JM FINN

No.49 *Winter 2024*

Prospects

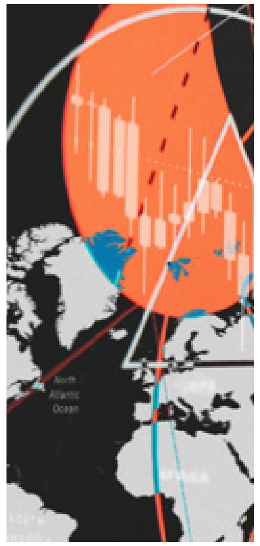
The JM Finn Quarterly Periodical

Pension changes
Impact on succession planning

Second homes
To sell or not to sell?

Big in Japan
A potted history of a unique economy

No.49
Winter 2024



Important notice
Please note that the value of securities and the income from them may go down as well as up and you may not receive back all the money you invest. Past performance is not a reliable indicator of future results. Any views expressed are those of the author. You should contact the person at JM Finn with whom you usually deal if you wish to discuss the suitability of any securities mentioned. Stock data quoted are as at close of business on 29th November 2024. Tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

Data protection
If you no longer wish to receive a copy of Prospects and /or to opt out of receiving marketing materials, including invitations to our seminars and events, please send an email to marketing@jmfinn.com.

We process your personal data in accordance with the law, and in particular with the UK General Data Protection Regulation of 1 January 2021. You have the right to object to the processing and use of your personal data, to access the data that we process, and to request that your data be deleted or that any errors in your data be corrected. To exercise these rights, you may write to us by post or by email. A copy of our Privacy Policy can be found on our website.

Editor
Carrie Lennard
carrie.lennard@jmfinn.com

Contents

Published by JM Finn on
13th December 2024

Welcome

2024 has seen many of the world's central banks reducing interest rates back down to more normalised levels. Although the decreases in the UK's interest rate may not thus far have been as substantial as we might have hoped, the Bank of England, European Central Bank and US Federal Reserve all appear on course to continue to reduce rates to more palatable levels by the end of 2025 – good news for those with mortgages.

Following the US election, at the time of writing, we wait to see if President Trump implements the policies set out during his campaign, including possible import tariffs on goods from China and the Eurozone. The impact of this and other market trends are a key focus in this edition: Head of Investment Office, Jon Cunliffe provides a snapshot of themes in the wider global economy in our new In Focus series on page 8, while the unique characteristics of Japan's economy and demographics are the theme of our editorial on page 4. William McCubbin explores the remarkable shift the country with the world's oldest population and highest debt-to-GDP ratio has undergone in the 70 years from the post-war period to the highs its Nikkei 225 Index has achieved in recent times.

At home, the Autumn Budget announcement has had a major impact and will undoubtedly still be top of mind for many of you. It was rather a mixed bag – whilst tax rises were anticipated, less expected was the inclusion of pensions within estates for inheritance tax purposes. Whilst we wait to see final details of the technical consultation next year, you may perhaps be considering your options for inheritance tax planning: Ryan Gordon of our wealth planning team covers the anticipated impact of the pension change on page 14. Our wealth planners recently ran a client webinar on 'protecting wealth across the generations,' to act as a useful starting point for those thinking about how best to pass wealth on to their loved ones. A recording of the webinar is available on the JM Finn website, which you may find beneficial – and the wealth planning team remain on hand for any client queries about this topic or the Budget's effect on your own finances.

Meeting client needs is at the heart of what JM Finn strives to do – and I'm proud to say that for the fourth consecutive year, we have been awarded 'Best Wealth Manager' by the Good Money Guide. What is particularly heartening about the award is that winners are chosen based on public voting and feedback from providers. I would like to say a big thank you to those of you who took the trouble to vote for the Firm.

As we head into 2025 our focus, as ever, is on aiming to deliver long-term returns for clients regardless of changing macroeconomic conditions. Wherever you are spending the festive period, on behalf of everyone at JM Finn, I wish you all a very Happy Christmas and all the best for the New Year.

Hugo

Hugo Bedford
CEO

Land of the rising sun

William McCubbin
Assistant Research Analyst

Assistant Research Analyst William McCubbin gives a potted history of Japan's extraordinary economic development over the last 70 years.

From a post-war economic miracle to a global leader in technology, Japan has consistently defied expectations. From the bullet train to the pocket calculator, the nation's innovations have consistently shaped consumer culture and advanced industries worldwide.

As we sit here today, Japan emerges from its economic challenges, reaching new market highs, but the question remains: Can Japan reclaim its position as the global innovation powerhouse it once was?

Japan underwent rapid expansion post-Second World War, driven by a focus on industrialisation through factory modernisation and market reforms. This period saw Japan emerge as the world's second largest economy in 1968, propelled by robust domestic demand, increased corporate investment, and a shift from primary activities like agriculture, manufacturing, and mining to processing, telecommunications and computing.

Stringent post-war tariff policies encouraged domestic savings, facilitating access to credit. This, coupled with a substantial trade surplus, led to Yen appreciation, further boosting the economy. During this time, Japanese companies allocated capital in overseas markets, reducing domestic prices and expanding the trade surplus. This, in turn, intensified Yen appreciation and fuelled speculation in the 1980s, as Japan outpaced economic rivals like the United States.

Simon Kuznets, the Nobel laureate famous for his work on standardising the measurement of gross national product, used to group economies into four categories: 'undeveloped, developed, Argentina and Japan'. He cited these two countries because their economies made them impossible to categorise neatly as either developed or undeveloped, with Japan's unique classification stemming from its status as the first non-Western country to successfully accomplish industrialisation.

However, in the late 80s the Bank of Japan's decision to tighten monetary policy by raising interest rates to curb speculation in equity markets triggered the bursting of the equity bubble in 1989, resulting in a significant decline in equity prices.

