JM FINN

No.24 *Autumn 2018*

Prospects

The JM Finn Quarterly Periodical

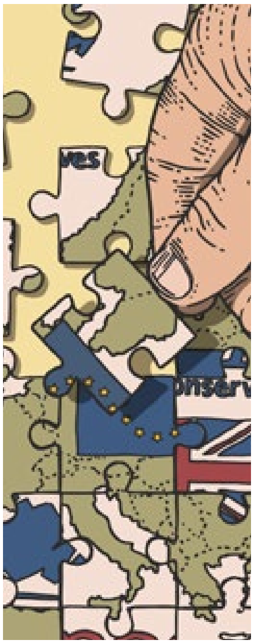
Trumping Trade
Are tariffs an effective brake?

Could Labour win an Election?
A political risk assessment

Property in Central London
Should buying still be the goal?

No.24

Autumn 2018

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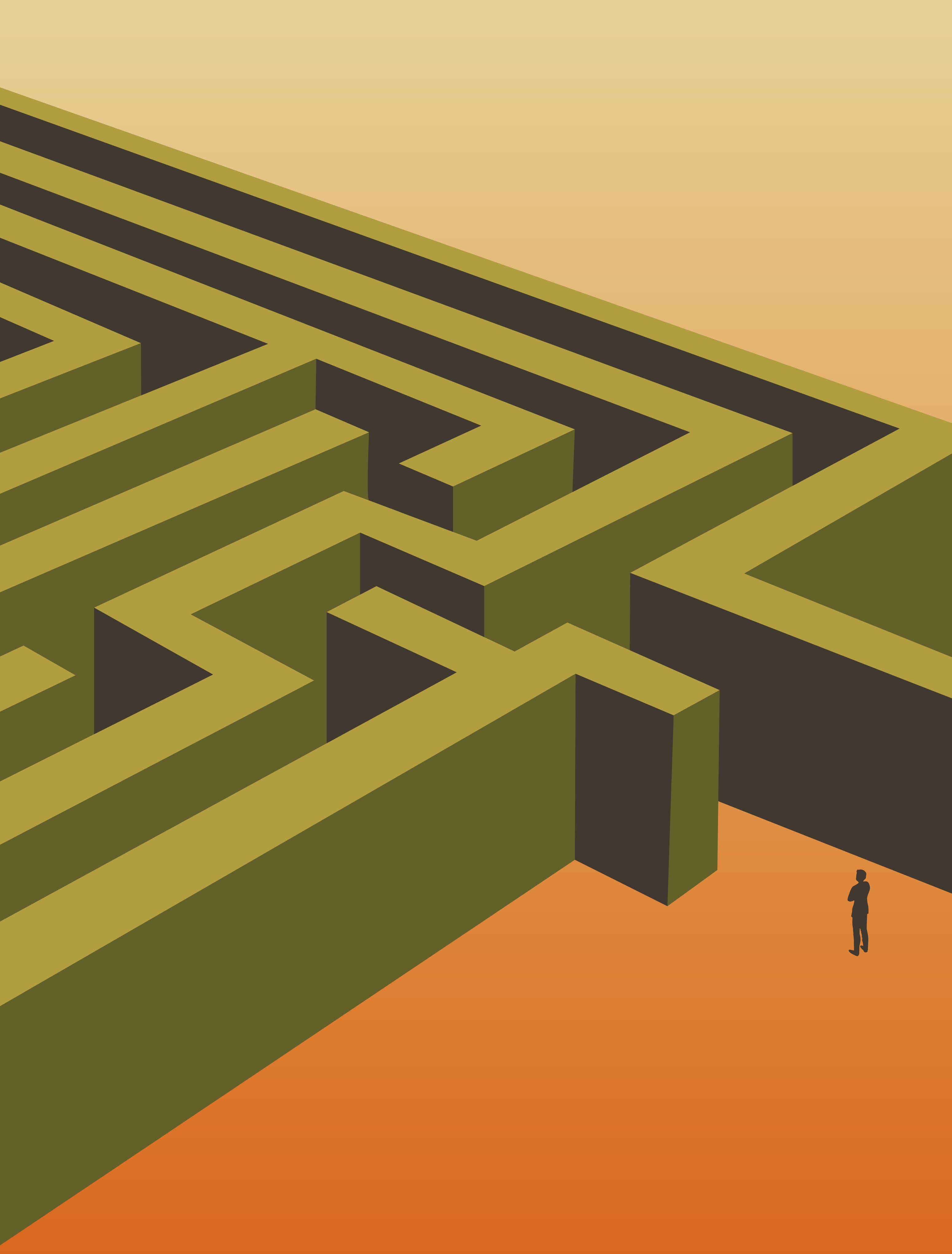

Welcome

Regular readers will know my primary concern for UK investors of late, notwithstanding the current market volatility, has been my lack of confidence in the current government which, should there be a general election, could possibly bring in Jeremy Corbyn, who I feel will not be investor or market friendly.

As part of the support that we as investment managers get, our research team make it their jobs to talk to as many people as possible to try and get the inside track on the issues at heart. Over the years we have been privileged to meet many current and former politicians and I am delighted that this issue of Prospects features a guest editorial by Natascha Engel, who up until the last election was Labour MP for North East Derbyshire.

Upon reading her contribution and a subsequent meeting in the office, I am a little more sanguine about the current government's chances should we have an election in the near future, although who will be leading that campaign is anyone's guess.

We have been attempting to mitigate the political risk over the last 12 months by reducing our exposure to the UK which has seen significant volatility in recent months. We have had a mixed year thus far in 2018 with US markets, which makes up around half of the capitalisation of world stock markets, showing a small increase and UK equity markets falling by just under 10%.

Of course the rise in the US market has been dominated by the technology sector, particularly a few large capitalisation stocks, including the FAANGs: Facebook, Apple, Amazon, Netflix and Google. These rises have been exaggerated by the nature of passive fund investment and the considerable amounts of money invested in exchange traded funds, which are directing more capital to the large capitalisation stocks to the detriment of the smaller ones.

I do not think this is a positive trend, as it helps fuel the overvaluation of some of the larger stocks. It does mean we are looking to invest on a more regional basis, although it is worth pointing out that by investing in some regions of the world we are not necessarily getting the exposure to the countries that we might expect. Many of the companies we invest in operate on a global basis, such as the UK's Diageo and GlaxoSmithKline who have considerable exposure to the US, or Prudential and its exposure to the Far East.

With regards to inflation, which is gradually increasing, John Royden gives his views within his Bond Focus on the seemingly eternal question of whether we should change the measure used from RPI to CPI. We also feature an article by Natalie Berg who presented at our conference in May. Natalie is a retail expert who regularly comments on the structural change taking place on our high streets thanks to the inexorable rise of Amazon, which also features as one of the stocks covered within equity prospects, and other online retailers such as Ocado, which is covered in the Company Meetings feature.

Finally, I'd like to draw our clients' attention to the news article highlighting that we are no longer accepting cheques as payment, in a bid to counter the rise of fraud. We know this might not be ideal for all, but the risks of fraud are high, as described on page 32, and we feel it is our responsibility to act.

James Edgedale

James Edgedale
Chairman


TRUMP

Editorial

Trumping Trade

By John Royden
Head of Research

Illustration by Asa Taulbut

***"Tariffs are the greatest! Either a country which has treated the United States unfairly on Trade negotiates a fair deal, or it gets hit with Tariffs. It's as simple as that — and everybody's talking! Remember, we are the "piggy bank" that's being robbed. All will be Great!"* So tweeted President Trump back in July.**

To date, Trump has slapped a 25% tariff on $50 billion worth of Chinese goods. He also mooted a 10% levy on an additional $200 billion of imports. China retaliated with tariffs on $50 billion of imports which prompted Trump to threaten tariffs on another $300 billion if China refused to back down. That would add-up to tariffs on $500 billion of Chinese exports.

So why is all this happening? The beneficiaries of a tariff are those industries who are allowed to either raise prices or displace foreign competitors, with the consumer typically bearing the cost. Does Trump really want to hurt the US consumer? That is clearly not the answer.

Benefits for Trump include the American perception that being tough on China is a vote winner. The official longer term aspiration is not just to block trade but to exert pressure on China, to open up its market access and to have greater, more robust and enforceable protections for US intellectual property. The effect of this will be to slow China's technological development down.

In my mind there is another hidden agenda. I think Trump might be exploring ways to apply an effective brake to the US economy. This takes the negative control away from the Fed to some extent and allows Trump the ability to apply the brakes and then release them in the run-up to any election. It is usually only the Fed that has the use of the traditional brake; interest rate policy.

> *Trump might be exploring ways to apply an effective brake to the US economy.*

The potential outcomes are broad in terms of scope, impact and severity. At one end of the scale, the world tips into a fully-fledged trade war with Europe, the US and China all retaliating against each other and spiralling into a recession with global GDP shrinking by 2.5% as a result.

My expectation is that the trade wars have taken more heat out of the US economy than people realise. US housebuilders should be increasing supply in light of house price increases. But they are not. I think this is an indication that big ticket items are being delayed. If this mentality pervades in corporate thinking then the US economy could slow down quicker than expected. Trump can't hold his strong negotiating position with a weakening economy behind him and that would prompt him to try and reverse out of his trade wars with some kind of publicity-worthy, but effectively irrelevant treaty; like agreeing to limit Chinese car imports to above their existing levels.

