a similar level, however the additional risk Givaudan has taken on, could leave it exposed to potential operational issues and economic challenges. In contrast, the benefits of Robertet being held largely en famille mean it is much more resiliently capitalised.

> In some cases, family influence can contribute to a sense of responsibility and stewardship that result in superior standards of governance.



> Family owned companies spend a lower proportion of revenues on R&D compared to their non-family peers.



Governance

Criticisms are occasionally raised about the governance of family owned companies. For instance, when a family business lists on the stock market to gain an injection of external capital, they may choose to issue dual share classes: one for new investors and one for the founder or founding family with higher voting impetus. This can be problematic for the external investor, whose opinion will be less influential than that of the founding family, often regardless of the amount of shares bought.

Meta (formerly Facebook) is a prime example. Mark Zuckerberg – Founder, Chairman and Chief Executive Officer – holds 95% of the Class B shares whereas most other investors hold the Class A shares. One Class B vote is worth ten Class A votes. Through this structure, Zuckerberg enjoys 59% of the total votes with only 13% ownership of the total shares, allowing him to retain control of the company, while still being able to benefit from external investors' liquidity. The problem is that checks on his power are therefore limited. In the Reality Labs division, he has so far invested over US$40bn into the Metaverse (a virtual world users can access by donning a virtual reality headset). However, this vanity project is yet to turn a profit and made a loss of US$13.7bn due to the amount being spent on continued development. Zuckerberg does have a strong track record and these investments may well pay off, but even large investors with a differing view of the future of communication will struggle to have a material impact on the direction of travel.

> **The cautious influence of a long-term family shareholder can help avoid expensive vanity projects.**

In some cases however, family influence can contribute to a sense of responsibility and stewardship that result in superior standards of governance. Deborah Cadbury's book Chocolate Wars tracks the progress of her family's chocolate empire from its humble beginnings in Birmingham in 1824. She illustrates the benefits of their Quaker capitalist principles. Believing that cocoa was a nutritious alternative to gin – the tipple of choice in the early nineteenth century – the Cadburys grew the sales of their innovative products quickly. For instance, instead of excessive advertising, which they viewed as disingenuous, they relied on the quality of the product to grow the customer base. Their intention to do business for the benefit of society rather than personal gain along with their pious principles of hard work helped steer the brand to global popularity within only a few generations.

Modern standards of stakeholder capitalism in family owned companies are often supported through a foundation structure. This is the case with Associated British Foods, a UK listed company whose underlying businesses include Primark and Fortnum & Mason. The Weston family has a 56% stake, principally through the Garfield Weston Foundation, which donates £90m annually to a multitude of charitable causes across the UK. This commitment to multigenerational philanthropy gives the foundation a clear incentive to ensure Associated British Foods is managed responsibly with a long term-time horizon, since the company's dividend is the ultimate source of funding.

Conclusion

Not all quality companies are family owned, and not all families are good stewards of capital. Like any investment approach, nuance is required to identify those companies that will benefit most from the stabilising influence of family involvement. The constant that emerges in companies that overcome the hurdles around succession, capital allocation and governance are those where the family or large shareholder instils a long-term view. Preparing thoughtful and meritocratic succession plans, treating capital with care through focusing on cash generation, and engendering a sense of responsibility to investors and stakeholders are all key.

In their cult classic book Freakonomics, Steven Levitt and Stephen Dubner argue that 'incentives are the cornerstone of modern life'. The alignment of incentives is a crucial tool for the long-term investor. If our aim is to participate in the trajectory of the companies in which we invest for decades to come, then aligning ourselves with management styles predicated on generational wealth preservation is surely a good place to start.

Please read the important notice on page 1.

Guest Editorial

AI: From chess champion to everyday companion

Jed Backhouse
Associate Director, Brand and Digital, SEC Newgate

10,000 words per minute. That's the speed at which Google Bard read the text across the JM Finn website and various Prospects issues.

Internet users have been asking questions to 'generative artificial intelligence' tools, such as Google Bard and OpenAI's ChatGPT, since their general release between November 2022 and March 2023. This is just the surface, however, of a much deeper and much more capable technology that has emerged into public use over the past year. So, what's it all about? Why is everyone talking about it and why should you care?

In this article we will take a brief look back in time to understand how AI got where it is today, then consider some important current issues as AI becomes a more regular tool for many businesses and individuals.

What were you doing in 1997?

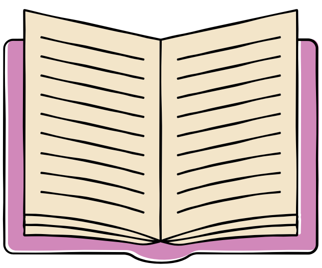
Artificial intelligence (AI) has been through a turbulent history over the past 75 years, since the Turing Test first suggested in 1955 that machines have the potential to be intelligent. It took various success stories and some failures in both computing and robotics through the 1960s-1980s to get to some significant breakthroughs in the 1990s. IBM's Deep Blue supercomputer was the first to hit the news headlines: the strongest chess computer ever built, it beat world chess champion Garry Kasparov in under 40 moves (a rarely mentioned aside is that Kasparov asked for a rematch, but IBM declined). The news spread globally and the excitement — and anxiety — around a future of intelligent machines started to build.

Things began to pick up. The Massachusetts Institute of Technology launched an 'emotionally intelligent' robot that recognised and reacted to human audio and facial expressions — and we got our first Roomba, an intelligent vacuum cleaner that navigated and cleaned rooms in your home. By 2011, the big tech brands had joined the party — Apple launched Siri, its intelligent virtual assistant, and a few years later Amazon launched its smart speaker Alexa, who could shop online.

But while consumer sentiment was all very positive about machines that could help in daily lives, one story got many thinking beyond the day to day. Eugene Goostman, a chatbot developed by a group of three programmers in 2014, not only won the largest ever Turing test contest (a test of a machine's ability to display human behaviour) at the time, it also fooled 29% of judges that it was human. Human minds began thinking — and worrying, as we do — what might happen if machines got more intelligent?

Keep in mind that all the time early AI machines were being taught to learn from reading data and information, the internet was quickly becoming a global free-for-all repository of (mostly unregulated) content. And as we discovered with Search Engine Optimisation (SEO) when the likes of Google Search took marketing and communications teams by storm in the late 1990s, the more people (and businesses) ask questions and provide answers, the quicker you can find an answer to pretty much anything. Now combine this with an intelligent machine that can read the entire internet and respond with a relatively human conversation: enter the era of generative AI.

“By early 2023, two of the big tech companies in the west had launched their universally accessible and user-friendly chat tools that brought AI to the masses.



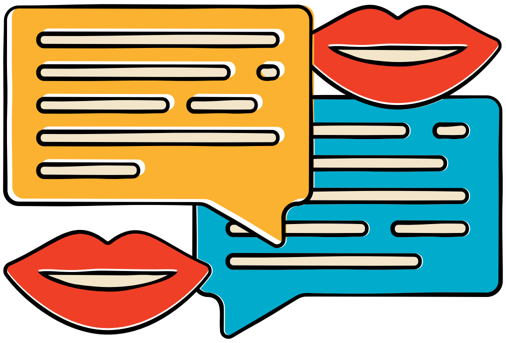
“Multiple studies have proven that bias and stereotyping are significant issues.

The world at our fingertips

By early 2023, two of the big tech companies in the west had launched their universally accessible and user-friendly chat tools that brought AI to the masses — Microsoft launched Bing Chat and Google launched its platform Bard. These were beaten to public release by OpenAI (developer of ChatGPT), founded by a consortium of six Silicon Valley stalwarts, of which Elon Musk was one (though he resigned from the board in 2018). And despite Microsoft's huge US$1 billion investment and 49% ownership stake in the company, OpenAI continues to operate as a private entity — projecting a non-profit, research-driven brand that “benefits all of humanity.”

This was the point at which many businesses and creators changed the way they think about AI. What was at first a novel conversation tool, or a means to find answers to questions that otherwise you'd have to read Google's best bet from search results, was now able to learn throughout a conversation and provide insights using a wide variety of sources. Businesses started asking questions about reputation — could past controversies be rediscovered? Was information about their company correct and up to date? What if one of their employees entered confidential business information and it was used in a response elsewhere in the world?