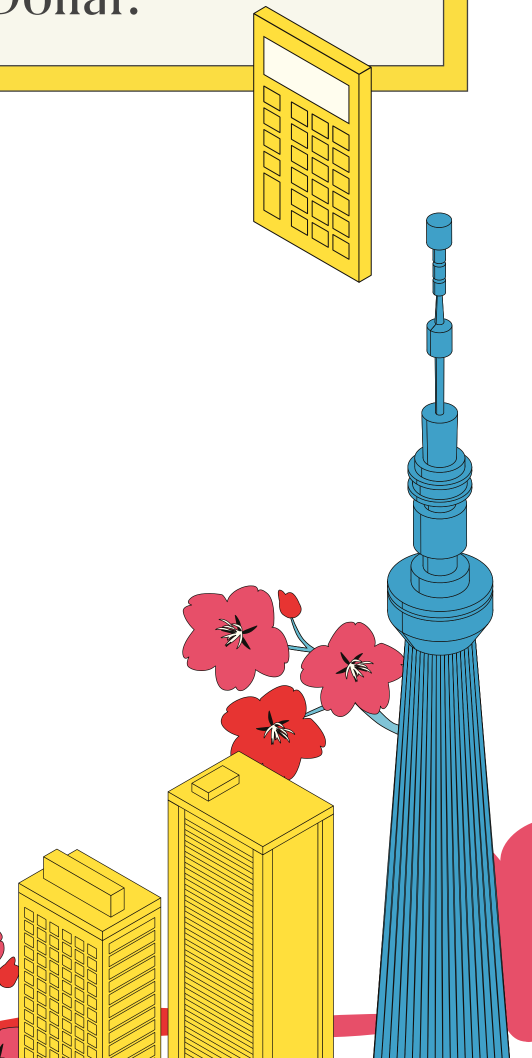
The lost decade

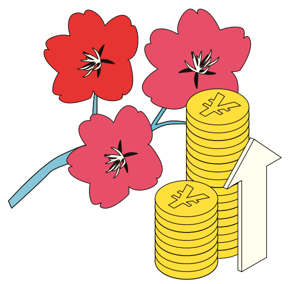
In the early 1990s, the Bank of Japan continued to implement a series of interest rate hikes to curb rising real estate prices. However, this prolonged period of restrictive monetary policy inadvertently set the stage for a liquidity trap (when very low interest rates fail to stimulate demand) and a subsequent credit crunch. As a result, real estate values plummeted, beginning in the early 1990s and extending into the mid-2000s. Japan became an outlier again, as the only advanced economy in the world where inflation, interest rates and wage growth all remained zero.

The sleeping giant

Since 1993, Japan had essentially experienced zero economic growth. There have been brief periods of expansion such as in the mid-2000s, but the Global Financial Crisis of 2008-09 plunged Japan back into economic uncertainty. There was much hope that the election of Shinzo Abe as Prime Minister in 2012 would herald a new era of prosperity. His "Abenomics" strategy, a three-pronged approach of monetary easing, fiscal stimulus, and structural reforms aimed to revitalise the stagnant economy. Similarly to prior Japanese economic policy, it yielded success at points, whilst stalling at others. While 'Abenomics' offered a temporary reprieve, Japan's long-term economic health remained tied to addressing deep-rooted structural issues, whilst fostering sustainable economic growth.

> "As Japan is behind the curve compared to other developed economies on policy rate hikes, the Yen has been strengthening against the Dollar.





The Sakura Blooms again

Numerous attempts to revitalise the economy through quantitative easing, negative interest rates and yield curve control, all had limited impact. However, recent developments suggest a potential turning point. In March 2024, Japan ended six years of negative interest rates, shifting its monetary policy stance to normalisation with the gradual raising of interest rates, and simultaneously easing its monthly bond-buying program. These moves, coupled with the appointment of a new prime minister, have sparked optimism and helped Japan's Nikkei 225 Index hit all-time highs.

As Japan is behind the curve compared to other developed economies on policy rate hikes, the Yen has been strengthening against the Dollar. This divergence in monetary policy has led to bouts of financial market volatility when the Yen has rallied sharply. In this environment, investors who had borrowed in Yen (where the cost of borrowing is still very low) to fund purchases of international equities have been forced buyers of Yen and sellers of equities. Whilst being optimistic on equity markets in the round, as we look ahead into 2025 it is nonetheless reasonable to expect further Yen strength to cause periodic market volatility.

Japan's interest rate rises have been driven by the exogenous shocks of the Covid pandemic and the Ukraine war, providing a catalyst for economic growth. Imported inflation, driven by rising commodity and energy prices have seeped into wages, marking the first significant wage growth in over two years. This newfound spending power among consumers is now driving domestic demand.

> "Japan can aspire to reclaim its position as a global economic powerhouse.

Beyond monetary policy, Japan is undergoing significant structural changes. The Tokyo Stock Exchange has implemented reforms to corporate governance structures, encouraging greater alignment of interests between shareholders and management. Elsewhere, corporates are reducing cross-shareholding (where publicly traded companies own shares in other publicly traded firms), a positive step towards efficient capital allocation in the minds of investors. Moreover, increased government spending on defence and technology, along with a more favourable investment climate is attracting foreign direct investment, further stimulating domestic demand.

As the land of the rising sun navigates the complexities of a rapidly changing global landscape, the future rests on its ability to achieve sustainable economic growth. By addressing structural and demographic issues, whilst fostering a more dynamic business environment, and embracing technological advancements, Japan can aspire to reclaim its position as a global economic powerhouse. Only time will tell whether the sleeping giant will awaken and once again shape the course of global economic history.

Please read the important notice on page 1.

In Focus

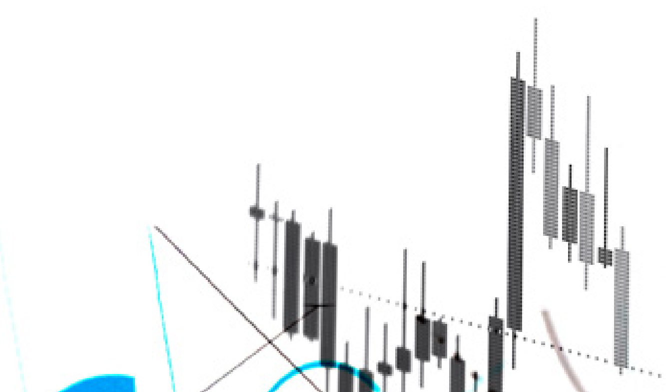
Markets In Focus

Jon Cunliffe
Head of Investment Office, JM Finn

Jon Cunliffe has recently joined the firm to lead our investment office, which supports our Investment Managers' robust decision making process with market and economic insight. He will also play a strategic role in guiding the direction of our fund investing. This quarter, in place of our usual guest editorial, we have the first of our new In Focus quarterly Prospects series, where Jon covers a roundup of global markets.

The biggest surprise to most economic commentators this year is just how resilient the US economy has proven to be. The consensus at the start of 2024 was that the unprecedentedly rapid 5.25% of interest rate hikes during 2022/3 would almost inevitably precipitate a US recession. It was felt that sharply higher borrowing would close the door on the soft landing scenario by jolting households and the corporate sector into a sharp retrenchment.

Instead, it seems that the sensitivity of key actors in the US economy to higher interest rates has proven to be somewhat less than feared. Homeowners had already locked in low borrowing rates, whilst households and corporates have paid down debt in recent years, with high levels of liquidity built up during the pandemic providing a significant cushion. Elsewhere, several government programmes (CHIPS Act, Inflation Reduction Act, JOBS Act) have continued to provide significant fiscal support to the economy.



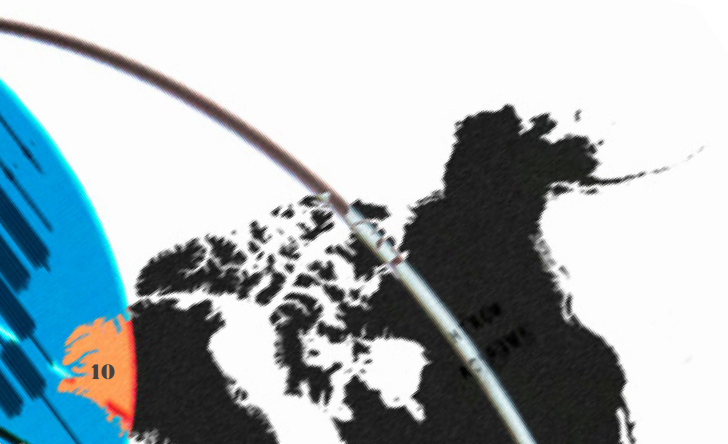
> “Stringent curbs on immigration and the imposition of tariffs are likely to be growth negative.