It is unlikely that tariffs will drive too much inflation into the US economy because imports only account for about 15% of American GDP. But there is the chance that the additional inflation could drive the Fed to be firmer on rates and flip the economy into recession. That would again leave Trump looking for a reverse gear.

> *The Chinese are very wary of social unrest and anything that looked likely to boost unemployment would be resisted.*

You may have seen that Trump recently promised $12 billion in aid to placate farmers and offset the economic loss from lower demand for US agricultural products from China. If US sectors such as car manufacturers started to line up behind farmers, in terms of asking for compensation, you might well find that the weight of all their claims is another persuasive factor in terms of Trump looking for the reverse gear.

The Chinese may react to a drop in trade by trying to stimulate their economy. The Chinese are very wary of social unrest and anything that looked likely to boost unemployment would be resisted. If stimulation were to include lower interest rates and greater money supply from lower bank required reserve requirements ("RRR") then that drives the renminbi lower. The renminbi has already fallen from CNY 6.3 per $1 to CNY6.9 since April. More monetary expansion would cause it to fall further, making Chinese goods even cheaper and going some way to counter-balance the effect of tariffs.

> **The 13% of UK exports that go to the US represent only 2% of our GDP.**

So where does this leave us as investors? Shelter can probably be best found in the sectors that are unaffected by tariffs. This includes defence manufacturers as well as the service sector with financial services as a stand out choice.

In terms of the UK, we are caught by Trump's tariffs on the EU's steel and aluminium. Luckily for us, our £1 billion of metal exports to the US represent less than 0.1% of our GDP. Trump has threatened to extend the tariffs out to cars and take the rate from 2.5% to 20%. That would hurt our £7 billion of automotive exports and shave 0.2% off GDP.

Although the EU responded with tariffs on $3.2 billion of iconic US goods, including Bourbon whiskey, peanut butter, motorcycles and blue jeans, the US and the EU appear to have formed a treaty for the time being. So we don't expect any more sanctions in the near term. But if it did worsen, the UK would probably find itself in a relatively better position than the rest of Europe. The 13% of our exports that go to the US represent only 2% of our GDP.

Understanding Finance

GROWTH vs MAINTENANCE CAPEX

Michael Bray
Research Analyst

Companies typically refer to all internal investments as capital expenditures (capex), but there is an important distinction that needs to be made between capex required for maintenance and that for growth.

Maintenance capex can be considered the cost of sustaining current revenue and profits for a business. This type of outlay is equivalent to a normal operating expense; such an example would be the replacement of a truck tyre at a haulage firm.

Whereas growth capex should be considered as an investment made for the purpose of increasing revenue and profits, organically (i.e. not through acquisitions). Examples being the construction of a new plant to increase capacity or new stores for an expanding retailer.

The lines can however become blurred between the two distinctions. This is certainly the case with advertising, where ongoing brand advertising campaigns are important in sustaining awareness - a maintenance capex cost- whilst also influencing a new generation of consumers – growth capex. Research and development (R&D) costs are similar, as some expenses are necessary to maintain a business, whilst others are best viewed as investments in future growth.

Why does this matter? Well, it's necessary to differentiate capital expenditures in order to understand the underlying cash flows of a business when it is not growing, and this is important in calculating the intrinsic value of a business in status quo. But the concept of cash flows and valuation is a story for another time...

AB FOODS

Sam Statham
Research Assistant

PRICE
£22.36

52 WEEK HIGH-LOW
£33.87—£21.86

NET YIELD
2.6%

HIST/PROS PER
17.3—17.1

EQUITY MARKET CAP (M)
£18,026

AB Foods (ABF) is split into five rather different divisions, Sugar, Agriculture, Retail, Grocery and Ingredients. By far the largest of these is Retail or more accurately, Primark, a budget fashion retailer. Primark is unique in that it currently doesn't have any form of online presence and operates solely out of a store estate. This strategy splits opinion amongst investors.

Bears will say that shopping is rapidly shifting online and Primark aren't going to be able to compete with online giants such as Amazon. If you listen to some pundits, the high street is said to be "dead". We have seen Toys R Us and Maplin plunged into administration, New Look announce that it has shut 60 stores and cut almost 1,000 jobs and most recently, Next has reported multiple store closures.

The bulls would argue that Primark's differentiated offering should allow them to continue to survive on the high street in an increasingly competitive environment. Given the expense of delivery costs, it is impossible to sell a £2 t-shirt at an acceptable margin online. In addition to this, we are increasingly hearing that shoppers are looking for an "experience". Primark offer this through what can best be described as a treasure hunt for the hidden gems in their shops amongst their other ludicrously cheap options.

Please read the important notice on page 1.


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Guest Editorial

With Brexit uncertainties in Government, what are the chances of a General Election any time soon – and how likely that Labour could win it?

A political risk assessment

By Natascha Engel
Illustration by Adi Kuznicki

If the aim of the Chequers proposal was to show the Cabinet and the country that the government had taken back control of the Brexit negotiations, then it didn't quite go according to plan. Instead, it showed just how deep the rifts in the Conservative Party had become with high-level resignations and ever-bolder talk of leadership challenges.

Such visible instability in Government inevitably leads to talk of general elections and suddenly we're only one step away from the possibility of seeing the keys to 10 Downing Street in the hands of Jeremy Corbyn.

The outcome of the Brexit negotiations and the terms on which the UK will (or will not) trade with the rest of the world is one thing. The Labour Party in its current form in government is quite another.

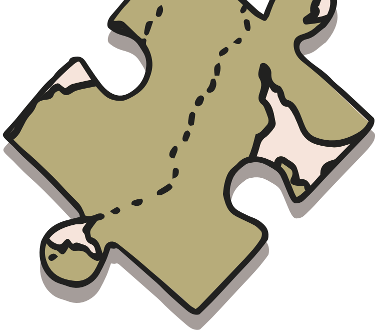
So how likely is it and what would it look like if it happened?

First, no-one in politics or in the wider country wants a General Election – not even the Labour Party. Who would want to take over the insoluble and all-consuming puzzle that is the Brexit negotiations? Far better to leave Theresa May to it at least until Brexit Day next March and then think again.

In the meantime, there are more pressing concerns if you're an MP, like the boundary review. Started in 2011 by David Cameron to cut the cost of politics, the chances are that the number of constituencies (and therefore MPs) will be reduced from 650 to 600. Shortly after that, at Labour's Annual Conference, we can expect further rule changes that put more power into the hands of Jeremy Corbyn-supporting Labour Party members.

> ***Who would want to take over the insoluble and all-consuming puzzle that is the Brexit negotiations?***

That will fire the starting gun for sitting Labour MPs to scramble for the nomination in 50 fewer seats and will see many of those critical of the Labour leadership lose to candidates from the far Left of the party.



If the boundary changes do go through (and in many ways we are asking turkeys to vote for Christmas), the outcome at any General Election becomes harder to predict. But one thing is always true: incumbency is a huge advantage. People vote for what and who they know. And they really don't like it when a small group of Labour Party members get rid of a good local MP.

> *Economists, politicians, lawyers and investors will all want to know exactly how nationalisation would work in every case*

At the same time, Labour's internal row on anti-Semitism is one of the more toxic manifestations of the war for the soul of the party. The battleground is local party meetings where Momentum, branch by branch, constituency by constituency, is taking over. These are battles fought behind closed doors in church halls and community centres. It means that the Labour Party, once a formidable campaigning machine, is no longer talking to voters.

But it's not really voters who these new Labour Party and Momentum members are interested in. They want to rid themselves of moderates so that the party can return to a purer and truer form of its Socialist self. Whether that policy agenda is popular with the wider electorate is irrelevant to them.

Yet, nationalisation of certain industries is ever more popular in the opinion polls. This is not a complete surprise considering the chaos that came with the new train timetables, or water companies threatening hosepipe bans days before announcing record executive bonuses, or with the Royal Mail fined record sums for losing parcels and poor performance.

While the Tory government is in paralysis over Brexit, there is little in the way of an alternative narrative or anything resembling a debate on how we deliver our public services as efficiently and cost-effectively as possible.

That means Labour's nationalisation programme doesn't have to be too carefully argued or costed. It is enough to declare that water bosses are fat cats and that the trains aren't running on time.

This is not to say that the Labour Party isn't thinking about how to implement its proposals. It is. As natural monopolies, the water companies would come back into national hands (the Welsh and Scottish models are usually used as examples), and the energy companies would be challenged by local-government-led cooperatives and mutuals where workers and consumers sit on boards and take decisions.

But that won't be detail enough when it comes to an actual General Election campaign. Economists, politicians, lawyers and investors will all want to know exactly how nationalisation would work in every case, how compensation will be calculated and who is going to pay.

That's before the trade unions who organise in these industries start to ask questions about what happens to their members, and to their members' pension funds, many of which are heavily invested in public utilities.

The main reason, though, why these plans are unlikely to be implemented is because whoever forms the next government, Brexit and its long tail will not have gone away. For good or bad, leaving the European Union is, and will continue to be, a political and economic upheaval.

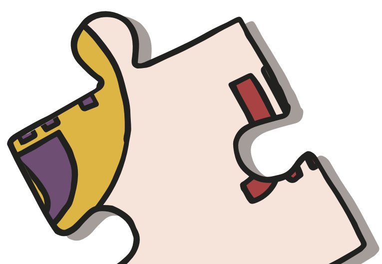
And most people, especially investors, just want things to settle down again. What they don't want, and what they are unlikely to vote for, is radical social change and uncertainty about whether the lights will stay on.