As you can imagine, things can go wrong. Firstly, remember that by asking questions and providing information to Generative AI tools such as Bard or ChatGPT, you are teaching it — feeding it data that it will store and reference in future. If you're a business owner and you don't already have an internal AI usage policy, I suggest addressing this quickly. View content entered into AI tools as the equivalent to posting in the public domain.



“

In a similar way to refining a Google Search presence, now more than ever, we must all be aware of our digital footprint.

Secondly, while it's great that more and more people are finding new ways to use these tools, remember that their data bank is the entire internet. And a vast amount of content on the internet is unverified. Multiple studies have proven that bias and stereotyping are significant issues, especially in image generation AI tools, with one recent study[1] showing that 97% of 96,000 images generated white males when given prompts like 'CEO' or 'director' and images of cashiers and housekeepers skewed towards women of colour. Other issues have emerged around copyright of AI-generated content. Meanwhile 'deepfake' content has become a powerful weapon in the wrong hands, as Sir Keir Starmer recently discovered when he became a victim of a deepfake audio clip falsely purporting to show him swearing at staff members.

While governments and regulators across the world are exploring ways to manage the potentials of publicly accessible AI tools — and the businesses behind them — we should not be afraid of a future alongside AI. But we must also not ignore the issues right now. In a similar way to refining a Google Search presence, now more than ever, we must all be aware of our digital footprint.

[1]Stable Bias: Analyzing Societal Representations in Diffusion Models (arxiv.org)

So, what's next?

The second half of 2023 has seen multiple iterations of these generative AI tools — each one bringing more integrations and wider possibilities. Microsoft Copilot is becoming a standard operating tool in many businesses, covering a wide variety of admin tasks and giving creative and strategic human minds more time to think. AI-powered chat features have taken over voice apps such as Siri and Alexa. AI automation tools are streamlining how brands and influencers create and publish content. And more recently, custom generative pre-trained transformers (GPTs) - a type of artificial language model used to create chatbots - are allowing developers and creators to build entirely new AI tools that will fuel bigger and brighter ideas still. It's like a virtuous technology developing circle. Like growing a plant in a garden that produces seeds that grow into new and better plants (a metaphor provided by Google Bard to describe the idea).

It's difficult to predict where this will ultimately go. It's already apparent that AI technology requires massive amounts of energy to power, which presents a real-world threat to our planet. Another possibility is that GPT-powered AI tools could become so powerful that they can automate all human creativity and innovation. Alternatively, and more realistically, new AI tools could become so widely used that they become ubiquitous - meaning that everyone would be able to access them and no new tools would be needed.

Whatever happens, AI is certainly here to stay and will only become more integrated into daily life over time. Are you ready to embrace it?

www.secnewgate.co.uk

Company Meetings

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

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

Sir John Royden
Head of Research
(Shell)

Jack Summers
Research Assistant
(Genus, IMI)

COMMUNICATION SERVICES
Vodafone

CONSUMER DISCRETIONARY
Dowlais, Tesla, Tractor Supply

CONSUMER STAPLES
Ocado, Reckitt Benckiser, Diageo

ENERGY
Shell

FINANCIALS
Prudential, HSBC,
Lloyds Banking Group

HEALTH CARE
Genus

INDUSTRIALS
DiscoverIE, Experian
IMI , Intertek, RELX
Ceres Power, Spirax Sarco
Smiths Group, Diploma
Exponent, Axon Enterprise

INFORMATION TECHNOLOGY
Cadence, Nvidia
Advanced Micro Devices
Palo Alto Networks, Fortinet
Zscaler, ServiceNow,
Microsoft, F5, Salesforce

MATERIALS
Croda International,
Hill & Smith, Rio Tinto

REAL ESTATE
Home REIT, LondonMetric
Prologis

UTILITIES
National Grid, SSE, Pennon

1.

Genus

Equity Market Cap (M) **£1,285**

Health Care
Alison Henriksen – Chief Financial Officer

Genus runs Nucleus farms which produce porcine and bovine semen and piglets ("genetics") for farmers across the world. This improves the quality of their herds on a range of metrics including milk yield, growth rates, carcass quality and birth rates.

The company has struggled of late in part due to weak hog prices in China which have fallen from RMB30/kg to just RMB17/kg – below the cost of production at RMB19/kg. The Chinese producer market is relatively unconsolidated, meaning the overall herd size (supply) and therefore the hog prices tend to be quite volatile. Alison is hopeful that as the market matures, consolidation will result in larger producers with stronger balance sheets and that Genus will see improved revenue stability from its volume-based royalty contracts.

Investors have been eagerly awaiting Genus' PRRSV (Porcine Reproductive and Respiratory Syndrome Virus) resistant genetics coming to market. Resistance has been achieved via gene editing as opposed to genetic modification. This produces biologically identical pork that Genus believe will make government approval straightforward. Alison highlighted that PRRSV resistant genetics will add US$2/head to the cost of Genus genetics, which is significant considering they currently charge US$1.5-US$2/head. This may seem expensive, but PRRSV costs farmers US$1bn/year in the US alone and so the cost benefit to the producer is clear. Genus anticipate it will take 5 years to achieve herd immunity and therefore capture the full $2/head value.

I queried whether we should be concerned by consumer pushback on eating gene edited pork, to which Alison clarified that the UK and Europe are very different in terms of acceptance versus the rest of the world. The plan for Genus is to target PRRSV resistant genetics into the US, LatAm and China where early indications are that uptake will be strong.

2.

IMI

Equity Market Cap (M) **£4,106**

Industrials
Luke Grant, Group Financial Controller

In its simplest terms, IMI makes 170,000 different valves and actuators (machine components that produce force) of all shapes and sizes for a host of end markets. For context, their largest valves, for use in liquefied natural gas terminals, weigh 88 tons, and their smallest, as light as 500 grams, are used in air conditioning units. IMI is somewhat of an ongoing turnaround story: having been relegated to the FTSE 250 in 2014, recent performance has seen IMI return to the UK's blue-chip FTSE 100 index.

The period 2014-18 under the then CEO Mark Selway was a difficult period for IMI in terms of headline numbers, with a -0.7% underlying revenue growth rate and margin contraction from 17.7% in 2013 to 14% in 2018. Grant pointed out that the trajectory of results after 2014 was a product of underinvestment in preceding years, coupled with a lack of foresight on the trend direction and cyclicality of the product portfolio and their end markets. Selway's strategy sought to refresh IMI's product range to drive growth and pricing power and overhaul operations to increase efficiency, providing the foundation for performance under current CEO Roy Twite. Whilst some end markets are still cyclical, IMI have made efforts to spread end market exposure across the business cycle to deliver more consistent growth. This was evident in results for the first half of 2023, where strong performance in process automation and transport more than offset a decline in life sciences to deliver +3% group organic growth.

Despite this, IMI continues to trade at a discount compared to industrial peers with similar financial credentials on a price/ earnings basis. To earn a re-rating it not only needs to deliver on its targets for consistent organic growth and improved margins, but disprove that 'old habits die hard' and maintain investment, ensuring those credentials are sustainable over a longer time horizon.

3.

Shell

Equity Market Cap (M) **£169,393**

Energy
Maarten Tiemstra, Senior Investor Relations Officer

Shell and BP, the UK's largest oil and gas companies, trade on forward price/ earnings ratios of 8 and 7 – lower than USA listed companies ExxonMobil on 11 x and Chevron on 10 x.

Shell's new CEO, Wael Sawan, appears to be tackling the valuation gap. Oil companies should have similar growth prospects regardless of whether they are in the UK or the USA (driven by the price of oil) and trade at broadly similar price/earnings ratios.

Under Ben van Beurden, the previous CEO, Shell appeared to proactively react to robust media and political commentary, urging them to take greater steps to reduce hydrocarbon output in the name of combating global warming.

At the same time, Shell increased its aspirations for investment in renewables. Shareholders were worried that the yields from investing in renewables would not be as high as Shell hoped they would be; and that, from a financial perspective, this would damage the share price.