On a more negative note, the persistent inversion of the US yield curve for much of the last two years has garnered much attention as a recession signal. However, over recent years central banks have been active participants in bond markets, buying up huge swathes of securities to lower market interest rates and increase the provision of liquidity into the financial system. In our view, the market distortions created by this have made the bond market a much less reliable predictor of future economic conditions.

With Donald Trump's decisive victory in the US Presidential Election, focus has shifted to the impact of his strongly reflationary policies on the economic and financial market outlook. The prospects of deregulation and lower corporate taxes are growth positive and supportive for business sentiment. Stringent curbs on immigration and the imposition of tariffs are likely to be a headwind to growth and will temper what has been a disinflationary trend this year. The broader effect of Trump's measures on US growth however should be net neutral, but for its trading partners it is reasonable to expect less robust global economic activity next year. The effect of tariffs is to create a form of supply side shock which will be most keenly felt in China, but also in the Eurozone – and the key risk is whether we see a tit for tat trade war.

Another concern is the sustainability of public finances, particularly in the US. The baseline scenario before the US election was for publicly held US debt to rise to 125% of GDP by 2034. Under Trump, estimates are that this figure could rise to 145%. At this level of indebtedness, the US Central Bank would not be able to set interest rates without having one eye on their impact on the budget deficit. In our view, the way around this problem would be for the US authorities to engage in currency debasement, by limiting any undesirable increase in bond yields by mandating its central bank to use its balance sheet to buy US treasuries. This type of reflationary policy is likely to be a tailwind for risk assets such as equities.

During the year, most of the world's key central banks have been able to begin the process of bringing interest rates back down as inflation has cooled rapidly. With monetary policy generally restrictive, we feel that the Federal Reserve, European Central Bank and Bank of England will continue to reduce interest rates at a measured pace until they reach a more neutral level towards the end of 2025. As a group these central banks believe the downside risk to growth and financial stability outweigh any medium-term upside risks to price stability, and, whilst the effects of Trump's trade policy and fiscal laxity are a concern, this is a view we share. In the round, we remain optimistic that we shall see the fabled 'soft landing' scenario for the global economy and would note that historically equities have performed well when rates have been cut in such an environment.



> The Federal Reserve, European Central Bank and Bank of England will continue to reduce interest rates at a measured pace.

Another worry this year has been a downshift in global goods demand, with most manufacturing surveys slipping into contractionary territory. Japan and the UK have been holding up relatively well, but the Eurozone (particularly Germany) and China have been disappointing. Within the Eurozone much of the focus has been on the German economy, which has seen its manufacturing sector contract sharply. The German economy is highly sensitive to the global trade cycle and the effects of higher energy prices. Furthermore, it seems to us that the costs of the green energy transition, weaker Chinese growth and increased competition, a challenging environment for the automotive sector and unfavourable demographics are a structural rather than cyclical headwind to growth. Taken together, the scenario for the Eurozone economy remains 'muddle through', with growth in 2025 likely to be modest. However, we must remain cognizant of the potential effects of US trade policy under Trump which do pose downside risks to this outlook for moderate growth.

Offsetting the weakness in global manufacturing has been an improvement in final demand as consumer spending has reaccelerated, with retail sales surprising on the upside in the US, UK and Japan. Elsewhere, in Emerging Market Asia (ex-China) the picture has been brighter, with growth likely to be solid – helped by strong export growth and high real interest rates providing scope for more monetary easing.

In Japan, developments in the economy have been generally positive, and whilst headline growth has been anaemic (reflecting the ageing population), GDP per capita has been growing strongly after the pandemic-related decline. After a sluggish start to the year, wages have been rising in real terms and consumption growth has picked up. Furthermore, it looks like the economy has finally exited the deflationary trap it entered in the 1990s. Recent Japanese Yen strength needs to be watched carefully given its impact on domestic financial conditions, but the Bank of Japan is likely to tread carefully in raising rates whilst the Fed eases. As highlighted in our editorial, the unwind of cross shareholdings to facilitate business portfolio restructuring and increased business investment is a long overdue positive for the economy.

The key regional focus remains on disappointing incoming activity data from China, which remains mired in a domestic economic environment characterised by a Leninist obsession with production and export-led growth, without a western consumer model. As a result, industrial production growth has been consistently outstripping consumer spending, exerting downward pressure on the rate of inflation and dampening consumption growth.

> There is a mixed picture - with generally better growth and lower inflation this year offset by the uncertainties around the impact of Trump's policy agenda.

Elsewhere, in the absence of the creation of a real estate resolution fund to provide a safety net for the housing market and allow real estate developers access to legitimate funding, the negative wealth effects from the property sector will be felt for several quarters to come. The recent monetary policy stimulus from the People's Bank of China, the increase in bank capital and liquidity support for local authorities have provided welcome respite for investors in China, but we would like to see more material countercyclical fiscal stimulus. At best China is a cyclical play, with structural headwinds remaining strong and the threat of tariffs dampening sentiment.

All the foregoing paints a mixed picture, with generally better growth and lower inflation this year offset by the uncertainties around the impact of Trump's policy agenda, and that is before we factor in the potential impact of elevated geopolitical risks.

However, there has been a significant shift in the thinking of policymakers around the globe. In the post-Global Financial Crisis period the focus of policymakers was on shrinking debt-to-GDP ratios. Now policy is set to boost GDP, with monetary and fiscal policy aligned to support nominal growth and inflate away the government's debt burden. In the round, this policy mix is reflationary and generally supportive of broad-based asset price reflation as we head into 2025.

Please read the important notice on page 1.

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.

Jack Summers, *Research Assistant*
William McCubbin, *Assistant Research Analyst*

CONSUMER DISCRETIONARY
Greggs

CONSUMER SERVICES
Auto Trader

FINANCIALS
Mastercard

HEALTH CARE
Genus

INDUSTRIALS
BAE Systems, DiscoverIE, Spirax Group, Melrose IMI, Diploma

INFORMATION TECHNOLOGY
Halma, Kainos

MATERIALS
Croda International

REAL ESTATE
Segro, LondonMetric Property

1.

BAE Systems

Equity market cap (M) £ 37,253

Industrials
Charles Woodburn, CEO

Since we last met, BAE's CEO Charles Woodburn has been busy integrating a new acquisition. In February BAE acquired Ball Aerospace (now renamed Systems Space & Mission Systems). The acquisition came with a hefty price tag, but Woodburn explained that the integration was going well. This acquisition comes at a time when BAE's order book is swelling, as their global customer base attempts to replenish arsenals and modernise militaries in response to growing geopolitical threats.

This order book provides visibility to the business and management were keen to stress the long-term nature of some of these projects. BAE holds commanding positions in the AUKUS submarine building pact between Australia, the US and the UK and also in the next generation Tempest European fighter jet programme in the UK. These projects should provide revenue streams well into the 2030s – and the recent recommitment to Tempest ahead of the government's first strategic defence review is testament to its importance.

Contracts of this length are not without risk, and in the past BAE has not been immune from cost overruns. Since joining BAE in 2016, Woodburn has tightened restrictions on fixed price contracts and the third of revenue derived from these contract types tend to be de-risked before a contract is accepted.