The real beneficiaries of the last General Election were William Hill and Paddy Power. Most political analysts and commentators, had they put their money where their mouths were, would have been seriously out of pocket.

That's to say that nothing in politics is certain, but if I had to take a bet, as things stand, I'd say 3:1 on a Tory win. But I wouldn't put more than a quid on it.

Natascha Engel

Until the last election, Natascha Engel was Labour MP for North East Derbyshire and Deputy Speaker of the House of Commons. She has since made a living as a political analyst and writer, particularly on energy and public utilities.



Index linked gilts ~ RPI or CPI?

By John Royden
Head of Research

The UK has two main measures of inflation, the Retail Price Index ("RPI") and the Consumer Price Index ("CPI") and they give different results. The RPI includes housing costs but that is not the reason why it tends to be 0.7% per annum greater than CPI. It is the method of calculation that drives the difference. For those with Maths A Levels, the RPI is arithmetic whereas the CPI is a geometric calculation. Statisticians say that geometric is the one to go for.

Index linked gilts ("linkers") are indexed to the RPI, but over the last few months the debate has arisen as to whether the government should change to CPI or indeed whether the RPI should be calculated geometrically. A geometric RPI would result in it being lower by 0.7% per annum.

If that change was made overnight and in a way that was legal and binding, then a simple calculation would show that it would be devastating, particularly to the long dated end of the index-linked market. The 1/8ths linkers of 2068, due to mature in fifty years time, currently cost you £266 based on RPI averaging 3.3% over the life of the gilt. If that value driver suddenly dropped to 2.6% (3.3% - 0.7%) per annum then you would have 50 years x 0.7% less return each year which gives you a fall in value of 35%. Compounded, the effect would be closer to 42%.

In January of this year, Mark Carney told the House of Lords that he wanted it changed and that he would not want to see RPI driving the linker market in ten years' time. And in July the debate re-surfaced in the House of Lords when the head of the Office for National Statistics, John Pullinger, said he now favoured a change that took effect "more quickly than ten years". At the same time Liz Truss, Chief Secretary to the Treasury invited the UK Statistical Authority to review the method.

There have been other examples of reform. Ofwat is moving to CPI rather than RPI but then compensating the water companies by giving them greater yields elsewhere. Chris Grayling recently suggested that the rail fares get indexed to CPI to keep down prices; which would in turn mean lower wages for railway workers.

> “
> IF THAT CHANGE WAS MADE OVERNIGHT AND IN A WAY THAT WAS LEGAL AND BINDING, THEN A SIMPLE CALCULATION WOULD SHOW THAT IT WOULD BE DEVASTATING.

My own view is that the government would lose the trust and confidence of investors if it suddenly expropriated large lumps of value from investors to itself by modifying or replacing the current RPI. In the short term there would probably be a buyers' strike prejudicing the government's finances. In the long run, investors would demand a premium to compensate themselves for taking the risk of more unilateral and adverse changes to the way that our government borrowing works; and the government's borrowing costs could potentially rise in the long term to a point where the effect was a greater cost than the original saving on the RPI calculation change.

In my opinion the way to solve the problem could be to issue new gilts linked to CPI rather than RPI and to possibly buy in the longer dated RPI issues over time.

General Interest

Amazon

How the world's most relentless retailer will continue to revolutionise commerce

By Natalie Berg
Retail Analyst & Founder of NBK Retail

Illustration by Adam Mallett

This is retail Darwinism – evolve or die.

Retail is going through a transition. The naysayers will call it an apocalypse; to others, it's digital transformation. But one thing we can all agree on is that this is a period of profound structural change.

The rise of online shopping, combined with broader shifts in consumer values and spending habits, has exposed an overbuilt retail landscape. 2018 is shaping up to be the year of the Company Voluntary Arrangement or CVA and stores are now closing at record rates: according to a report from Deloitte and LDC, the first half of 2018 saw 4,400 net closures across the UK high street, up from 103 in 2017. Traditional business models are being displaced and everyone is now scrambling for survival. The world's largest retailer has even changed its name: after nearly half a century as Wal-Mart Stores, in 2018 the retailer dropped Stores from its legal name to reflect the new digital era. This is retail Darwinism – evolve or die.

But there's one word that often gets overlooked in all this talk of an impending apocalypse – relevance. The most important rule in retail is being relevant to customers. If you can't deliver on the basic principles of giving customers what they want or standing out from the competition, then you don't stand a chance. For these retailers, yes, the Doomsday clock is ticking.

For those willing to embrace change, however, this is a fantastically exciting time to be in retail. The future is fewer, more impactful stores. The future is offering shoppers a more blended online and offline experience. And the future is excelling at WACD: What Amazon Can't Do.

Now the fifth largest retailer in the UK, Amazon is redefining the rules of retail. Amazon has grown from online bookseller to titan of 21st century commerce, having recently become the second company in the world to be valued at $1 trillion. Amazon's platform has become a dominant e-commerce enabler, with the retailer now accounting for nearly half of e-commerce sales in its home market. What is more, Amazon is also the world's largest product search engine (move over, Google). Its algorithms promote its own products. Its various devices – from Echo speakers to Dash buttons – seamlessly funnel purchases through to its platform. Amazon has access to data unlike any other retailer in the world. It isn't subject to the same tax laws as its bricks and mortar counterparts. Its retail business is subsidised by higher-margin segments like cloud computing services and, in the future, advertising should continue to grow to become another highly profitable revenue stream. You don't need to be an antitrust guru to recognise Amazon has reaped the rewards of an uneven playing field.

Nonetheless, Amazon has made online shopping completely and utterly effortless by giving consumers access to millions of products right at their fingertips – which magically turn up the same or next day! Today, the consumer is firmly in the driving seat, and expectations around convenience, assortment and speed have never been greater.

In the future, this will go one step further as certain household products move towards simplified and auto-replenishment. As our homes get smarter, shoppers' lives will get easier. The average adult currently makes a whopping 35,000 decisions every day but, in the future, our connected homes will do all the low-level, mundane re-ordering of household products, freeing up time to focus on more enjoyable tasks. Shoppers will no longer have to traipse down supermarket aisles when they run out of bleach or toilet paper. They will spend less of their valuable time buying the essentials and I believe the impact on the physical store will be immense: retailers today should be rethinking store layout and broader purpose of the store.

We will see a greater divergence between functional and fun shopping. For all its perks, shopping on Amazon is still a very utilitarian experience. This presents an opportunity for bricks & mortar competitors to distance themselves by injecting some personality and soul into their stores, which will further blur the lines between retail, hospitality and lifestyle. The store of the future won't just be a place to buy things but also a place to eat, play, discover, and even work. It will be a place to borrow and to learn, but also crucially a place for retailers to appease the 'on-my-terms' shopper through instore collection and returns, as well as same-day delivery. In an increasingly digital world, the role of the physical shop will have no choice but to move from transactional to experiential. Product alone is no longer enough.

We're already beginning to see this unfold at the big department stores, which are arguably the most at risk of disappearing from our high streets. In the past, it made sense to dedicate 100,000-plus square feet of retail space to these 'palaces of consumption', aggregating a significant number of brands under one roof. But the original premise of a department store - one-stop shopping - has been eroded by online retail. At the same time, there has been a fundamental shift in consumer values which means that, when it comes to discretionary spending, consumers are increasingly prioritising experiences over simply buying more stuff. Womenswear has been hit hardest as a result. In the UK, Barclaycard data showed that spending on entertainment, in pubs and in restaurants all individually saw double-digit growth in 2017 while spending on women's clothing dropped 3%. Other factors contributing to a decline in the category include a lack of any ground-breaking new fashion trends over the past decade, more blended wardrobes, an ageing population and increased awareness of sustainability.

In many ways, department stores need to go back to their roots. They must engage with shoppers in a way that transcends the transaction, providing an immersive and memorable experience worth ditching our screens for. As Harry Gordon Selfridge once said, "A department store should be a social centre, not merely a place for shopping."

"

In an increasingly digital world, the role of the physical shop will have no choice but to move from transactional to experiential.

Digital transformation may dominate the headlines, but we can't overlook how bricks & mortar disruptors are also changing the game – particularly in the grocery sector. Over the past five years, Aldi and Lidl's combined UK market share has grown by 80% - they are no longer just a pesky thorn in the supermarkets' side. The discounters have wreaked havoc on the incumbent players, leading to unsustainable price wars, cost-cutting and industry consolidation. The Big 4 are about to become the Big 3, provided the Competition and Markets Authority approves the Sainsbury's-Asda merger. Meanwhile, Britain's largest retailer, Tesco is poised to launch its own discount format called Jack's, clearly not dissuaded by Sainsbury's short-lived Netto venture.

In a period of profound structural change, here's my advice to UK retailers:

1. *Curate: don't try to out-Amazon Amazon.*
2. *Differentiate: go (way) beyond selling.*
3. *Innovate: think of your stores as assets and not liabilities.*
4. *Don't go it alone.*
5. *Move quickly.*

2019 will undoubtedly bring more short-term pain. We must brace ourselves for further rounds of store closures, bankruptcies, redundancies and consolidation as the sector reconfigures for the 21st century shopper. Time is of the essence – there will be no second chances for retailers that fail to adapt, as the climate is simply too unforgiving. Ultimately, the retailers that survive digital transformation will be those that follow the customer, ensuring they remain relevant in a digital age.