Under the new CEO, the language has changed. 'Culture shift' and 'the realisation that hydrocarbons are here to stay' are part of the new vocabulary. Guidance has also moved from 'declining oil production' to 'stable oil production'. Shell also refers to 'capital discipline' as a goal, which implies being more rigorous with renewable investment. Shell also has a preference for deep water operations, where it has a competitive advantage. Managing deep water is difficult and hard work. Few can do it well. There is also a desire to make Shell's assets more streamlined, efficient and less risky by locating them in countries with relatively higher scoring political systems, like the USA.

Please read the important notice on page 1.

Wealth Planning in focus

Navigating annuities

Michael Law
Paraplanner, JM Finn

Michael Law, Paraplanner at JM Finn delves into the possible circumstances where purchasing an annuity may be beneficial, and explains why annuity sales are currently elevated.

Purchasing an 'annuity' simply means swapping your pension fund for a guaranteed income for life. However, annuities remain a topic of confusion for many people – and have sometimes been viewed as offering bad value. This perception may now be changing: ongoing raised interest rates have led to an increase in annuity rates, triggering a recent sharp rise in annuity sales.

Understanding types of annuities and annuity rates

There are many different types of annuities and options available in the marketplace, such as those that include inflation protection. An annuity 'rate' determines the level of income you will receive, and is based on different factors including your age and the value of your pension fund. Anything that might mean your life expectancy is reduced could mean you get a higher income. This is because annuity providers decide your income based on how long they think you will live. The longer they estimate you will live, the longer they will need to pay you.

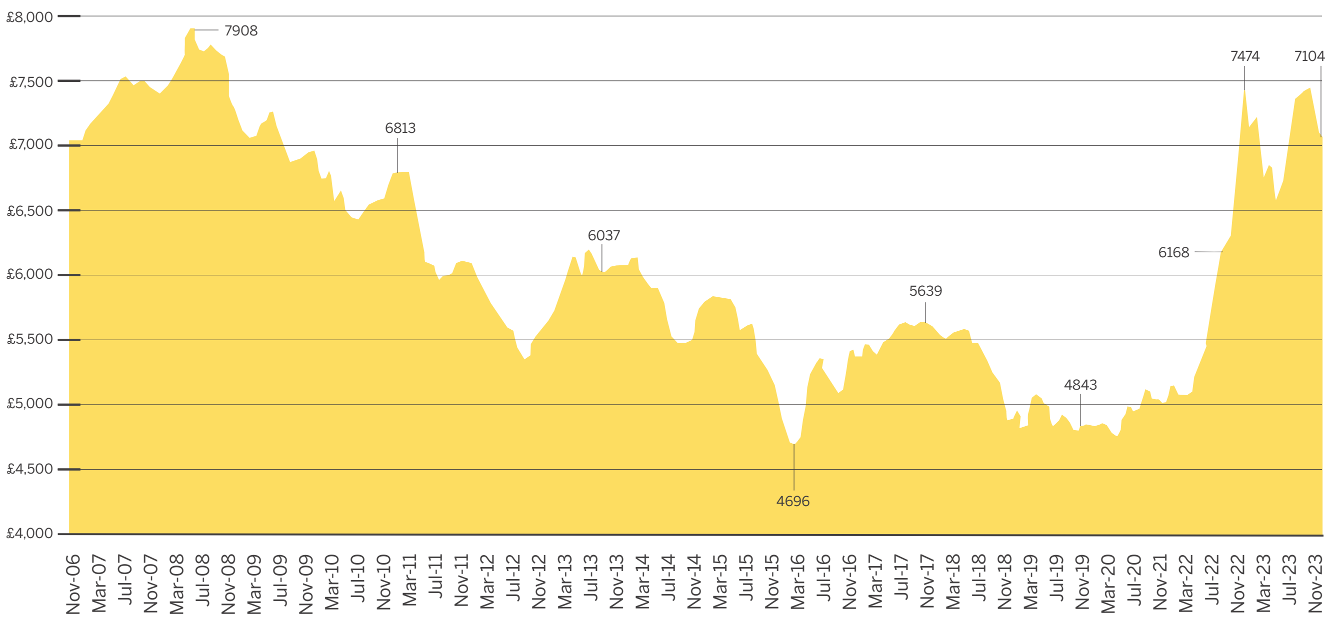
Are annuities and interest rates linked?

Annuity rates are significantly influenced by interest rates and exhibit a direct positive correlation with them. Annuity providers tend to buy government bonds to create reliable returns for their customers. When interest rates go up, bond returns rise with them and this boosts annuity rates too. As an example, as of mid-September 2023, a 65 year old with a £100,000 pension fund would secure an annuity of £7,462 per annum[1], a sharp increase from an all-time low of £4,696 per year for equivalent circumstances in August 2016.

The Bank of England plays a pivotal role in shaping the financial landscape, including annuity rates. When the Bank of England started raising interest rates in December 2021, annuity rates began to rise, triggering elevated sales of annuities. In 2023 interest rates increased even further, resulting in around 16,000 annuities being sold in the first three months of 2023, the highest figure since 2019[2].

[1]Based on single life only with no spouses pension, level in payment with no indexation and no guarantee period in the event of early death.
[2]The Association of British Insurers.

UK annuity rates 2006 - 2023



Note: annuity rates chart for £100,000 fund, aged 65, level and single life
Source: Sharingpensions.co.uk

Annuity providers decide your income based on how long they think you will live.

Who might annuities be suitable for?

Those who are approaching retirement age and are seeking a reliable income stream for the rest of their lives may wish to consider an annuity. They could be attractive for individuals with a lower risk tolerance who prioritise financial stability and want to try to safeguard against outliving their savings.

Partial annuity purchases

In the realm of annuities, there exists a flexible option: partial annuity purchase. Instead of committing their entire savings to an annuity, clients can choose to invest a portion of their funds. This approach allows individuals to balance their need for a secure income with the desire to maintain liquidity and flexibility in managing the rest of their assets.

In summary

Understanding the correlation between annuities and interest rates is essential for making informed financial decisions: keeping an eye on the Bank of England's decisions and their impact on annuity rates can empower individuals to make prudent choices about their retirement.
If you are considering an annuity, it is important to evaluate your options carefully and shop around. Quotes are only guaranteed for a limited time and annuity rates change frequently. Rates can also vary greatly between providers, and your current pension provider may not offer you the best deal.

If you would like further information on annuities, or to find out how our Wealth Planning team can help you with any aspect of your retirement, please speak to your Investment Manager.

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

JM Finn News

Prospects survey: what did our clients tell us?

Carrie Lennard
Marketing Manager

Thanks once again to everyone who completed the survey on preferences for Prospects magazine and wider communications from JM Finn which we included with our summer edition. We're very pleased to hear that so many of you enjoy Prospects and find it a valuable read. Highlights of the survey results are in the infographic opposite.

Survey feedback

It's clear that the majority of Prospects readers are happy with the format, frequency and coverage of Prospects. As a result, we'll keep the format largely the same and maintain the quarterly send schedule. However, from this issue onwards you'll be able to spot a few tweaks to the magazine which we've implemented based on your survey feedback:

Glossary: As 27% of our readers wanted terminology clarified, we will include a lexicon in every edition of the key financial terms used for that issue. Financial content can often be complex by nature, however we work hard to clarify challenging topics, such as term premiums in this edition. Our Understanding Finance column, which was voted one of the most popular articles, is another way that we deep dive into financial terminology.

Improved readability: We have removed dark background colours throughout the magazine in order to make Prospects easier to read for our clients with reduced eyesight.

Better visuals: Our Asset Allocation and Sector Focus sections have been redesigned with a new look to make them more visually appealing.

More thematic content: There were many requests for us to cover different themes across investing and wealth planning. In this issue we've put the spotlight on family owned companies and pension consolidation; you'll find more in-depth coverage in future editions.

Print/ digital: A majority of our readers prefer to receive the magazine in print format, so we will continue to offer this as the default format. We also offer an email version of Prospects for clients wishing to opt for digital-only, please speak to your Investment Manager if you would like to switch.

Is Prospects read?