Looking forward, we were keen to understand management's approach to capital allocation. Mergers and acquisitions are usually bolt-ons, however Ball Aerospace was more opportunistic. The business is cash generative and much of this is now returned to shareholders. The focus now is on execution. Thus far, Woodburn seems to have implemented the right controls but only time will tell.

2.

DiscoverIE

Equity market cap (M) £ 599

Industrials
Nick Jefferies, CEO, Simon Gibbins, CFO

DiscoverIE is a UK-based design and manufacturing holding company specialising in niche customised components sold into a range of end markets including renewables, medical and industrial. The past 12 months have not been easy; customers have sought to unwind excess inventories, resulting in negative organic sales growth for the period. Nick admitted that destocking has been painful, but that customer stock and order levels are finally approaching normal levels. The obvious concern here would be demand weakness being misconstrued as destocking. Nick suggested visibility on customer stock levels is good and that destocking has mostly abated for all but a select few large customers, as evidenced by an improving book-to-bill ratio of 0.98x (for reference, a book-to-bill higher than 1x signifies growth).

There have however been some bright spots in this period. The business continues to improve its operating margins, achieving this through a combination of accretive acquisitions and disposals, higher margin design wins and operational efficiencies. The latter point is the most impressive given volumes have been weak, which would normally be associated with operational deleverage and downward margin pressure. Design wins have also been positive and are expected to be up +8% in the first half, providing reassurance that DiscoverIE continues to fuel its future growth engine. Part of this figure is attributable to DiscoverIE's newly defined 'security' target market, with a large spec having been won to produce cabinet locks for individual computer units within data centres.

Despite tricky conditions, DiscoverIE has continued to acquire businesses. Simon highlighted DiscoverIE's balance sheet strength with Net debt/EBITDA at 1.5x, comfortably within the target range of 1.5-2x, offering firepower for further acquisitions should opportunities arise.

3.

LondonMetric Property

Equity market cap (M) £ 3,947

Utilities
Andrew Jones, CEO, Gareth Price, Head of Investor Relations

LondonMetric Property (LMP) has experienced significant growth, culminating in its inclusion in the FTSE 100 Index. The growth has been driven by a series of successful mergers and acquisitions, whilst also delivering organic rental growth.

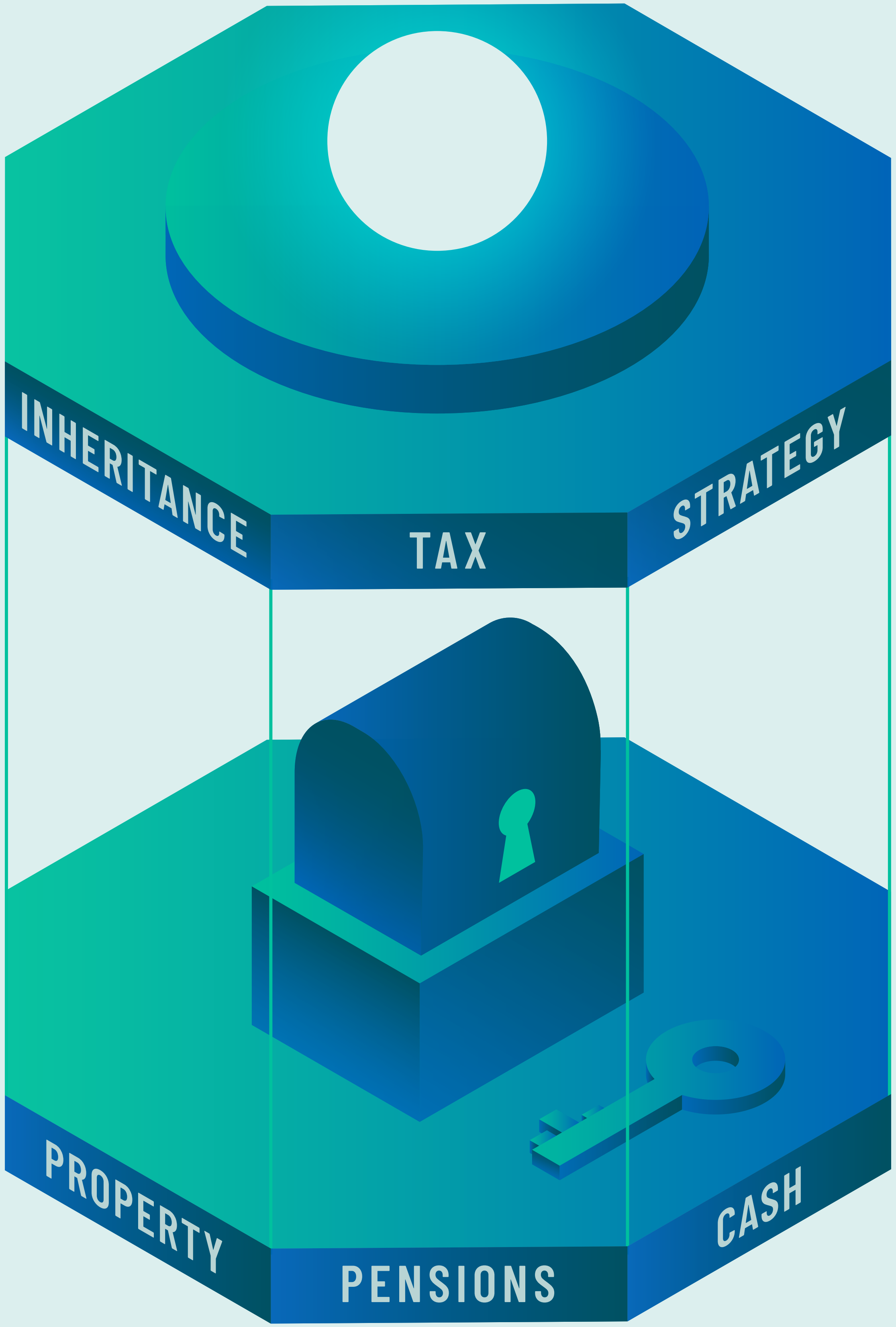
In our recent meeting with Andrew Jones, he discussed what they feel sets LMP apart from other Real Estate Investment Trusts (REITs) – the main deviation is that they do not operate through a fixed speciality but rotate in and out of their chosen thematic. A decade ago, as much as a quarter of its portfolio was in office buildings, however, due to changing market dynamics, LMP actively chose to rotate out of the sector.

We discussed the two recent transformative acquisitions of the last two years. The first was the £200 million acquisition of CT Property Trust, which gave LMP greater exposure to urban logistics, whilst also being very attractive financially. The second was the all-share merger with LXI REIT, which elevated LMP to a top four UK REIT, significantly boosting its portfolio value to over £6 billion.

While the portfolio remains diversified across multiple end markets, logistics still forms the core; however, the convenience, healthcare, leisure, and entertainment sectors now constitute substantial portions.

LMP's investment strategy has been focused on the triple-net model – where tenants assume responsibility for operating expenses, rent, and utilities. This allows LMP to run a more streamlined and leaner operation, allowing management to have more control in decision making at group level. It was clear throughout the meeting however that being purely triple-net or having long lease terms are not enough alone to drive growth: the most important factor is a presence in the winning sectors where LMP can deliver organic rental growth.