For a chance to win one of 50 copies of Natalie's book, entitled *Amazon*, which is published in January, please send an email to marketing@jmfinn.com telling us how often you use online shopping:

- I do all my shopping online
- I use websites for occasional online shopping
- I love going shopping but do research online
- I don't shop online

AMAZON

James Godrich
Research Analyst

PRICE
$1,970.19

52 WEEK HIGH-LOW
$2050.5—$931.75

NET YIELD
0.0%

HIST/PROS PER
194.2—71.3

EQUITY MARKET CAP (M)
$930,624

It would be easy to write about all the reasons to be impressed by Amazon. Whether it be their globally leading cloud-computing business, their e-commerce platform which continues to dominate the online retail space whilst taking share from traditional bricks and mortar operations, or their Prime product with its various benefits aimed at growing shopper loyalty and increasing customer retention.

What is harder to write about are the reasons to be concerned about Amazon. Where investors had previously focussed on margin concerns, they have now shifted to the slowing revenue growth in North America.

Recent results have shown a slowing top line in their most mature region (albeit still >20% growth) but with good improvements in the operating margin. The bears will say that these results are a first sign of moderation in Amazon's top line, the bulls might put this down to a shift in emphasis from revenue to profit growth.

Regardless of either of these points, we would still note a growing penetration rate of e-commerce in retail sales globally which could offer a structural runway for Amazon for some time to come.

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

James Godrich
Research Analyst

Michael Bray
Research Analyst

Sam Statham
Research Assistant

BASIC MATERIALS
Rio Tinto , Croda International
Johnson Matthey

HEALTH CARE
GlaxoSmithKline
Dechra Pharmaceuticals
Novo Nordisk

CONSUMER GOODS
Burberry Group
The Kraft Heinz Co
Unilever, Nestlé

INDUSTRIALS
Smurfit Kappa Group
Experian , Chemring Group
Qinetiq Group , Clipper Logistics
Hill & Smith Holdings
DS Smith , Equiniti Group
Ricardo, Siemens Ag
Worldpay Inc

CONSUMER SERVICES
Moneysupermarket.com
Ocado Group, Asos

OIL AND GAS
BP, Exxon Mobil Corp
Royal Dutch Shell

FINANCIALS
Royal Bank Of Scotland Group
Aviva, Standard Chartered
London Stock Exchange Group
Euronext, Mastercard Inc
Visa Inc

TELECOMMUNICATIONS
Vodafone Group
Verizon Communications Inc

UTILITIES
SSE, Centrica

1.

Experian

Price **£19.45**
52 week high-low **£19.63 – £14.5**
Net Yield **1.8%**
Hist/Pros PER **27.2 –24.5**
Equity Market Cap **£17,472m**

Industrials
Nadia Ridout-Jamieson, Chief Communications Officer

In previous editions of Prospects we've described Experian as an information services firm known for providing consumers and businesses with credit reports on a mostly transactional basis. That is beginning to change; they now see themselves as primarily a data science company selling software on license agreements, which are more recurring in nature.

The business splits itself by both region and business line for reporting purposes. However we like to consider their revenues as either business-to-business (B2B) or business-to-consumer (B2C) in nature.

In their B2B division, Experian aim to utilise their proprietary data and analytics to improve the speed, accuracy and efficiency of credit related decisions for businesses. An example of this might be their 'Text for Credit' tool targeted at retailers or auto loan finance companies. Here, Experian have developed a product that allows them to identify a consumer based on their mobile phone number and immediately provide a pre-approved credit decision to the customers' mobile device without the need to fill out a lengthy and cumbersome credit application.

Their B2C division however offers a different prospect and remains something of a turnaround story. As their historic business model to provide credit reports to consumers has been disrupted by free equivalents, management have looked to reposition the business. They now look to sign up customers using free credit reports and to up-sell software products on the back of this. As an example, they have developed Identity Works in the US; an identity-theft product which monitors the internet for illegal or fraudulent use of the customers identity.

Organic growth across the two divisions remains a tale of two halves. The upside therefore is that the B2C repositioning finds its feet, the downside is that recent investment into the B2B loses steam.

2.

Nestlé

Price **CHF 81.28**
52 week high-low **CHF 86.4 – CHF 72.92**
Net Yield **2.9%**
Hist/Pros PER **30.3 –20.8**
Equity Market Cap **CHF247,429m**

Consumer Goods
Alex Howson, IR Officer

Nestlé is responsible for a vast product line which includes dairy products, bottled water, coffee, cereals, baby food, pet food and their classic confectionery portfolio. In January 2017 Ulf Mark Schneider was appointed CEO of Nestlé, the first outsider to take the helm since 1922. An interesting choice, given his background is almost entirely in pharmaceuticals and healthcare.

We are told that in the past year the business has undergone considerable change. After travelling around each of the business units separately, Schneider has made it clear (by altering remuneration for senior managers) that the two areas he is looking to focus on are profit margins and return on invested capital. Cost cutting is another focal point and has involved a head count reduction, as well as descaling offices. They currently have 20 offices in Switzerland and that number will be reduced to seven over the coming months.

In May 2018, Nestlé acquired the rights to sell Starbucks branded coffee in supermarkets for $7.1bn. This has allowed them access to the US which is the largest country for coffee, as well as adding scale to an already advanced network. Their existing Nespresso and Dolce Gusto brands sell at a sizable premium to competition in 'pods' and largely dominate this space giving them c.22% of the growing global coffee market.

In confectionery we have seen consumers trading up recently, leaving Nestlé off the pace. Their only premium chocolate brand of note, Cailler, accounts for just over 1% of chocolate sales and has not shown growth for the past five years. Their investor relations team stated that they believe premium brands will outperform standard chocolate over the long term but have no plans to change strategy.

Anecdotally, Kit Kat (Nestlé's largest chocolate brand) is actually seen as a premium product in Asia selling for between $5 and $20. In the interest of research, we have since tried a variety of Japanese Kit Kats and can report that they are extremely pleasant. Unfortunately, this is a small part of the business and there are no plans to roll it out further afield.

3.

Ocado

Price **£9.55**
52 week high-low **£11.63 – £2.36**
Net Yield **0.0%**
Hist/Pros PER **N/A – N/A**
Equity Market Cap **£6,319m**

Consumer Services
David Shriver, Communications Director

Ocado is the only worldwide provider of end-to-end grocery e-commerce solutions. The company is made up of Ocado Retail - which encompasses Ocado.com - and Ocado Solutions which sells Ocado's technology to other worldwide retailers.

Ocado's technology is utilised via its Smart Platform which includes real time control systems and robotics, computer visions systems, machine learning and AI, and delivery routing systems; all of which allows for a highly automated handling process and efficient delivery service. The company employs over 1600 programmers to develop and maintain its platform. This technology has yet to be replicated with five worldwide grocery retailers partnering with Ocado to use its platform. The standard 'store pick' model for grocers' e-commerce sales, whereby an in-store employee manually fulfils an order, is inefficient and non-scalable. Grocery retailers also have no experience developing such technology, incentivising them further to partner with Ocado.

Amazon is certainly a company which Ocado concede can compete but believe they are a few years behind them. Amazon has an average order size of 1.8 items, whilst Ocado's is 50 items and across multiple temperature zones. Amazon also has a more manual handling process and Ocado's 300 patents are likely to stall its advance. Ocado believe that their proof of concept technology, which they have used in their own retail business, puts them at a competitive advantage.

Online penetration of the grocery market is low, accounting for 7-8% of grocery sales. 55% of grocery sales are within bricks and mortar stores, and more than half of which are big basket shops that are more likely to migrate online. Ocado believe there is a strong argument that 20% of grocery sales go online by 2022 and that they will see the direct benefit of this, but given the technology advancement apace in the online grocery market, this is not an assured outcome.

Please read the important notice on page 1.

Economic Focus

Collateral Damage

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Andrew Rees

If there has been one element in the past couple of years that has made predicting the future that much more difficult, it has been the seemingly erratic and aggressive behaviour of US President Donald Trump. His "America First" policy has seen the introduction of widespread tariffs that threaten the very continuation of global economic growth, not to mention the withdrawal of support from a number of cross border agencies and agreements in the interest of saving the US money and isolating perceived enemies.

While investors in the US have been buoyed by impressive economic growth and low unemployment, other parts of the world have been less sanguine over the effects of the President's actions. Emerging market indices technically slipped into bear territory, recording falls from the peak of more than 20%. Many nations in the developing world have seen their currencies savaged in foreign exchange markets as investors distance themselves from these potentially damaged economies.

But is such a bearish stance justified? After all, these are countries that remain set to deliver economic growth on a scale that the developing world can only dream about. China should deliver a rise in their gross domestic product of 6.5% this year – India an even greater increase. And many other Asian nations will not be far behind. Indeed, the long term case for investing in emerging markets – large populations eager to play catch up on the West, with cheap labour allowing competitive industrialisation - remains intact, despite the imposition of swingeing trade tariffs.

Unfortunately the bigger long term picture fails to take into account the shorter, more challenging reality of what is presently going on. A stronger US dollar and rising interest rates there are sucking out cash from the emerging world and starving them of credit. Moreover, there are pockets of real concern within this particular universe. Populous countries like Brazil and Turkey have been suffering extreme economic hardship. Venezuela has imploded, despite having some of the largest oil reserves in the world. Argentina's foreign debt crisis is leading to real hardship. And geo-political uncertainty continues, most notably in the Middle East.