90%

of our clients read it regularly

Ease of understanding

84%

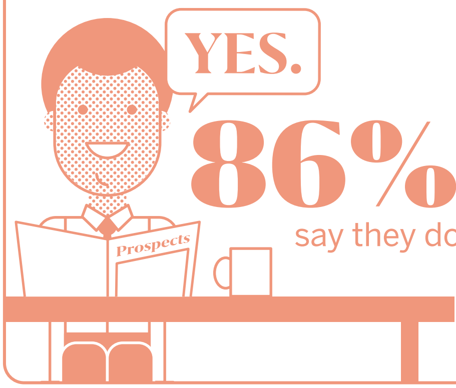
agree that Prospects is clear and easy to understand

Explaining terminology

27%

would like us to clarify investment terms used in Prospects

Do readers find Prospects interesting?



86%

say they do

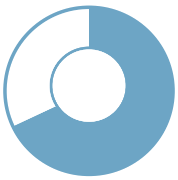
Most useful content

At **80%** each, **Independent View** and **Understanding Finance** were the top rated

Is Prospects relevant?

68%

feel the articles related to them



Digital vs print

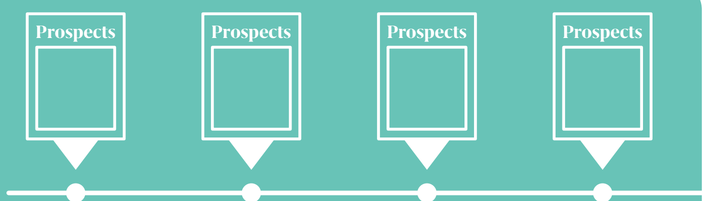
1 in 5

are interested in our digital content but don't currently subscribe

Frequency preferences

67%

would like to continue to receive Prospects quarterly



Collectives commentary

The future of investment in clean energy

William Argent
Fund Manager, Gravis Advisory Limited

The global clean energy industry has experienced rapid growth over the past decade, driven by governmental and corporate commitments to environmental and sustainability initiatives. Over time, these ambitions have continued to expand.

The Paris Agreement, adopted by 197 countries at the UN Climate Change Conference (COP 21) in 2015, brought in a legally binding international treaty with an overarching focus on limiting global temperature rises to no more than 2% above pre-industrialised levels. More recently, major economies have committed to achieving 'zero' greenhouse gas emissions, which is a crucial step in the process of limiting global climate change, underpinned by frameworks to support a global energy transition.

The 'energy transition' refers to a move away from a global economy dependent on energy generated through burning fossil fuels towards one that operates and relies more heavily on electricity produced by renewable and low-carbon forms of power generation. On the supply side, renewable energy generation has become a key component of the energy mix. According to the World Economic Forum, in 2022, renewable forms of energy accounted for 40% of the total electricity generation in the United Kingdom[1], while the US Energy Information Administration says this figure is 23% in the US[2]. Meanwhile, on the demand side, consumption of energy is slowly transitioning away from fossil fuels. Two key objectives are the 'electrification' of end users (i.e., shifting away from fossil fuels to renewable energy sources) and the decarbonisation of energy intensive industry. In this regard, consumers are incentivised to switch to electric vehicles (EVs) and to install heat pumps, while the potential exists for greater use of green hydrogen and carbon capture technologies to help decarbonise large industrial users in future.

Short-term challenges

Despite what has been, and remains, a supportive backdrop for the clean energy industry, the sector has proved a challenging area for investors over the past few years. Indeed, the (predominantly US-focused) iShares Clean Energy UCITS ETF Index has lost approximately 60% in value between its peak in January 2021 and the end of October 2023. The high point certainly coincided with a peak frenzy for environmental, social and governance (ESG) investors (i.e., those with a focus on ethical and sustainable investing) attracted to the sector's environmental credentials, but more recently the sector has suffered from the high inflationary backdrop and aggressive tightening of monetary policy in key jurisdictions like the US, the UK and other European countries.

Inflationary pressures and higher interest rates have increased the costs for development projects that were struck at prices that no longer appear economically viable. Supply chain constraints pinching at key project delivery points in coming years serve to compound the problems. Developers and component manufacturers have faced margin pressures for some time in a highly competitive industry, while higher reference yields have proved a headwind to the perceived value of operational projects, where value is essentially driven by discounting expected future cash flows at an appropriate rate.

Long-term opportunities

With influential central banks signalling that the interest rate hiking cycle is finished and key governmental initiatives in the US and Europe priming the clean energy sector with huge stimulus packages, we believe the sector is potentially reaching a positive inflection point following its material de-rating (i.e. downgrading of its perceived investment potential).

[1]World Economic Forum, 6 January 2023
[2]World Energy.org, 28 February 2023
[3]EIA, EPA, Joint Committee on Taxation, IRA, November 2023

“There are incentives to drive greater adoption of electric transportation and biofuels among consumers, and hydrogen hubs and carbon capture within industry.

The most powerful example of stimulus is the combination of the Inflation Reduction Act (IRA) and Bipartisan Infrastructure Bill in the US, which allocate US$260bn and US$80bn[3], respectively via tax credits and incentives for investment in the energy transition. The legislation – labelled as a 'game changer' – provides a decade-long growth runway for projects including wind generation, solar generation, and energy storage solutions by introducing predictability over governmental support. There are incentives to drive greater adoption of electric transportation and biofuels among consumers, and hydrogen hubs and carbon capture within industry. There are also credits for domestic manufacturing supporting the clean energy power sector and allocations for grid enhancement and EV charging infrastructure. Some industry players have suggested the IRA could catalyse total investment approaching US$3 trillion over the next decade.

We would contend that the energy transition is a multi-decade, structural trend that will provide many opportunities for investors at all levels of the value chain. After a period of reset for the industry, largely driven by macroeconomic factors, the prospects for recovery should not be overlooked.

William Argent, Fund Manager at Gravis Advisory Limited

Gravis Advisory Limited.
Registered Office: 24 Savile Row, London, W1S 2ES.
Registered Number: 09910124

Please read the important notice on page 1.

Stock in focus

Intuitive Surgical

Henry Birt
Assistant Research Analyst

When Intuitive was founded in California in 1995, the field of robotic-assisted surgery (RAS) was conceived.

Intuitive Surgical ('Intuitive') designs, manufactures and sells robots through its da Vinci brand, which assists surgeons in conducting minimally invasive surgery (MIS). They also produce instruments and service the robots. A da Vinci system is a set of robotic arms that can be operated by a surgeon from a nearby console. The system operation mimics the use of the human hand but, crucially, without the tremors inherent in even the steadiest of hands. The arms of the system can also bend and rotate much further than the human hand, thus augmenting a surgeon's dexterity too. This allows surgeons to conduct surgery through minute incisions. The result is less patient blood loss, less scarring, less pain and faster recovery times compared to traditional open invasive surgery.

Procedures are split broadly into two categories: cancer and benign conditions. Insurance payments to hospitals for cancer and other complex procedures are at higher rates than for benign tumours. Intuitive therefore targets benign condition procedures with its cheaper da Vinci Xi Surgical System. Their full featured da Vinci Xi is designed for more complex procedures. System sales, priced between US$500,000 and US$2.5m, are typically ad hoc, however the sale of consumables (US$700-US$3,500 per surgery) and servicing contracts are of a more recurring nature. Recurring revenues provide more visibility to investors and with this predictability, often come higher valuation multiples.

Recurring revenues provide more visibility to investors and with this predictability, often come higher valuation multiples.

8,200 da Vinci systems are currently in operation in hospitals globally. However Intuitive is only c.30% penetrated into its total addressable market (TAM) of an estimated 6 million soft tissue surgical procedures. This TAM should continue to grow as the company expands into new geographies and new uses and thus Intuitive estimate they are only c.10% penetrated into their long-term 20 million procedure global TAM.

Group revenue has grown at an annual average of +15% per year over the last five years, a solid performance considering revenue growth slowed to +1% in pandemic-affected 2020. Total revenue growth has been driven by +17% per annum growth in instruments, and a +12% per annum sales increase of da Vinci systems and services. The benefit of the recurring consumables revenue model was demonstrated in the pandemic: sales of da Vinci systems declined -12% in 2020 compared to 2019, yet instrument sales still grew +2%. Operating margins are among the highest in the medical technology sector and range between 35% and 40%. A key metric watched by investors is the number of procedures conducted on Intuitive's systems, which has grown by an annual average of +16% over the last five years.