Please read the important notice on page 1.



Wealth planning

Time for a rethink?

Ryan Gordon
Paraplanner

The Autumn Budget threw an unexpected curveball by including pensions in estates for inheritance tax purposes. Ryan Gordon of the JM Finn Wealth Planning team considers the possible impact on retirement and inheritance strategies.

As the new Chancellor Rachel Reeves announced the details of her first Budget, she outlined what her objectives were; namely to tackle the £22bn deficit 'financial black hole' and fund public infrastructure by raising approximately £40bn in taxes. Time shall tell how achievable these objectives are, but she certainly delivered a tax and spend approach, with the biggest hike in taxes since 1993.

One of the most surprising and notable changes announced in the Autumn Budget was that all defined contribution pension assets will be brought into the inheritance tax regime from 6th April 2027. After weeks of speculation and rumour, the concern ahead of the Budget was that the government would target the 25% tax-free cash lump sum benefit of pensions. The concern was so great that it encouraged some to take their tax-free cash early ahead of the Budget. However, rather than removing the tax-free lump sum benefit, Reeves instead confirmed that pension funds would no longer be considered outside of an individual's estate and therefore would be included within the inheritance tax calculation on death.

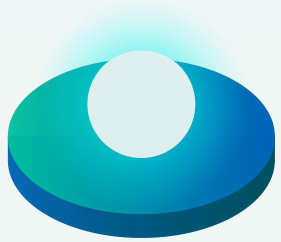
Based on current inheritance thresholds (which continue to be frozen), on death each person is entitled to a £325,000 nil rate band allowance and a further £175,000 residence nil rate band if a main residence is passed down to a direct descendant. Married couples or civil partners can combine their allowances to make a total inheritance tax allowance of £1m. This may sound like a fairly significant sum, but with total assets, property and now pensions included; it is likely that many more people will have total assets exceeding this sum. When considering inflation and increasing house prices, the fact that nil rate band thresholds have remained frozen since 2009 means that the actual worth of these thresholds reduces year on year, dragging more individuals into the inheritance tax net. Additionally, the inclusion of pensions within the inheritance tax calculation will likely disqualify more households from receiving the residence nil rate band, as this tapers away on estates over £2m.

Bringing pensions into an individual's estate may mean many people will need to adopt a revised approach to both retirement and estate planning. These will become more intertwined as, subject to a consultation period, the inheritance tax liability will be deducted from the pension before the estate can be finalised. In addition, for those who die aged over 75, the inherited pension fund will not only be subject to inheritance tax but also income tax on the residual amount at the beneficiary's marginal rate.

It would be sensible for those impacted by the changes to review their retirement strategy before the new rules are implemented in 2027. Prior to the Budget, it was often advised that other assets be drawn on to support retirement, in preference to the pension. This was because the pension, being inheritance tax exempt, could be passed down intact to beneficiaries on death. Other assets that were in the estate were instead accessed to reduce the inheritance tax liability. Now the pension will also be brought into the estate, there could be less incentive to retain the pension fund. Please do remember however that the pension fund will still benefit from valuable tax benefits: like an ISA, the investments are not subject to Income Tax or Capital Gains Tax within the pension fund so grow without any tax constraints until withdrawals are required. Also, there remains tax relief on personal contributions when paying into the pension, and 25% tax-free cash is usually available at retirement so they remain a valuable vehicle to use for future retirement.

As the new rules will not apply until April 2027, there is plenty of time to consider the changes. The complexity of the implementation may lead to some changes before the effective date and this will be confirmed once the government consultation has concluded. The consultation paper explains the changes and states that inheritance tax will be payable on the value of the gross funds in the pension immediately before death, but before being distributed or designated to the beneficiary.

> “Bringing pensions into an individual's estate may mean many people will need to adopt a revised approach to both retirement and estate planning.



> “Gifting this cash away to your beneficiaries should be considered, rather than leaving it in the pension.

If you are funding your pension purely for estate planning purposes, then you may wish to reconsider this approach. Likewise, if you have deferred taking tax-free cash beyond age 75, then it could be wise to revise this strategy. If the tax-free cash is not required to support retirement, then gifting this cash away to your beneficiaries to reduce your estate should be considered, rather than leaving it in the pension. It will also be important to review pension expression of wishes, as passing the pension fund now to your spouse may give more opportunities to remove funds from the estate before they pass away.

The JM Finn Wealth Planning team are on hand to discuss any of the areas covered in this article — please speak to your investment manager to be put in touch.

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.

Case study:
Mr Smith adopts a more tax-efficient approach

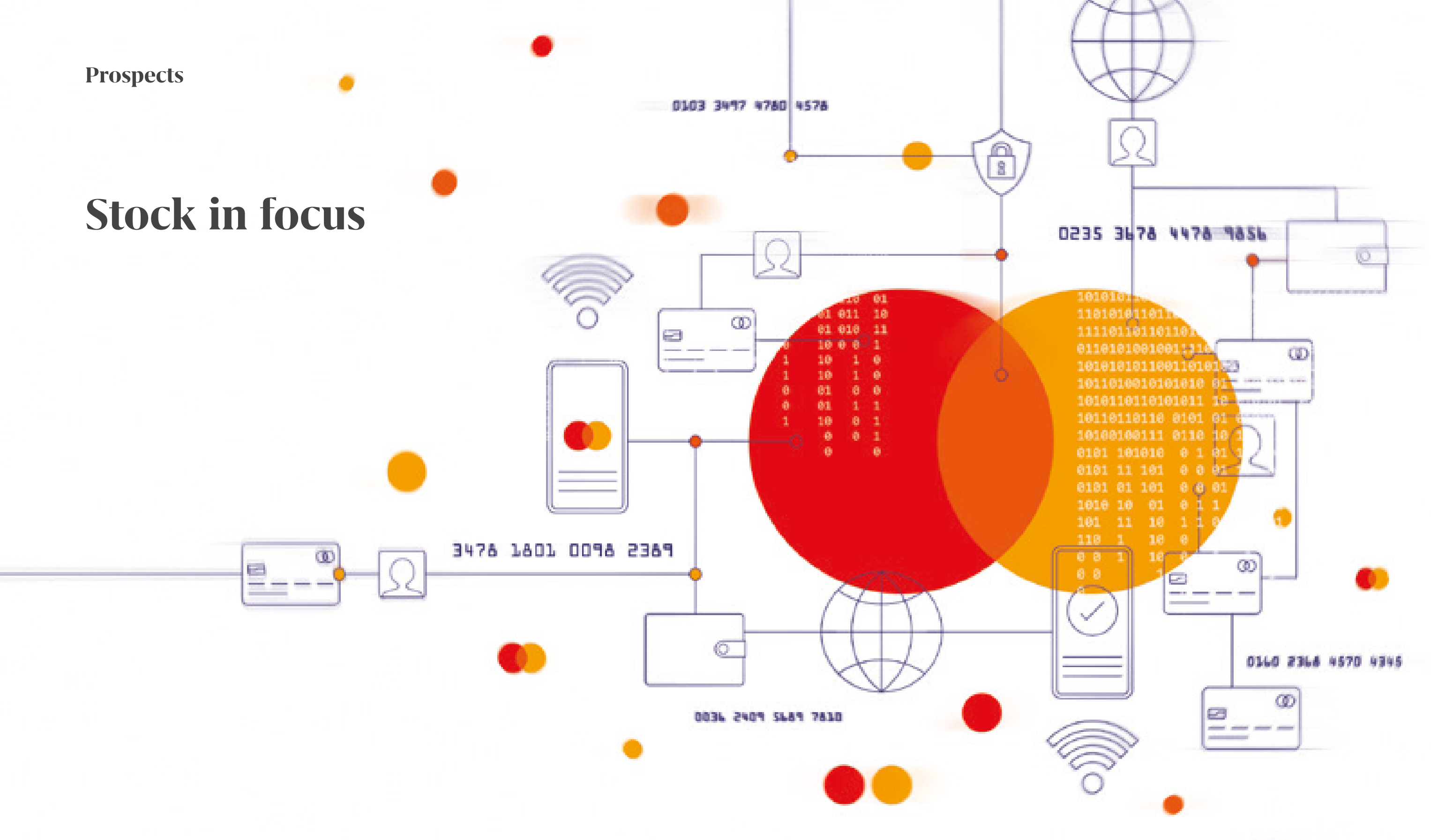
Mr. Smith, a 73-year-old with a Self-Invested Personal Pension (SIPP) and General Investment Account (GEN), had been preserving his SIPP to pass on to beneficiaries while meeting expenditure through withdrawals from his investment portfolio. However, following the announced changes to inheritance tax on pensions in future, he plans to change his strategy to adapt to the new rules.