So, perhaps unsurprisingly, we have been seeing a wholesale withdrawal of cash from these markets – a reflection of the perceived higher levels of risk they now contain. According to the Institute of International Finance, foreign investors sold more than

> ***A stronger US dollar and rising interest rates are sucking out cash from the emerging world and starving them of credit.***

$12 billion worth of stocks and bonds in May alone this year and the outflow grew even more in June. Interestingly, China saw much of the selling pressure, yet they remain a massive holder of US government paper – something that Mr Trump needs to bear in mind as he reviews which other products from the world's second largest economy are worthy of being hit with punitive tariffs.

It seems the risk-off attitude of investors has had some merit. The question is, has the correction gone far enough or is this simply the beginning of the end of the long term argument for backing these markets? Much will, of course, depend on whether the unpredictable US President continues his mission and the success or otherwise of his actions. Only time will tell, but the likelihood is that sentiment could turn on a sixpence if it looked as though a trade accord was in the offing or if a gentler approach was emanating from the White House.

However, there are other elements in the mix that suggest some emerging markets may prove less vulnerable to upsets generated by the developed world in the future. In particular, technology will undoubtedly play a much larger role in how some of these nations prosper in the future. While US companies like Apple, Google, Facebook and Amazon may be considered the market leaders in their respective fields, China is already playing a significant role on the world technology stage and has some world class players capable of competing internationally.

There are other straws in the wind too. According to Franklin Templeton, a prominent investor in this field, emerging nations purchased more than two and a half times the number of smart phones last year than the developed world. And China and India both outpaced the US in terms of their use of the internet. Moreover, Dr Mark Mobius, who once headed the Franklin Templeton emerging markets team, is coming out of retirement to launch a new investment trust to take advantage of what he sees as an opportunity created by the setback.

These markets are clearly a riskier option than those of the developed world and would undoubtedly suffer if world trade is further impacted by a deepening tariff war. But they contain great potential and are likely beneficiaries of the greater use of technology in a widening array of spheres. Emerging markets may have been damaged in the fall out from US policy changes, but they remain worth watching.


THE UNITED STATES OF AMERICA
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Collectives Commentary

Gold, reinvented in paper form?

Peter Spiller and Alastair Laing
CG Asset Management

Illustration by Jordan Atkinson

Interestingly, the origin of the dollar symbol $ remains unclear to this day. One theory links it to the Caduceus, a staff entwined by a serpent carried by the Roman god Mercury.

Mercury was associated with commerce and negotiating and a simplified pictorial representation of the Caduceus was a symbol widely used by alchemists until the 18th century. There are some less classically inspired (and more probable) theories as to the origin of the $ symbol, however it is nice to think that alchemists' otherwise fruitless efforts to turn base metal into gold may have had some lasting impact on the monetary system.

Historically gold was attractive because it was a currency and a store of wealth, whose value was not derived from a claim on a third party. A third party can always default, however a gold coin is money with its own imbedded collateral. In its purest form these attractions were manifestly true, for example a gold sovereign circulating during the classical gold standard of Victorian Britain.

Today gold is not money, it is a commodity. When Richard Nixon closed the gold window in 1971 the final tenuous link between gold and money was severed. Since that date the price of gold in dollar terms has been every bit as volatile as any other commodity. Gold generates no yield so it cannot be valued based on future cash flows. It is often held out to protect against inflation but its own history strongly refutes that claim. Anyone who held gold between 1980 and 2000, a period of relatively high inflation, can painfully confirm this. Gold still has a modest role in a diversified portfolio as insurance against catastrophic risk, however it is a speculation on future commodity prices not a risk free store of wealth. What can fill the gap vacated by gold in the portfolio of the defensive investor?

Sadly there is no risk free store of wealth, however in our opinion, index linked bonds issued by the highest quality governments are as close to that description as can be achieved. Index linked bonds provide the holder inflation protected returns, with both the coupon and final maturity value of the bond increased by an inflation index, such as the consumer price index. Throughout the 1970's many governments, including the UK, effectively defaulted on their debt by pursuing policies that generated high inflation; bonds were widely known as certificates of confiscation. Index linked bonds go a long way towards protecting against this inflationary risk that hangs over all conventional debt and cash.

> *Today gold is not money, it is a commodity.*

Financial theory predicts that relatively low risk assets will deliver relatively low returns, and that is true for high quality index linked bonds. However every portfolio should contain a range of assets including some that will retain and increase their value even in the teeth of the worst financial crisis. Inflation linked bonds issued by high quality government issuers such as United States, Canada, Sweden, Australia, Germany and the UK fulfil that role. With some money safely tucked away, an investor is free to pursue higher risk and higher return opportunities elsewhere in their portfolio.

CG Asset Management is a boutique asset manager with a limited range of funds, all of which have a strong wealth preservation bias. The longest running of these funds, Capital Gearing Trust plc, has delivered 15% compound annual returns since 1982 with only one year of negative returns. Today Capital Gearing Trust plc has more than 30% of its assets in index linked bonds, as these instruments seem to us to be the best shelter from the storm we see coming when rising inflation causes long bond yields and equity prices to come under pressure. Great buying opportunities will present themselves in the future and it is important to have a little dry powder set aside to exploit them. What better way of doing that than holding the modern version of gold?

Wealth planning

Buy-to-let property vs an investment portfolio

By Simon Wong
Wealth Planner

It is becoming less attractive for private investors to buy and own investment properties, as landlords feel the pinch from tax changes aimed at making properties more affordable for home owners.

According to Savills estate agency an estimated 53,000 buy-to-let properties have been sold over the past 12 months which is the lowest number since 2007.

Although the number of new loans approved for purchases of rental properties in June 2018 was nearly 20 per cent lower than the preceding year, according to trade body UK Finance, there are still about 1.9 million outstanding buy-to-let mortgages.

Tax changes have made buy-to-lets less economical for some landlords who are highly leveraged. From April 2017, landlords have faced a gradual tapering of the amount of mortgage interest on which they can claim tax relief. In this tax year, 2018-19, they can claim only 50 per cent of the mortgage interest against their tax bill. For 2019-20 this will fall to 25 per cent, with the relief withdrawn altogether in 2020-21. The tax relief is being replaced by a new tax credit of 20%, making buy-to-let mortgages less attractive to tax payers who fall into the higher rate of income tax. Previously all mortgage financing costs could be deducted from the rent received before landlords could calculate tax.

> *Tax changes have made buy-to-lets less economical for some landlords who are highly leveraged.*

Tax Year	Percentage of mortgage interest payments deductible from rental income	Percentage of mortgage interest payments qualifying for the new 20% tax credit
Before April 2017	100%	0%
2017-2018	75%	25%
2018-2019	50%	50%
2019-2020	25%	75%
After April 2020	0%	100%

Since April 2016, the 10% Wear and Tear Allowance has been replaced by the less generous Replacement Relief.

Since 31st March 2016, an extra 3% of stamp duty has been payable by residential property owners purchasing an additional residential property.

The new lower Capital Gains Tax rates of 10% and 20% introduced for disposals from 6 April 2016 do not apply to disposals of residential property. CGT rates for these transactions remain at 18% and 28%.

Tax Year	Buy-to-let property	Portfolio of Stocks and shares
Capital Gains Tax within the Basic Rate Band	18%	10%
Capital Gains Tax within the Higher Rate Band	28%	20%

The income tax rates for investment income is generally lower than that of buy-to-let properties. For a basic rate tax payer, the tax on dividend income is only 7.5% whereas the tax on rental income is 20%.

Tax Year	Buy-to-let property	Portfolio of Stocks and shares
Income Tax within the Basic Rate Band	20%	7.5%
Income Tax within the Higher Rate Band	40%	32.5%
Income Tax within the Additional Rate Band	45%	38.1%

> **There are still about 1.9 million outstanding buy-to-let mortgages.**

From April 2015, non-UK residents have to pay CGT on gains realised on UK residential property. The gain taxable is restricted to any growth from the April 2015 value. Alternatively the seller can elect to pay on a time apportionment basis if doing so would be beneficial. For example: where Principal Private Residence would be available.

Although residential property has been a popular investment in the past, not only are the returns now being affected by an increased rate of tax, but they can also be high risk because of a lack of diversification.

One of the problems with buy-to-let investments is that large amounts of capital have to be held in one single asset and landlords are often vulnerable because they hold a number of properties within one region.

The lack of diversification a single buy-to-let property represents on an investment level and tax-efficiency level should not be underestimated. For example, instead of a single buy-to-let property worth £500,000, a basket of 20+ stocks and shares might be held which provides options to withdraw future capital as well as take an income from the portfolio. A diversified portfolio of assets would allow a discretionary investment manager to use an investor's annual tax-free allowances of Capital Gains exemption (worth approx. £11,700 pa) and tax-free ISA allowances (worth £20,000 pa), which would be otherwise lost if a buy-to-let property was owned.

Buy-to-let properties require much more involvement from an investor. A landlord has to factor in void periods, the income tax due on rental income, property management fees, legal fees, insurance, the need to keep up to date with future legislation affecting landlords, the landlord's own time and effort etc.

What might initially appear a good return on paper, in reality may turn out to be not so advantageous after tax, expenses, time and hassle is taken into account. Also if the ultimate aim is to pass on the value of the buy-to-let to children to help them on the property ladder, it may not be as flexible or liquid as one might hope.