Equity market capitalisation (m)
US$109,438

52 week high-low
US$358.07 - US$222.65

Net dividend yield
0.00%

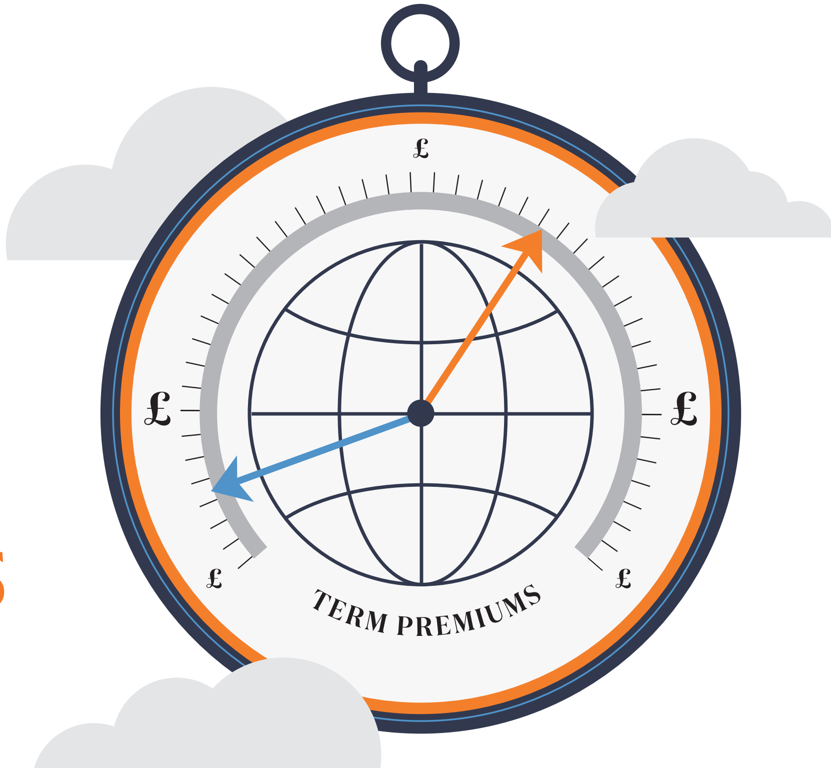
Price/earnings ratio
56

With the financials clearly impressive, we are naturally left asking what can go wrong. For an answer, we turn to the competitive dynamics of the RAS market. Intuitive has for the last two decades operated in a monopoly. However, inevitably with the scale of the available profit pool, well capitalised competitors have been preparing to enter the market. The most serious competition comes from Medtronic and Johnson & Johnson. Medtronic is developing an RAS system named Hugo, and Johnson & Johnson is developing its six-armed Ottava system. Both systems have their relative merits but up until now both have experienced delays in the US launch timelines, with entry of Medtronic's Hugo (the closest to launch) not expected until 2024. Intuitive will not give up its position easily though and has built a strong competitive 'moat'. Surgeons have had up to 20 years to become comfortable with operating the da Vinci system and the accompanying instruments. Competitors are likely to have to demonstrate a very significant cost and/or health benefit to induce surgeons to switch systems. Intuitive also has a 20-year head start. In a market where regulatory approval can be hard won, catching up with Intuitive will be a tall order.

The risk though is that upon entry of a new system in the market, the acquisition of new customers in new markets becomes harder. In those markets, where the above dynamics are less strong, more cost-conscious customers could begin to consider other systems and a degree of pricing pressure may exist. This is the key risk for Intuitive and it is hard for investors to forecast the outcome as and when competition emerges. We continue to monitor these competitive dynamics carefully.

Please read the important notice on page 1.

Bond Focus



Term premiums

Sir John Royden
Head of Research

Sir John Royden explains 'term premiums' in bonds – and how the JM Finn research team use them as a barometer to spot potential opportunities in corporate and government bonds.

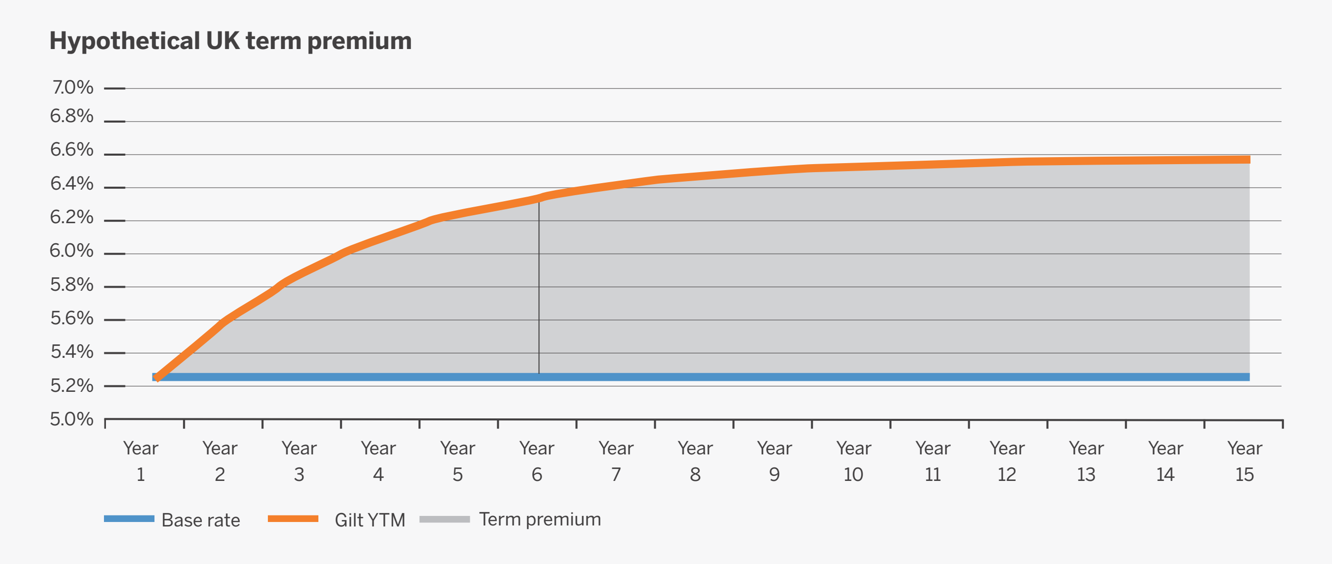
After years in the wilderness, many bonds (including government bonds, known as 'gilts') are currently generating their highest returns since 2007 – and consequently have become of renewed interest to investors. At JM Finn we calculate and monitor bond 'term premiums' to give us insights into trading in bonds and gilts and to discover potential investment opportunities for our clients.

What are bonds and 'term premiums'?

At its simplest, a bond can be thought of as a type of IOU or a loan. In the same way that we might expect to receive a higher interest rate from a savings account where we cannot access the money for a number of years, the 'term premium' of a bond can be thought of as the extra premium that investors demand for holding longer-dated bonds instead of shorter-dated bonds. If this risk is high, investors will demand higher 'yield to maturity' (YTM) to compensate them for the risk of missing out on higher deposit rates in the future. 'Maturity' is the date the repayment on the bond is due, and the yield to maturity is the average annual yield that an investor would get from the bond each year until it reaches maturity. The yield to maturity includes both (a) interest payments and (b) capital gains or losses.