Mr Smith now plans to withdraw the 25% tax-free cash from his SIPP to gift to each of his two children who are in their 40s, enabling them to maximise their ISA allowances and contribute towards school fees. Additionally, he will draw pension income up to the basic rate tax threshold and gift this surplus as part of his 'normal expenditure out of income' exempt from IHT.

This approach reduces his estate from 2027 and diminishes the taxable pension fund that will otherwise incur income tax for his beneficiaries if he dies after 75, balancing immediate family support with long-term tax efficiency.

Please read the important notice on page 1.

Stock in focus



Mastercard

Jack Summers
Research Assistant

In the 1960s, an alliance of US banks formed the Interbank Card Association (ICA) following Bank of America's success with the first type of payment card 'BankofAmericard', which would later go on to be spun out as Visa in 2008.

The ICA introduced 'Master Charge' in 1969, an interbank payment card that could be used by the cardholder at any bank within the alliance. In the years following, the ICA formed alliances with banks in Mexico, Europe, Australia and Africa, prompting a rebrand that saw the birth of 'Mastercard International' in 1979 – which went public as a standalone company in 2006.

Similarly to Visa, Mastercard provides the network infrastructure that allows the flow of payments made using credit or debit cards to pass from the customer to the seller (merchant) in a transaction. The process begins with a customer presenting their card to the merchant's card reader, which in turn presents the transaction data to the merchant's chosen processing firm or 'merchant acquirer.' The data then moves through the Mastercard payment network to the customer's issuing bank (e.g. Santander or Lloyds) which checks the account balance and responds with an authorise or decline signal, this is sent back through the network to the merchant's card machine. If the transaction is authorised, the issuing bank debits the amount from the customer's account and sends the funds to the merchant's bank via the merchant acquirer.

> Its operating margin is the fifth highest of any company in the S&P500.

The system is complex, with several stages and stakeholders. The success of card networks relies on numerous cardholders, issuers, merchants and merchant acquirers singing from the same hymn sheet to ensure that a customer can always pay using their card and a seller can always accept that card. It is these characteristics that make the barriers to entry associated with card networks so high, and the near global duopoly that exists between Mastercard and Visa one of the fiercest.

As should be expected with almost all duopoly market structures, Mastercard has regularly found itself in the crosshairs of antitrust competition authorities. This year in the US, a lawsuit filed nearly 20 years ago has sought to cap the credit interchange rate that Mastercard and Visa charge merchants on credit transactions in a similar way to the 2010 Durbin Amendment, which capped regulated US debit interchange rates. Interchange fees, also known as 'swipe fees' are set by the network provider and charged to the cardholder. The total fee is typically comprised of a fixed amount as well as a percentage of the spend amount and varies depending on the card type. They are used by the networks to cover transaction costs, but also to fund incentives and rebates which the networks use to lure banks (and indirectly their customers) into issuing (and using) cards on their network. Whilst Mastercard (and Visa) have historically navigated evolving regulation well, it is an ongoing threat that requires monitoring.

Equity market capitalisation (m)
$ 489,205

52 week high-low
$ 536 - $ 404

Net dividend yield
0.5%

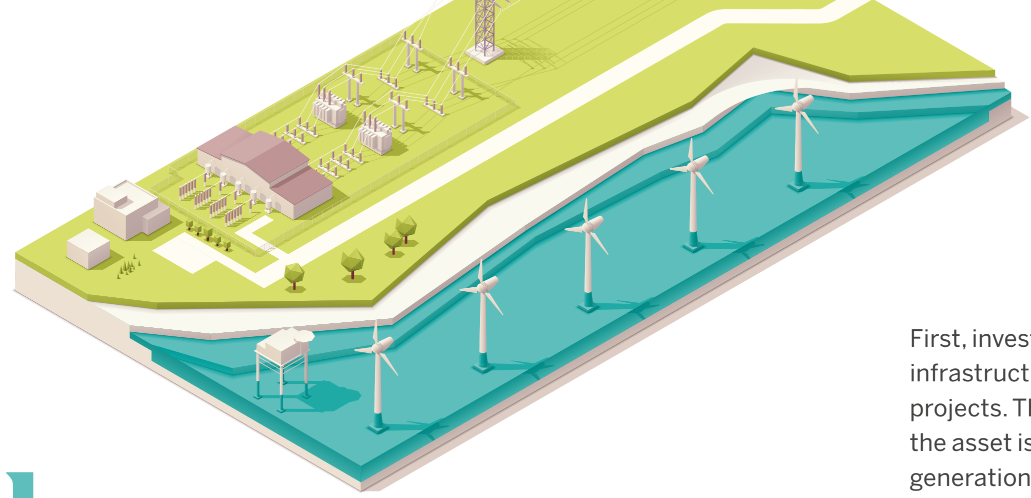
Price/earnings ratio
37

Unsurprisingly, Mastercard boasts stellar financials. Its operating margin of c.55% is the fifth highest of any company in the S&P500 and it has grown net revenues at 10.2% p.a. over the last decade. Within the wider consumer payments space, growth has historically been driven by increases in personal consumption and the trend of payments moving from cash to card. The US and UK have been the fastest to make this transition, but these markets have historically been dominated by Visa. With Visa's attention somewhat focussed on these cash cow markets, Mastercard set its sights on other regions of the world and bolstering its value-added systems and services (VASS) offering.

VASS covers a range of services that complement the traditional card network service for facilitating payments. These services include fraud protection and mitigation, cyber security and intelligence within the payments network and the provision of consultancy to the various stakeholders within the network. VASS is a no brainer for the card networks: it can be bolted on to existing services to add significant value along the entire stakeholder chain, giving Mastercard a large established customer base to sell to. Whilst there is more external competition in VASS, Mastercard already has well-established relationships with the target market and, similarly to the provision of the network, it is a business that carries significant scale benefits. VASS has grown at a high teens rate annually, and now makes up c.44% of total Mastercard revenues. While we expect this rate to moderate somewhat, VASS is likely to remain a key contributor to growth in the coming years.