In summary, buying property is a good idea if it is to purchase a home, e.g. helping children to buy their first home. But viewing property as an investment is becoming increasingly less attractive because of i) the lower income yields attained after taking into account taxes, fees, void periods and ii) lower capital returns achievable because of the various taxes that now apply.

Stock in Focus

Euronext

James Godrich
Research Analyst

Imagine next Saturday I thought that Burnley, against the odds, might win their first game of the Premier League season (at the time of writing they have one point from four games, much to the author's disappointment).

I have, broadly speaking, two options as to how I might act on this view to make profit; find a friend that is willing to take the other side of my bet, called an over the counter (OTC) wager or to place my bet on an exchange and wait for an unknown party to agree to my terms. Clearly the benefits of placing my bet on an exchange are that an intermediary mitigates counterparty risk (the risk that my friend doesn't pay up if and when Burnley do win), helps with price discovery (how would I know what the 'right' odds to offer my friend are without knowing what the current price in the market is?) and provides liquidity to a large number of participants (what if I can't find a friend that's willing to take my bet on this occasion?). The most obvious downside is that the exchange provider is likely to charge for that service.

Euronext are a pan-European stock exchange and around a third of their revenues come from providing just that service for listed equities across a number of geographies. The business operates a federal model with the Belgian, French, Dutch, Portuguese and now Irish stock exchanges run as part of one corporate entity. A small number of additional volume related revenues come from providing a similar service for derivatives and FX, then providing the clearing (actual transfer of money) and settlement (transfer of securities) post-trade across all asset classes.

That leaves around 45% of revenues (roughly equal to the cost base for the business as a whole) coming from non-volume related revenues such as market data and listing fees. Market data involves charging fees to end users (such as JM Finn) for data related mostly to previous trading activity. Whilst listing fees are paid by the listed entity and come from IPO charges, follow on fees from additional capital raised and annual fees based on the market cap of the business.

That model slightly differs from a number of other listed stock exchanges such as the London Stock Exchange and the Deutsche Boerse who have in recent times adapted their model to include a greater reliance upon these mostly recurring non-volume related revenues. The market clearly appreciates the greater visibility afforded in the revenue of Euronext's peers; that's why the LSE trade on a 24x price to earnings, Deutsche Boerse on 20x and Euronext on just 16x.

However one attribute that all of these businesses do possess are the high barriers to entry that come from the network effect of their dominant position as the number one stock exchange in each of their respective geographies. Euronext hold around a 60% share in their home markets, Deutsche Boerse 64% and the LSE 63%, and if we return back to some of the benefits of the exchange model, it becomes clear that it is very difficult for new entrants to enter the market under this dynamic and without scale.

PRICE
€54.55

52 WEEK HIGH-LOW
€61.35—€47.14

NET YIELD
3.2%

HIST/PROS PER
14.7—16.5

EQUITY MARKET CAP (M)
€3,822

> ***The market clearly appreciates the greater visibility afforded in the revenue of Euronext's peers.***

Would it be possible to provide genuine price discovery with less than 10% of trades going through one's exchange? It seems unlikely. How about market liquidity? Well if 60% of volume is already going through one venue, that is likely to be the best place for me to find liquidity so I will most likely choose to trade there. And what about counterparty risk? Well, whilst it is possible for an alternative exchange to provide this, who am I more likely to trust; the large incumbent who has, in most cases, been operating in the market for a number of years, or a new entrant who may be lesser known and as yet unproven?

The difference between a new entrant and the incumbent in most cases comes from the service on offer and the implicit, rather than the explicit costs.

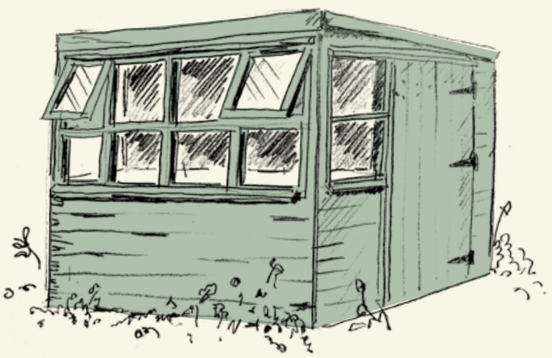
Whilst the core business at Euronext generates impressive levels of cash, at good margins with exceptional returns on capital, management are seeking to utilise that cash as part of their acquisition strategy to drive top line growth and benefit from multiple expansion within the share price valuation as they increase the proportion of non-volume related revenue, similar to that of their peers.

To that extent management are looking for acquisitions that either diversify their revenue line, such as the recently acquired FastMatch – a technologically advanced FX trading platform - or move to consolidate European exchanges to further improve liquidity across the group, such as the recent acquisition of the Irish Stock Exchange.

Euronext can trace its roots back to the Amsterdam stock exchange which was first established more than 400 years ago and, as long as publicly listed equities remain the primary means of capital allocation amongst finite resources, we would expect the business to remain in operation for another 400 years or more.

The fate of the share price between now and then we think depends on management's use of the cash generated from the core business and, for the near term at least, their ability to use their acquisition strategy to drive the business forward whilst volumes remain low and volatility remains muted.

James Godrich is a beneficial owner of Euronext
Please read the important notice on Page 1.



The Potting Shed

No.2

With over 150,000 new private businesses started in 2017 it seems that everywhere we look there's a start-up. In this new series we asked friends of JM Finn to describe the challenges entrepreneurs face as they look to change the world, make a fortune or simply earn a living.

When Ronel Lehmann founded Finito, helping first-time job hunters get Work Ready and mentoring those seeking a career change, he learned the importance of listening to others. Here, he shares some of the challenges he encountered, and his tips for other entrepreneurs.

In 2016, I launched Finito, having spent a long and successful career in public relations in the City of London. Having founded my own marketing communications agency in 1988, the decision to start all over again was not taken lightly, but I really believed I had an idea that could make a difference to people's lives.

Ever since my first job in a leading insurance recruitment firm in the Eighties, I have had a passion for helping individuals, family and friends find alternative employment. I get a buzz out of guiding people into the careers that are right for them – where they will enjoy what they are doing, thrive and be successful – and I have taken every possible opportunity to do that.

It has always struck me that prospective candidates appear to leave school, college or university lacking the life skills that employers are really looking for. It does not matter how impressive their academic results may be, or how many extra-curricular activities they are able to list on the CV, many embark on a job hunt with covering letters, emails and approaches that are too often ill-conceived or haphazard.

This is where the idea for Finito was born. After 26 years of working with clients in the corporate, financial, professional services and luxury brand markets, I decided I actually get more pleasure from helping those seeking work, who are typically bright, ambitious and enthusiastic, rather than prospective employers. Finito helps school leavers, university graduates, college leavers and mature or overseas students move smoothly into the employment market, providing a mix of mentoring, coaching and guidance to students as they first decide on a career direction, and then seek to make that a reality.

I decided it was time to plug the gap and help more young people get prepared for an ever-more challenging employment market. I felt confident I had found a niche, which is so important when starting a new business, and I conducted further investigation of potential competitors and was assured that no one was really doing what we were planning to do.

In the early days, I shared my idea with John Griffin. I have known John a long time: he founded Addison Lee in 1975 with just one car and sold the company to The Carlyle Group for £360 million in 2013. While business success relies heavily on your own personal traits, you need to listen to others and surround yourself with people who are really enthusiastic about what you are doing. John had himself mentored thousands of people during his career and could immediately see the potential of the business idea, and he agreed to become my Chairman.

Turning the idea into reality then required the drafting of a credible business plan, raising seed funding, and – in the case of Finito – building an advisory board that shared our passion. We were able to bring some fantastic people on board, including Dame Mary Richardson, the former Chief Executive of HSBC Global Education Trust; the Rt Hon Nicky Morgan MP, the former Secretary of State for Education; Sir Anthony Seldon, Vice-Chancellor of the University of Buckingham; Elizabeth Diaferia, previously Head of New Business for The Conservative Party; Ty Goddard, co-founder of The Education Foundation; and, Neil Carmichael, a former MP and Chair of the Education Select Committee.

“From day one we have worked meticulously to ensure we never let go of a student until we are confident they are settled into employment.

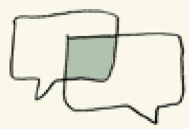
We also built a management team that includes Colin Hudson, Director of Career Development at Cranfield University; Derek Walker, a former Director of Careers at Saïd Business School; and, Professor Robert Campbell, Emeritus Professor of Philosophy at the University of Bolton. We knew that without the commitment and belief of these senior players in their fields, the new organisation would not be able to attract the business mentors it needed to in turn attract students.

Early on, we set ourselves a target launch date, and we ironed out the company structure, the business location, and of course the vitally important business name and trademark.

The next stage of taking a new business forward requires finessing your proposition, and that means giving serious thought to exactly what it is you are offering, and how you are going to communicate that to prospective clients. In the case of Finito, we needed clarity on what our students could expect to leave Finito with, and we needed to establish partnerships that would help us reach those students in the first place. We also knew that our best hope of success required us to establish a 100% success rate, and so from day one we have worked meticulously to ensure we never let go of a student until we are confident they are settled into employment.

“Surround yourself with great people.

Marketing activities are, of course, the bugbear of any new business – so essential, and yet with the capacity to swallow such a chunk of much-needed funding. We focused early on proving our business model, which meant establishing case studies and testimonials, and making sure that all our students and their parents became ambassadors for the business. We established strong Quality Assurance protocols, knowing that those would guarantee our ability to scale up, and we have never stopped talking about what we are doing – participating in events and publications relevant to thought leadership in education and employment.