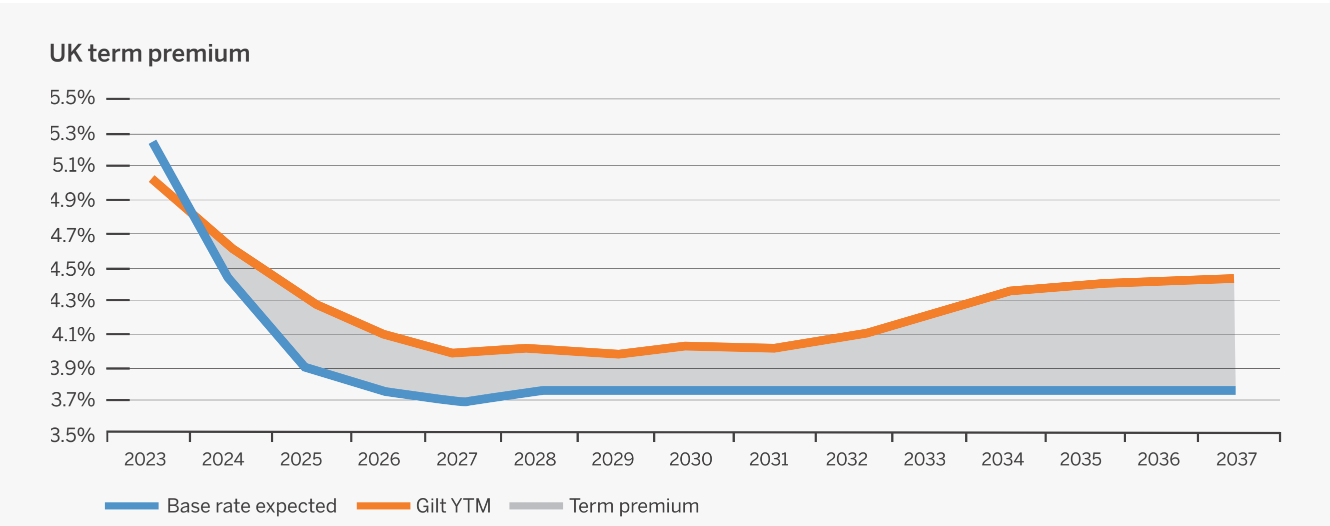
The concept of a term premium is illustrated by the hypothetical example in the first chart, which compares the yield of gilts (shown by the orange line) to base rates (shown by the blue line). In this example a gilt maturing in year 6 has a yield to maturity of 6.36%; in other words the investor will receive an average annual return of 6.36% on the purchase price.

The base rate is assumed to remain unchanged at a rate of 5.25% per year, which indicates that an investor depositing money with a bank for the same 6-year period could expect to earn 5.25% each year. The 'term premium' is the difference between the gilt yield and the base rate – so over the six years, the term premium of the gilt is 1.11% (6.36% - 5.25%, or the orange line minus the blue line).



In reality there is of course always a risk that inflation could push interest rates higher or the government could over-issue gilts and drive yields higher, so both base rates and yields could be subject to change.

Today's term premium (i.e. the additional return for longer-dated bonds) for bonds has to be estimated by seeing what people expect base rates to be in the future. I turn to the gilt market to get the yield to maturity rates for gilts, and the futures markets to get my estimates of what base rates are going to be. The below chart shows what the UK curve looks like on the assumption that the implied base rate stays constant from 2031 onwards.



You can see from the gap between the base rate line and gilt yield to maturity lines in the chart that a UK term premium persists for much of the next eight years but then increases further after 2032, suggesting a perception that investment in longer-dated UK gilts will become riskier thereafter. Factors exacerbating this perceived risk include concerns about the lasting effect of raised inflation, a weak pound or government debt funding.

As ever, we continue to closely monitor term premiums and bond yield rates throughout global markets in order to support our Investment Managers' strategies for client portfolios, and to try to ensure that we have an optimum mix of investments to generate returns for our clients.

Please read the important notice on page 1.

Financial challenges in focus

Should I consolidate my pensions?

Anna Murdock
Head of Wealth Planning

Like many people, you may have worked in multiple jobs with various pension schemes run by different providers. It can be very easy to lose track of the pensions you own – UK pension pots worth nearly £27 billion are currently deemed to be 'lost'[1]. Our Wealth Planners can help you track down pensions and decide if combining them into a single scheme (known as 'pension consolidation') could be the right option for you.

What are the benefits?

— **Simplification:** A key advantage is the ability to keep track of your pension funds in one place. As a JM Finn client, using our pension consolidation service will mean your Investment Manager will be a single point of contact for both your investments and your pension;

— **Less paperwork and administration:** If you have worked in multiple jobs, it can be very difficult to keep up with the administration for each of your pensions – consolidation can greatly streamline the paperwork you receive;

— **More retirement options:** Newer pensions can be more flexible, giving you more options to access your money when you are retired;

[1]https://www.abi.org.uk/news/news-articles/2022/10/call-on-uk-retirement-savers-to-take-action-on-26.6bn-in-lost-pensions/

— **Better ongoing servicing and management:** With pensions across multiple schemes, it can be much harder to spot when a fund is underperforming. Our Investment Managers will monitor the performance of your pension on an ongoing basis to ensure your money is working as hard as possible for you;

— **Ease of wealth transfer when you pass away:** Pension funds are typically free of inheritance tax and having a single pension can make the transfer of your wealth to the next generation a smoother process for them.

Can I still consolidate my pensions if I have already retired and am drawing from one or more of my pensions?

Yes if you are in drawdown then you can still consolidate your plans.

Are there any circumstances where consolidating a particular pension might not be advisable?

— Some pensions have inbuilt benefits such as guaranteed annuity rates which may be lost if the pension is transferred;

— If an existing pension has high exit fees, it may be best to avoid incurring them by transferring it.

Our specialist Wealth Planners will conduct a full review of your pensions and advise you on the best course of action.

What is the process for consolidating pensions with JM Finn?

Our Wealth Planners can conduct a review of your pensions to assess their suitability for consolidation. There is no obligation for you to go ahead with consolidating your pensions unless you choose to do so.

1. **Provide any pension statements and valuations you hold** to your Investment Manager for review by the Wealth Planning team

2. **Sign a letter of authority** to give permission for the team to contact your pension providers on your behalf

3. **Pension summary:** The team will prepare a summary showing all your pension plans, free of charge

4. **Fact find/risk profiling:** If you wish to proceed with advice, we will conduct a fact find meeting and agree a risk profile with you

5. **Pension advice report:** Pension advice report will be drafted and issued to you

6. **New Self Invested Personal Pension:** Should you choose to go ahead with consolidation, at this stage the Wealth Planning team would set up your new pension and arrange transfers from your old pensions for you. Your Investment Manager would open a new pension account on your behalf.

For further information about pension consolidation or to find out about other ways in which our Wealth Planning team can assist you to simplify your finances, please speak to your Investment Manager to arrange a meeting with one of our chartered Wealth Planners.

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

Independent View

Managing currency challenges in a changing world

Henry Wilkes
Head of Private Client Services, Oku Markets

As families are becoming more global, implementing a currency plan to mitigate against the effects of exchange rate fluctuations is increasingly important, writes Henry Wilkes, Head of Private Client Services at Oku Markets.

Since 2020 and the COVID-19 pandemic the world has been constantly changing – creating major challenges for governments, businesses and families alike. One noticeable trend is that families and their members are becoming even more global than ever before. This is having a major influence on their choices when it comes to planning their wealth and succession strategies. Families and high net worth individuals are now adopting a much more globalised footprint, bringing with it the dawning challenges of how they manage everything on a day-to-day basis.

We are seeing examples of a son or daughter choosing to go to university in America rather than the UK, which raises the question of how their studies will be funded while they are in America. Managing the risk of properties that have been acquired in multiple jurisdictions may require extra funding or produce additional revenue streams in different currencies. The larger the footprint, the more geographical, geopolitical and tax issues raise their heads – requiring a more global approach with broader expertise. Many people may hold assets in multiple jurisdictions and therefore are subject to legislation in different countries, which adds to the complexity.

Nowadays many families need a whole team of advisers to help them through the minefield of developing a financial strategy. This team will normally include various lawyers, tax advisers, accountants, bankers and investment consultants; however, based on the diverse nature and reach of their global footprint, the services of an independent specialist currency adviser will often also be required.

Currency is probably one of the most overlooked, underestimated and necessary services required by any business, entrepreneur, family, or high net worth individual operating on the global stage.

Currency is probably one of the most overlooked, underestimated and necessary services required by any business, entrepreneur, family, or high net worth individual operating on the global stage. It doesn't have to be complicated and if used correctly it could save or make you money, but used incorrectly or not at all it may lose you money.

So how does currency management work? Simply put, it is the purchase or sale of one currency versus the purchase or sale of another currency. For example, a UK client needs to buy US$50,000 to pay for his daughter's annual university fees in America, so he needs to sell enough GBP to buy US$50,000. The current rate is 1.2275 so $50,000 will cost the client £40,733. That looks easy enough, so where's the problem? Currencies are a 24-hour global market with prices changing all the time, so the client is likely to receive a very different price. If a client receives 1.2150 as a rate from his bank or broker, with their margin added on, that would mean US$50,000 costs him £41,152, an extra £419.