Please read the important notice on page 1.

Collectives commentary



Financing the energy transition

Minesh Shah
Managing Director, The Renewables Infrastructure Group (TRIG)

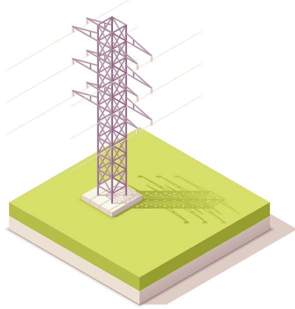
In recent months, climate change has been front and centre of the news agenda. It has been central to election campaigns across the globe and at COP29 in Baku.

In the UK, the new Labour government has elevated the climate agenda and is aiming to make Britain a clean energy superpower. This complex transition involves not only switching electricity generation from fossil fuels to renewables, but also the electrification of our economies to harness and deliver the abundant green energy supplied by wind and solar power.

The scale of the challenge requires the public and private sectors to work together to achieve this common goal. From the public sector, we need an economic environment that is conducive to investment: stability of public policy, a predictable planning system, and revenue support mechanisms that provide long-term cash flow visibility and inflation correlation to attract low-cost capital. There is a growing recognition of this across Europe, including the UK, with positive policy initiatives anticipated that we hope to see converted into supportive legislation and regulations.

The private sector not only brings the additional capital required to drive this transition but also competition to drive down the cost of that capital, and ultimately the costs to consumers. Companies such as The Renewables Infrastructure Group (TRIG), along with our peers, are well positioned to drive investment into renewables and the supporting infrastructure. This closed-ended listed investment company structure is uniquely positioned to invest for the long term and provides liquidity with millions of shares traded daily.

As an equity investment, a renewable energy project has the potential to deliver attractive returns on investment and the opportunity for portfolio diversification, whilst contributing to a positive climate impact. Returns can be achieved in three ways.



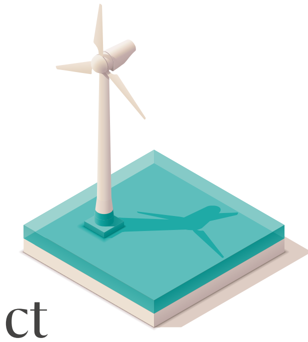
First, investors can invest in existing renewables infrastructure such as wind, solar and battery storage projects. This option carries the lowest relative risk as the asset is operational, with a track record of energy generation. Consequently, such projects will also have returns at the lower end of the spectrum.

The second option to deliver returns is to leverage an active asset management approach, which includes upgrading the hardware or software of an existing site. In doing so, the returns of an operational project can be enhanced. For instance, TRIG employs motorsport technology to improve the aerodynamics of wind turbines in the portfolio. This option enhances the output of existing projects and carries less risk than investing in a completely new site, therefore maximising the value of funds already invested.

Towards the end of a project's life, the investor will initially seek to extend the operational life of the asset through careful and calculated operations and maintenance regimes. Thereafter, it can be sought to repower the project. This involves using as much of the existing infrastructure as possible, particularly civil and electrical, to renew the electricity generating wind turbines or solar panels with the latest technology.

The final option, and the one with the greatest impact on the energy transition, is to develop new projects from scratch. This can range from developing a new project from a blank sheet of paper to entering a project at the ready-to-build stage with shovels ready to go into the ground. Investing at this stage allows investors to capture higher returns for their shareholders and is increasingly the approach being chosen by the most experienced management teams, recognising the proven nature of mature renewables technologies. TRIG, for example, has built nearly a quarter of its own generation capacity and has a further 1GW of projects, including 650MW of battery storage projects, that we are seeking to develop and enter into construction by 2030. Crucial to this development is balance sheet discipline, as it provides the option to either build the projects ourselves or sell them on to crystalise a development premium.

"The option with the greatest impact on the energy transition, is to develop new projects from scratch.

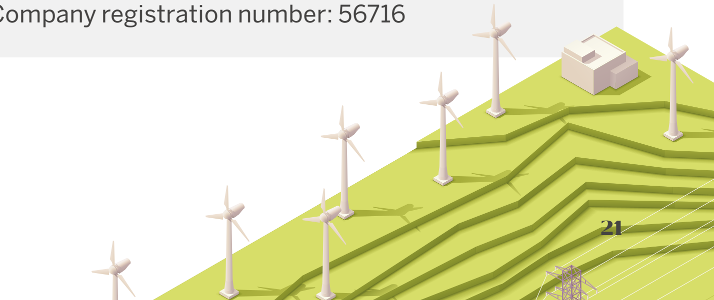


In a diversified portfolio, we believe there is a place for all three strategies to generate a resilient income stream as well as growth in the capital base. Deploying private capital across the spectrum of renewable energy investments is an economic opportunity for investors, environmentally important for society and will be instrumental in delivering the green transition.

Company name:
The Renewables Infrastructure Group Limited

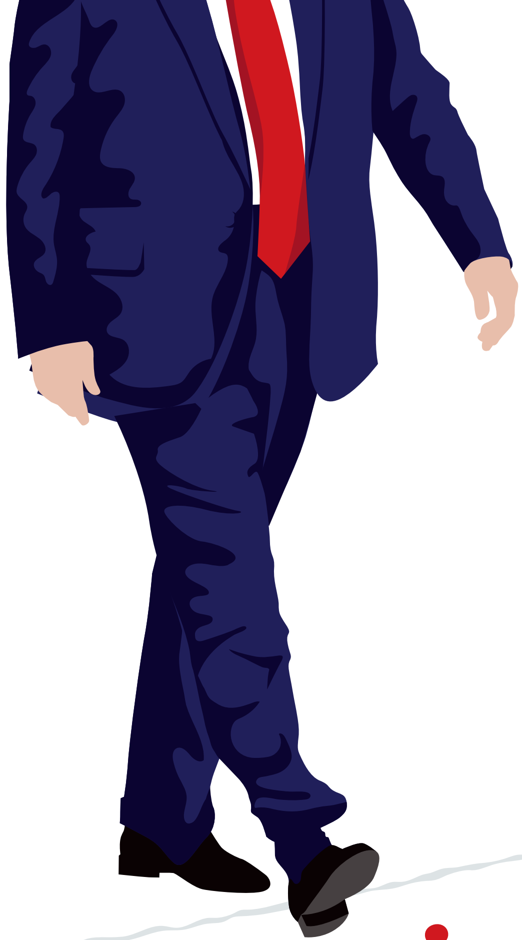
Registered office: East Wing, Trafalgar Court,
Les Banques, St Peter Port, Guernsey, GY1 3PP