The challenge when starting a new business is to make sure that everyone knows what you’re about; in our case, the vast majority of the people that hear about us know someone who could benefit from our service. So, we have to get our message out.

This is where those personal traits are so key: believe in yourself, foster an entrepreneurial spirit, and be willing to take risks, knowing that the difference between success and failure really is small. If ever things don’t go well, turn every negative into a positive, and learn as you go.

It is important to listen to others, but don’t be thrown off course. Instead, make sure that everyone around you is brilliant at what they do and passionate about what you are trying to achieve.

Share your success – if you help others, there is every chance they will find an opportunity to help you out further down the line.

And finally, laugh as much as you can. There is nothing more fun that making a good idea a reality, with the support of great people.

Independent view

Is it time not to buy in Central London?

By Andrew Symington
Managing Director, Symington Elvery

Prices in the Prime Central London (PCL) market have now dropped for fifteen consecutive quarters which is longer than the decline witnessed post Lehmans (6 quarters) or between 1989 and 1992 (11 quarters). Values are down by 18.2% (Source: Savills PCL flat index) across the board but this varies significantly depending on the nature of the property. For example, higher value properties which appeal to an international market are faring comparatively poorly compared to smaller homes that appeal to a domestic market.

£15

Consecutive quarters, prices have dropped

18.2%

Values are down

Opinions are divided on what will happen next. Many estate agents point to signs that "the market is bottoming out" and that now may be the time to buy. However, a more bearish view is that further price drops are inevitable and when the market does recover it will do so at a more modest rate than many would anticipate. While the decline has been longer than in previous downturns, it is still far less than the levels of price deflation seen in 2009 (22.6%) or 1989-92 (28.7%). As London is seen as a good long-term bet and the costs of holding the asset is low, the incentive to sell is more limited and the market therefore illiquid.

Before there can be recovery, the market must adjust to a number of headwinds. Firstly, London witnessed phenomenal price growth between 2009 and 2014. In certain areas, capital values doubled owing to both domestic and international demand fuelled by quantitative easing. Despite the subsequent price drops, the reality is that in most areas prices are only back to the levels witnessed a couple of years prior to the market turning.

Secondly, new and significant barriers to entry have been put into place, including high rates of SDLT (the liability for a £5m second home being £663,750) and new measures taxing both offshore individuals and properties held in offshore companies.

Thirdly, while there has been a decline in capital values, rents have also dropped and gross yields remain at between 2-3% which is the level witnessed in 2013 (i.e. just prior to the market turning).

Higher value properties are faring comparatively poorly compared to smaller homes

London is unquestionably a vibrant and interesting place to either live or have a home but remains expensive in a global context even after the recent price drops. In light of the headwinds that continue to face the market, is it sensible to investigate alternative means of living in London but reducing your exposure to the market?

The first, obvious solution is renting. Rents have barely changed over the last fifteen years and with gross yields at 2-3% one could employ capital elsewhere. The SDLT liability on a £5m flat covers the cost of renting an equivalent for approximately six years in Prime Central London. So, if a purchaser is of the opinion that the market is going to decline and/or that SDLT may be amended, is it not better to rent in the interim?

The decline is still far less than either

2009 (22.6%) OR 89-92 (28.7%)

However, if renting is seen as too temporary, Grosvenor has a number of flats in and around Eaton Square which trade relatively regularly on leases of up to 20 years. They are granted as such so that the Lessee will not be able to extend the lease under the terms of the Leasehold Reform, Housing & Urban Development Act 1993 (as amended). With a full term of 20 years, these leases trade at approximately 40% of an equivalent 100 year lease. While the lease is a diminishing asset, it can be sold on. In addition, the SDLT liability is significantly reduced and any further decline in the market is reduced by the more limited capital investment. These leases work particularly well with older buyers wishing to release money to their children and effectively pay their IHT liability to Grosvenor instead. As my former employer also remarked: "no one asks how long your lease is when they come to dinner."

Short and mid term leases are still relatively common throughout Prime Central London, those that were granted for a term of in excess of 21 years (by far the majority) have a higher resale value for the obvious reason that the Lessee has a statutory right to extend their lease. That said, a 20 year lease with this right would still probably only achieve 55-60% of the value compared to a 100 year lease. A buyer can wait to see if the market recovers in the knowledge that they will have a right to extend and there is currently political pressure to make the world of Leasehold Reform simple and cheaper for a Lessee.

Opinions are divided on what will happen next

Even if a buyer does not extend their lease or, indeed, chooses to buy a very short lease which would have previously been snapped up by a dealer seeking to extend, refurbish and sell on, they may be able to remain on as an Assured Tenant (i.e. with security of tenure for their lifetime) at the end of the lease; this is subject to it being their primary residence and certain rateable value limitations. The basis of this is set out in the Local Government & Housing Act 1989.

For those, such as myself, who derive a living from the Prime Central London market, it is sorely tempting to call the bottom of the market but I do not think that we are quite there yet. There will be those that take a long-term view and recognise that property (quite rightly) is not just an asset but something to enjoy. For those that cannot quite stomach a punitive tax on purchase and a potential further decline, there are viable alternatives for delivering the privilege of living in London.

BRITISH AMERICAN TOBACCO

Sam Statham
Research Assistant

PRICE
£36.60

52 WEEK HIGH-LOW
£51.08—£34.64

NET YIELD
9.1%

HIST/PROS PER
2.1—12.4

EQUITY MARKET CAP (M)
£83,733

British American Tobacco (BATs) and their peers have been plagued over recent years by concerns over pro-health legislation threatening parts of the industry. Thus far, tobacco giants have survived tax hikes, nasty packet coverings and most recently competition from Next Generation Products (NGPs).

NGPs come in the form of e-cigarettes and heated (rather than burnt) tobacco. It had been thought that NGPs were going to be more profitable for tobacco companies. However, uncertainty has since crept into analysts' forecasts following increased regulatory scrutiny, like the banning of new products with nicotine salts in the US. This leaves the incumbents (such as vaping company JUUL) in an enviable position.

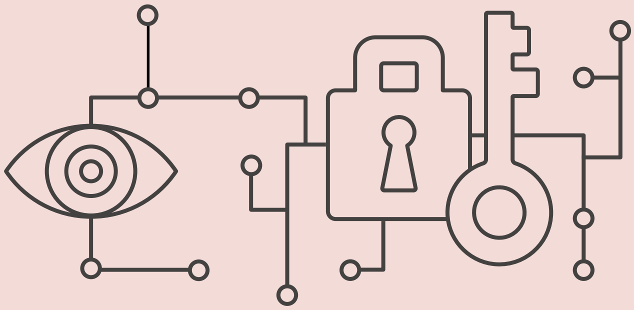
The main attraction to the tobacco space used to be high margins which rose each year thanks to pricing power and an absence of new entrants, as it was extremely difficult to advertise. The landscape is now going through structural change and new companies are starting to enter into the fold with NGPs sold as the "healthier" alternative.

JUUL, which has a 70% market share of the US e-cigarette market, launched in the UK in July 2018 with the mission to "eliminate combustible cigarettes from the face of the earth". BATs has an impressive track record of dealing with change in the industry but it appears there is one more hurdle for them to overcome.

Please read the important notice on page 1.

JM Finn News

Keeping abreast of Cyber crime



The cybersecurity community and major media have largely concurred on the prediction that cybercrime damages will cost the world $6 trillion annually by 2021, up from $3 trillion in 2015. This represents the greatest transfer of economic wealth in history, risks the incentives for innovation and investment, and will be more profitable than the global trade of all major illegal drugs combined, according to Steve Morgan, editor in chief of the Cybersecurity Market Report.

The cyber-attack on British Airways that compromised customers personal and financial data serves as a pertinent reminder of the risk of putting our data online and the sophisticated measures today's criminals are taking.

Most firms, JM Finn included, place the security of their data as a top priority. This is evidenced by the spend within the IT budget on cybersecurity, including the installation of multi-faceted detection and prevention tools, the quality and experience of our IT staff and the mandatory training of our staff.

This last point is crucial as a firm can have the most sophisticated prevention software in place, but more often than not data breaches occur as a result of human error. Phishing, when someone impersonates an organisation or, in our case a client, with the aim of getting them to transfer money elsewhere, is the main threat to firms such as ours. At JM Finn, head of IT Jon Cosson who recently achieved an MSc with distinction in Cyber Security, goes to great lengths to remind staff about the dangers inherent with online communication and is always keen to show us that people are often the weakest link.

To counter some of the threats and risks to us and your data, we have put in place a number of new measures in addition to current policies, some of which might seem to be compromising the service we offer, but we believe these are measures that are essential in safeguarding our clients' privacy, financial information and funds.

Cheque payments

We will no longer be offering cheques as a payment tool. Payments will instead be made electronically via BACS or CHAPS. This will help to protect your payments from being intercepted or amended by potential fraudsters and increase the speed at which you receive your funds.

Third party payees

From 1 January 2019, we will be reducing the list of third party payees that we allow to be paid from a client's account. This change is designed to protect clients from payment fraud which may arise from client or payee email accounts being hacked and payment instructions being redirected to the fraudster. The firm will instead send funds to the client's own account.

We recognise that some existing arrangements will have to change but firmly believe this is in the best interests of all.