Lesson No 1; It's difficult to judge what is a good price on an arbitrary day and time with market prices constantly moving and banks and brokers charging different fees.

Lesson No 2; A client is right in striving to achieve 'best price' when booking a trade but this should be the outcome of a clearly defined process to manage currency effectively. 'Best price' has become a mantra in the industry because that's how banks and brokers believe they can differentiate themselves when selling their currency services. If a client always books currency trades at an arbitrary moment in time then they are not creating an environment whereby they are able to control and achieve their agreed objectives.

Lesson No 3; Currency planning is a prerequisite. In the above example, annual university fees are US$50,000 but living and travel costs each year could amount to another US$50,000, bringing the annual cost to US$100,000. Over the four years, the family will need to buy US$400,000 to cover the anticipated cost of their daughter's university education. This is an ideal framework to plan a currency strategy, allowing the family to manage the currency risk around the established payment deadlines, control the timing and amount of their purchases depending on market trends to minimise the cost by avoiding any adverse market movements in GBP/US$.

A good illustration of sudden highly volatile market activity was the Truss/Kwateng budget in 2022. Between the 15th August and 30th September the GBP to US$ exchange rate dropped from 1.2150 to 1.0325 around 15% but by 7th November it had moved back to 1.1855 – a 14.8% rise, eradicating most of the move. One man's luck is another man's pain but implementing a currency plan allows a client the opportunity to take advantage of favourable market trends or protect themselves against adverse market movements.

okuprivate.com

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

JM Finn *News*

JM Finn chairman retires

After a tremendous 26 years at JM Finn, our Chairman, and former CEO, Steven Sussman retires at the end of this year.

Steven joined JM Finn in 1997 as Managing Partner and was quick to make an impression, establishing the Firm's first branch office in Bristol in 1999, which was soon followed by new offices in Yorkshire and East Anglia and later in Winchester.

In 2006, Steven oversaw the incorporation of JM Finn into a private limited company, taking on the new position of Managing Director. In 2011, he was instrumental in establishing the partnership with Delen Private Bank, which provided the stability and cultural fit that the Firm and its clients needed.

He became CEO in 2015 and continued to build the business, recruiting more investment management teams, and strengthening the Firm's governance structure. In 2017, he oversaw the introduction of the Firm's Wealth Planning division, which has become integral to the business.

Steven successfully steered JM Finn through the transition from traditional stockbroker to the wealth manager that the business is today. Under his tenure, the Firm's assets under management have risen from c£1.5bn to today's £10bn+. His calm, measured approach to management and his strong engagement with staff have been integral to the Firm's success and have made Steven a hugely respected figure at JM Finn.

Having carried the Chairman's role since 2021, he has now decided the time is right to 'hang up his boots'. He leaves a great legacy with the Firm and we are hugely grateful for his dedication to the business over so many years. A true leader whose mantra will long be remembered - "we don't want to the biggest, we want to be the best."

Special report: the Rise of the US Tech Titans

To support our investment process, we have a dedicated research team who continually meet with companies in person to assess their suitability for investment.

One of our Research Analysts recently visited 16 major US firms based on the West Coast – including many of those pioneering the world's adoption of artificial intelligence (AI). Our special report explores the ways in which these companies are simultaneously attempting to change the face of our everyday lives through AI, and working to achieve a competitive advantage at the same time.

Here is a snapshot of just some of the key findings. You can download the full report via the JM Finn website.

— Most businesses that were met view Generative AI as a promising revenue driver rather than a cost-cutting measure.

— Companies like NVIDIA are currently experiencing strong demand, because their products provide the essential building blocks for AI application development.

— The tech industry's increasing complexity is outpacing the supply of skilled labour. This shortage presents an opportunity for AI to fill the gap, but labour costs are likely to continue to account for a significant proportion of company costs.

— Hyperscaler companies – Amazon, Microsoft and Google – own and operate large cloud data centres which enable companies to scale up their operations quickly. Virtually every tech company spoken to emphasised how important the hyperscalers were to enabling their businesses to grow.

Please read the important notice on page 1.

Understanding Finance

VALUATION MULTIPLES

Jack Summers
Research Assistant

You might well have heard your Investment Manager referencing 'valuation multiples' when discussing your investments. The two most common multiples we look at are the price/ earnings (PE) and enterprise value-to-EBITDA (earnings before interest, taxes, depreciation and amortisation) multiples (EV/EBITDA), with each possessing merits depending on the type of company.

The PE multiple is most commonly used and is particularly useful for comparing stable, profit-making companies. It is calculated by dividing the share price by earnings per share (EPS) to produce a multiple that allows us to compare companies of differing size, sector and region.

In contrast, the EV/EBITDA multiple is useful where similar companies employ different accounting methods for the depreciation of capital expenditure (i.e., fixed assets a company has purchased) and amortisation of investments and goodwill. Depreciation and amortisation (D&A) can either be capitalised and then depreciated across a number of years or expensed entirely in a particular year. The two methods have different impacts on earnings which would make it harder to compare two companies. The benefit of using the EV/EBITDA multiple is that EBITDA is positioned above D&A on the income statement, nullifying the impact of the differing accounting methods and making the two valuations more comparable.

Another example where the EV/EBITDA multiple is more useful is for loss-making companies that are investing heavily in growth. Typically these companies will be generating EBITDA but have very low or negative earnings, making them appear expensive on a PE basis.

The EV/EBITDA multiple is by no means a perfect solution however, as EBITDA is a non-statutory item. Companies have different methods of calculating EBITDA, meaning adjustments often need to be made to compare apples with apples.

Glossary of key terms

Initial Public Offering (IPO) – where a private company is floated on a stock exchange for the first time, offering shares to the public.

Leverage – this entails a firm using borrowed money — bonds or bank debt — to invest and to generate a return on that investment.

Liquidity – a company's ability to turn its assets into cash without causing a major change in the assets' price.

Macroeconomic factors – factors focused on the performance of economies, including inflation, gross domestic product (GDP), inflation or deflation, and unemployment.

Market capitalisation – a measure of a company's value, calculated by multiplying its current share price by the total number of outstanding shares.

Maturity of a bond/ gilt – the date at which a debt instrument such as a bond or gilt matures, and the borrower must pay back the debt in full to the creditor.

Mergers and acquisitions (M&A) – in a merger, two companies join together to create a new organisation. In an acquisition, one company takes over another.

Net yield – the annual dividend per share, divided by its share price.

Organic growth – company growth that is achieved from its existing business (e.g. sales growth) without mergers or acquisitions (inorganic growth).

Price/ earnings ratio – the ratio of a company's share price to its earnings per share. It is used as a measure to determine if a company's share price could be over or undervalued.

Research and development (R&D) –innovation activity by companies to try to generate a competitive advantage; this could include launching new products or services.

Total addressable market – the total possible market share for a company, assuming it theoretically had a 100% share. Used to calculate the scale of potential revenue opportunities.

Asset allocation and sector focus

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

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

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

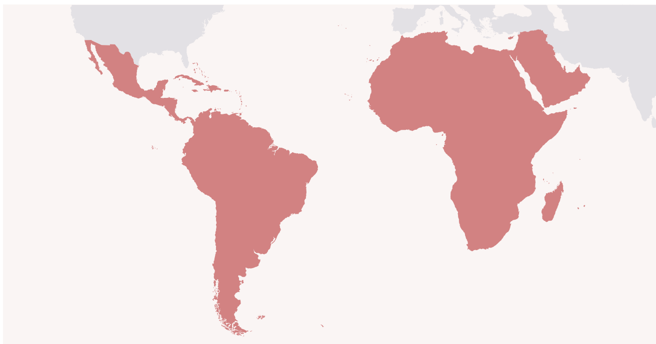
Here we present a snapshot of the current views.