Email fraud

Email payment fraud occurs when a fraudster hacks into the email communications between a client and a company. The fraudster places malware into a computer which will lie dormant, monitoring email activity until it recognises specific keywords relating to a request for payment. The fraudster will then contact the client and either amend a genuine payment request with different bank account details or send a request informing the client that the company's bank details have changed and requesting that they transfer the funds into the 'new' account. This type of fraud can be difficult to identify as the payment request will appear legitimate and also be a payment the client is expecting to make.

Please contact your investment manager to discuss how these changes might affect you and for any other concerns you may have.

Please also ask about our award-winning client portal which, in addition to providing up to date information about your portfolio, also stores your account documentation securely and supports secure messaging to share sensitive documents, like copies of your passport and bank statements, helping you avoid increasingly vulnerable emails. Available via an app, you can also use your fingerprint (where supported) to avoid the headache of forgotten passwords to access the portal in seconds.

•

An award winning portal:

Won *Best Online Development* at the Systems in the City Awards 2017.

Goodacre SYSTEMS IN THE CITY

View the portal via the app. Available at:

Download on the App Store

GET IT ON Google Play

INTUITIVE SURGICAL

Sam Statham
Research Assistant

PRICE
$568.36

52 WEEK HIGH-LOW
$572.96—$337.80

NET YIELD
0.0%

HIST/PROS PER
56.6—51.7

EQUITY MARKET CAP (M)
$63,545

Intuitive Surgical are the global leader in robotic assisted minimally invasive surgery through the “da Vinci System” as well as the related instruments and accessories.

The da Vinci System comes in several models but essentially there are two units, the surgeons console and the patient-side cart. The former creates 3D imagery of the operating area and allows surgeons to remotely carry out complex procedures like heart valve and cancer surgery through tiny incisions. The later holds the camera and either three or four robotic arms with interchangeable tools to perform the procedure.

The original prototype was developed in the late 1980s at the former Stanford Research Institute under contract to the US Army. While initial work was funded in the interest of developing a system for remotely performing battlefield surgery, commercial applications have proved to be more compelling.

There are currently over 4,500 of these machines in hospitals all over the world, the majority of which are currently based in the US but many are here in the UK. Due to the accuracy of the system, the base level of quality in surgery is on the rise. A frightening thought, but next time you are on the operating table undergoing surgery, you may be the only person in the room.

Please read the important notice on page 1.

JM Finn News

Surrey CCC crowned champions

> ***Champions at heart, champions in attitude.***
>
> – Kumar Sangakkara

With a ninth consecutive victory for the season, Surrey's young team, under new captain Rory Burns, eased to their 20th county championship and first since 2002. It's been a long time coming, but this year's victory in the Specsavers County Championship cements the club's position as the second most successful red ball county in the country.

JM Finn have been sponsors of Surrey County Cricket Club for 14 years – a partnership that is based on shared values of heritage, quality and performance.

Drawn by its historic and iconic venue, the member-owned club offers a great opportunity to place our brand alongside one of English cricket's leading and forward looking clubs and reach an ever-increasing and engaged audience.

To the modern cricket fan, Surrey CCC's home, the Kia Oval, is most remembered for the finale of the 2005 Ashes – one of the greatest series ever played. Today, the ground is home to all formats of club and international cricket. In 2018 the Oval saw England wrap up the series victory versus India, Alastair Cook's final innings as a test player and witnessed Surrey win the County Championship.

The Club was formed in 1845 and is one of the most historic sports clubs in the United Kingdom. Away from cricket, some say The Oval is where English team sport was founded. In 1870 the ground hosted the first ever International football match in England – between England and Scotland – and two years later, in 1872, hosted the first ever FA Cup Final between Wanderers and Engineers, won 1-0 by the Wanderers. The same year, 1872, also saw the ground host the first ever Rugby Union fixture to be played in England, between England and Scotland.

With two of England's newest recruits coming from Surrey, it's been an enormous year for the club and we are incredibly proud of the team's efforts. As Alec Stewart, director of cricket, tweeted "a lot of hard work has led to this special moment."

To view videos of some of the Surrey players discussing their memorable partnerships, please visit www.jmfinn.com/partnership.

Asset Allocation Focus

As part of our focus on providing a high quality, personalised investment service, we look to support our investment managers in their decision making when it comes to constructing client portfolios. Our asset allocation committee is one example of this, via their monthly output showcasing their views on a global sectorial basis.

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

Here we present a snapshot of the current views.

Positive | Neutral | Negative

FIXED INCOME		
UK Government Bonds – conventional gilts	Neutral	We think that inflation expectations are now going to moderate given that the pound has found a base. This drives us to extend our preferred maturity to six years.
UK Corporate Bonds	Neutral	Investment grade bonds with the shortest maturities are preferred, within the constraints of income requirements.
UK Government Bonds – index linked gilts	Neutral	In line with conventional gilts, the preferred maturity gets pushed out to five years. We are one year shorter than conventional gilts because of the risk that the RPI calculation gets re-based.
EQUITIES		
Materials	Positive	Global growth should support the sector, however ongoing trade wars are of some concern.
Consumer Staples	Neutral	We like this sector for its defensive qualities, recent weakness offers buying opportunities.
Consumer Discretionary	Neutral	Incumbents continue to be challenged by disruptive technology and changing consumer behaviour. Selective opportunities are on offer however.
Financials – ex Banks, Insurance & Property	Neutral	This includes a broad range of stocks which are generally geared into the cycle. Be aware of macroeconomic concerns.
Financials – Banks	Neutral	Prefer globally exposed banks to domestic, look for beneficiaries of rising rates.
Financials – Life Insurance	Positive	Supportive demographics, particularly internationally, however the sector is vulnerable to market correction.
Real Estate	Neutral	Global real estate may offer better value but we caution on bond proxy status.
Health Care	Positive	Growth and defensive attributes and global demographic tailwind. Distinguish between pharma/healthcare/biotech sub sectors.
Industrials	Positive	Potential for some profit taking on valuation grounds at this stage of the cycle.
Energy	Neutral	Robust global demand should help to underpin prices. Dividends looking more secure with oil at current levels, however valuations appear up with events.
Information technology	Neutral	Prefer both funds and international blue chips for exposure to specific tech themes. Long term attractions of the sector are clear.
Telecommunications	Neutral	Capex and competition remains an issue. Persistent underperformance an issue. Yields may come under pressure.
Utilities	Negative	Bond proxy. Political risk. High gearing. However valuations may now be starting to reflect the uncertainty.
ALTERNATIVES		
Absolute Return	Neutral	Exposure might be appropriate given current market conditions. We suggest caution on the "yield hunt" and are wary of lower quality products.
Infrastructure	Neutral	Investors should be cautious when looking for yield and pay close scrutiny to the quality of the investment product and premiums.

Meet the manager

Sam Barty-King

Senior Investment Manager, London

Lives Clapham, London

Family Married, 3 children

Education Radley College and Newcastle University

Started at JM Finn 2006

Favourite restaurant Frantoio, always fun.

Most proud sporting moment Beating Paul McGinly at golf (sadly only over 1 hole!)

Biggest fashion fail Long hair

Last holiday Yarmouth, Isle of Wight

In your view, what are the big issues that charities are having to deal with today, in terms of managing their existing assets?

I have written in previous editions of Prospects on the challenge faced by charities in maintaining income levels. Whilst this is still pertinent today perhaps a bigger challenge is the case for good governance and leadership. Recent high profile cases including the closure of Kids Company and issues at Oxfam have only heightened trustees' governance and legislation responsibilities. Trustees have to comply with certain legal requirements and duties when investing their charity's assets for financial return. In addition the Charities Act 2016, the General Data Protection Regulation (GDPR), the Common Reporting Standard (CRS) and CC14 (the Charity Commission's investment guide for trustees), are all helpful in parts but can lack substance in some areas and are unnecessarily detailed and confusing in others. One has to remember that trusteeship is a voluntary role and it shouldn't be daunting but rewarding. A good sensible approach to risk and governance should at least in part start to ease the burden.

How do you and your team try to help with the aforementioned challenges?

We are privileged to work with a broad variety of charities thanks in part to our client driven approach. Our focus on a high quality service along with a deep understanding of a charity's requirements has engendered long term relationships with charities throughout the UK. This deep knowledge, along with our strong relationships, has ensured we are well equipped to deal with the many challenges. We also run small trustee training sessions to help trustees deal with particular issues which are also a good opportunity for trustees to engage with one another and share their knowledge and experience.

Does the latest interest rate rise materially affect your portfolio positioning?

No. With the majority of asset classes remaining expensive we will continue to invest portfolios with a bias towards equities given the attractive yields on offer, however we remain acutely aware that we are closer to the end of the business cycle than the beginning. We will continue to adopt a defensive stance albeit we do think we can make further progress.

Presumably income generation is a key goal; how have you maintained appropriate levels in this low interest rate environment?

Pleasingly income levels have been maintained, albeit with a perceived increase in risk as equity allocations have increased and other asset classes have been introduced. Investments in infrastructure projects have been central to our approach in maintaining income levels whilst property has also played an integral role. Where we do hold fixed income, outside of a few individual issues, we have tried to invest with fund managers that have a more active approach to management whilst complementing each other with differing investment styles.

What's next for the team?

Our primary objective is always to help our existing charity clients grow their assets in real terms whilst providing them with a decent income; secondly if we can further educate trustees and help them with the increasing regulatory burden then that would be a bonus; and finally, it would be fantastic to get to know some new charities and help them achieve their investment goals.

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