Asset Allocation

Overweight Neutral Underweight

North America

The Magnificent Seven companies (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) drove slightly stronger relative index performance in the USA last quarter. Inflation is at 3.7% and interest rate markets suggest that rates have peaked for now. In October the US economy grew at a rate aligned with an unemployment figure of 3.9%. However, the US is now expensive on a price/earnings basis and we are worried about investor support for the US Treasury market.



Emerging Markets

Argentina may retain elevated uncertainty on the back of Javier Milei's recent presidential victory. Milei wants to sack the central bank, dollarise the economy and slash public spending by 15% of GDP. This has not been tried before. Elsewhere, there is a risk that the Chinese renminbi remains under pressure until its economy rebounds and that this will exert a downward pressure on other emerging market currencies at the same time.

UK

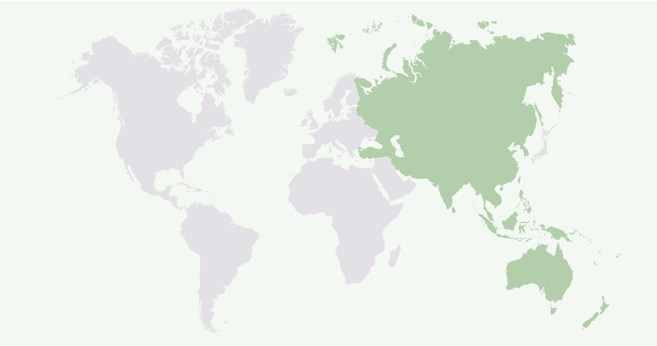
The UK moved sideways over the quarter in spite of an August base rate hike. We started with fears of higher rates for longer which morphed into the perception that rates had peaked and inflation is falling. The Labour party conference left us feeling that investor confidence in a stock market friendly Labour administration is growing.

Japan

In July the Japanese ten-year government bond rate was at 0.4%, which is where it was before COVID-19. It is now at 0.85%, which was last seen in 2013. The lift off started with Japanese inflation rising above US inflation in July, which fostered the idea that Japan might have to hike its interest rate.

Europe

Europe has seen future expectations for earnings rise over the last quarter, in contrast to the USA which has seen them fall. That said, earnings growth in Europe lags that in America on an absolute basis. Negative factors include fears over wage inflation, a weak Manufacturing Purchasing Managers' Index (an index of economic trends in the manufacturing industry) and a tightening monetary policy; however, we think these are outweighed by the positive factors: a peak in rates and moderating inflation.



Asia Pacific

China is often the main focus in Asia Pacific. It appears that China is managing the balancing act of de-leveraging the property sector and punishing property speculators without casting the rest of the economy into recession. Its most recent 5% GDP growth rate suggests that this is being achieved. Long-term demographics for the wider region continue to look favourable and the region should continue to deliver growth, although keeping a close eye on the aforementioned property sector is necessary.

Please read the important notice on page 1.

Sector Focus

Overweight Neutral Underweight

Communications

The telecoms sector has benefited from above-inflation price rises as many contracts factor in inflation increases, though this will abate now as global inflation rates are falling. Rising debt costs remain a headwind as companies are forced to refinance at higher levels. The portions of the sector more exposed to consumer discretionary spending would struggle in a recessionary environment.

Consumer Discretionary

Inflation has fallen significantly and wage inflation, whilst declining, is lagging. Wages are rising in real terms, which has traditionally been good for consumer spending. Since the pandemic, consumer discretionary businesses have been supported by excess savings. These reserves are now largely depleted, so while real wage growth is positive for the sector, the risk of a rates-induced recession still looms.

Consumer Staples

Input costs have been a headwind to the sector, however recent declines in inflation should reduce the problem. Pricing power has been resilient, however volume growth has suffered. Some of the sector is defined by non-discretionary demand and strong brands and recent retail results have been positive so there is an expectation of continued demand in a consumer slowdown.

Energy

At low oil prices Shell and BP share prices are highly correlated with the oil price. However, above US$90 the relationship progressively breaks down because the share price anticipates demand destruction from higher costs. With Brent currently at US$83, the market appears to be pricing in expectations for weaker GDP growth and lower oil demand.

Financials - Banks

Banks were recently criticised by politicians over deposit rates, yet many have large surpluses and might be relieved if some depositors withdrew cash. Whilst the UK's Asian banks should see some growth, American and UK banks may face pressure from credit losses. Firmer rates are helping insurance businesses, although the prospect of the rate hiking cycle ending is not.

Health Care

The sector has been a laggard recently and there have been multiple profit warnings. Continued disruption to procedures, funding issues in biopharma, and concerns about a regulatory crackdown in China have impacted the short-term outlook. Longer-term demand remains resilient and the structural drivers associated with an ageing population are unchanged. The pressure in the sector makes valuations more attractive.

Industrials

The earnings of industrials, including those cyclically exposed have held up relatively well throughout the recent rate hiking cycle. Whilst some industrial indicators have shown some weakness in the second half of 2023, current expectations are for improvements in 2024. Industrial valuations have been downgraded, with many now below 5-year and 10-year averages, so the sector looks attractive on valuation grounds.

Information Technology

Sector performance has been strong, as expectations about the potential of AI have increased some share prices and valuations. The sector is exposed to interest rates and so passing the peak of the rate hiking cycle should be a positive. The lack of margin for error provided by valuations drives a neutral rating.

Materials

China is the largest single driver of the sector and its economic data has consistently underperformed. Longer term, supply and demand dynamics in metals still look attractive, and demand for metals as part of the transition to cleaner energy is strong. At the company level, balance sheets remain strong, albeit underperformance in a recessionary environment is still likely.

Real Estate

Rising interest rates have been a drag on the sector and caused property valuations to decline. As we pass the likely peak in the rate hiking cycle, the pressure on valuations is likely to ease and with this, we would expect real estate companies to perform better. For now, we continue to see solid occupier metrics.

Utilities

Index-linked regulatory earnings models have largely protected utilities from cost inflation and margin pressure. Many utilities operate in markets with inelastic demand, which should offer recession resilience. As a result, there is more positivity on the utilities sector with a preference for power, where there is greater regulatory clarity on earnings growth than the water sector.

Please read the important notice on page 1.

Meet the manager

Lucy Coutts

Investment Director and Head of York, York Office

Lives	At the foot of the Howardian Hills, North Yorkshire
Started at JM Finn	2011
Hobby/pastime	Beekeeper and keen gardener. I also enjoying running and village tennis
Favourite holiday	The next one
Favourite film	Interstellar
If you weren't an investment manager	Political Journalist
Favourite book	The Kite Runner, Khaled Hosseini

You have recently been promoted to Head of the York office in addition to your role as Investment Director. What are your goals for JM Finn in the north?

Our relocation to York at the beginning of 2023 makes perfect sense – we have a wonderful new office which sits in the shadows of the ancient City Walls, and it is equidistant between London and Edinburgh. We have a great and trusted brand and a brilliant team, and the north of England and Scotland offer strong opportunities for us. I don't want to limit myself but there is no reason why, within the next 5 years, the office can't be two or three times the size it is now.

What do you think drives successful client relationships at JM Finn?

JM Finn is one of the few firms remaining that allows its Investment Managers to be directly accountable to their clients – to make investment decisions and to nurture relationships. While we cannot control monetary policy or geopolitics, we can control where we invest our clients' money and we build portfolios with direct holdings in the world's best companies, giving clients a sense of ownership and transparency. Markets have been testing for investors over the last two years but companies are generally going about their business – they might cut headcount, raise or cut prices, sell or acquire assets but it's an environment for businesses to adapt and become better.

Working alongside our Wealth Planning team, we value the long-standing, multi-generational relationships with clients, understanding their personal goals or fears – some of which are commonplace, and others unique to a family.

You champion women and young people working in finance. Please could you talk about some of the initiatives you have put in place at JM Finn?

By 2025, more than 60% of the UK's wealth is expected to be in the hands of women[1], and financial services firms will need to find ways to better meet the needs of female clients. JM Finn is a signatory of the Women in Finance Charter and we have a mentoring scheme to nurture talent within the firm – both of which I instigated. I'm lucky because we recognise the importance of having a workforce that is representative of our client base, but more can always be done to promote the industry to women. Among us there are volunteers for Girls are Investors (GAIN) and we have offered internships to young women through the scheme.

[1]The Centre for Economic and Business Research

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