Company registration number: 56716



Bond Focus

Sir John Royden
Head of Research



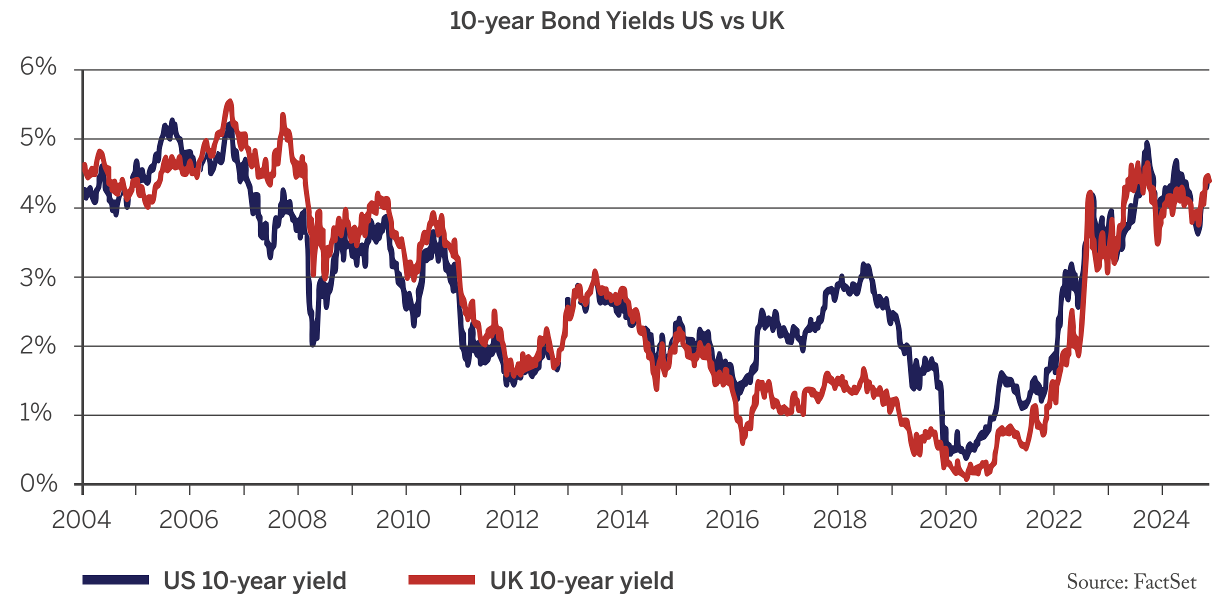
A special relationship

Sir John Royden, Head of Research, explores the close link between bonds and interest rates in the UK and USA.

What happens to US and UK interest rates is key to our approach to investing in fixed income markets, because a large proportion of the bonds we invest in are denominated in those two currencies. The first thing to point out is that there is a very high correlation between US and UK interest rates.

Ten-year rates for both countries are now close enough to 4.5%, below their recent peak but elevated versus the last decade, and the question must be what happens from here in the new post-election and (for the UK) post-Budget world.

The rise in the UK ten-year rate is attributed to the certainty of the spending implications in Rachel Reeves' Autumn Budget outweighing the lack of certainty that surrounds the anticipated tax revenues that Reeves hopes will contribute to balancing the budget. The move from 3.7% in September to 4.5% in mid-November 2024 can be interpreted as bond investors or 'bond vigilantes' warning Rachel Reeves not to replicate the mistakes of Liz Truss and Kwasi Kwarteng, whose promises to increase spending triggered a bond market revolt with ten-year yields spiking dramatically.



> A line exists for Donald Trump – we just don't precisely know where it is.

The near identical recent hike in the US ten-year rate is attributed to Trump's more inflationary agenda and the run-on implication for higher interest rates needed to contain inflation. Import tariffs are inflationary because they raise the price of imported goods for Americans. Higher federal spending that is unmatched with tax receipts has to be financed by issuing bonds. At the start of Trump's policy implementation, expect the extra spending to find its way into the economy by boosting both demand and prices in the short term; it takes factories a certain amount of time to build new capacity to meet new long-term demand. These factors have led us to hike our expectations for the long-term neutral rate for the USA from 3% to 3.75%. The neutral rate is the stable rate that gives stable trend growth, full employment and inflation, with our higher expectation for this metric based on the inflationary pressures discussed above.

Beyond the short term, the question that bugs us most is how sustainable the US deficit is. The USA has two advantages over the UK in that the dollar is both the world's reserve currency and the currency of global trade. The reserve currency status means that the world has demand for trillions of US dollars and US government debt which drives lower rates for America. Trillions of US dollars are sitting in USD current accounts not earning interest but more to the point, not costing the US government anything to print those dollars. By costing, I mean that the US government does not pay interest on US dollar bills.

As things stand, by 2034 publicly held debt-to-GDP is likely to increase from the existing Congressional Budget Office baseline of 125% to something in the region of 145%, likely increasing borrowing costs. This forecast for publicly held debt-to-GDP could be problematic for the Fed because the deficit will need to be top of mind when planning monetary policy.

Liz Truss discovered that there is a line in the sand beyond which the markets will not go, when her plans caused a bond market revolt and spike in borrowing costs. A line exists for Donald Trump – we just don't precisely know where it is. Does the line sit at 145%? Or higher? Or lower? Our estimates are at higher levels and that leaves us optimistic for the future.

Please read the important notice on page 1.

Independent View

To sell or not to sell?

Thomas Dawson
Partner, BCM Wilson Hill

The Autumn Budget brought with it several key points pertinent to the property industry that will have an impact on second home owners. In the wider context of forthcoming council tax rises in some UK counties, Thomas Dawson, Partner at BCM Wilson Hill delves into the changing landscape for second homeowners.

Our residential sales team work regularly with their clients and advisers on succession planning for second homes or in advance of selling their property. The changes in the Budget will necessitate that this process continues and, in some cases, may precipitate a sense of urgency given the new regulations the Government has announced.

A lot of our work, especially transactional, is for high-net-worth individuals who are seeking to dispose of their second home, usually situated around the South East of the UK. Our wider rural team also advise clients with similar properties across the UK, although the latter are usually part of wider rural asset portfolios.

According to the latest English Housing Survey (updated July 2023) there are 809,000 second homes owned by households in England, which equates to 3% of the UK population. However, just over 60% of those were UK-based; the other 40% are outside of the UK. The survey goes on to state that the overall use of second homes varied: 35% were used as a long-term investment, 45% as a holiday home, 9% as a retirement, 8% as an escape from the city, 7% as a previous main home, and 13% for other reasons.

Budget impact

In terms of impact of the Budget, despite the media trailing major increases in Capital Gains Tax (CGT) and Stamp Duty Land Tax (SDLT) in advance, the impact of changes was something of a mixed bag for second homeowners.

The basic and higher rates of Capital Gains Tax increased from 10% to 18% and 20% to 24% respectively for non-residential property. What is more, there was no CGT increase for residential properties which is great news for buy-to-let investors and the like.

However, the surprise announcement was that Stamp Duty Land Tax for the higher rate payer seeking to purchase an additional dwelling would rise from 3% to 5%, taking effect from 30th October 2024. This means that if you purchased a property on the 31st of October 2024 as opposed to 30th October 2024, based on a purchase price of £500,000, the SDLT would have been £37,500 instead of £27,500 if completed the day before.

> The impact of changes was something of a mixed bag for second homeowners.

Council tax on second homes

The Levelling Up and Regeneration Act 2023 comes into force from 1st April 2025, with second homeowners being charged up to twice the normal rate of Council Tax. It is within the jurisdiction of the relevant local authority to decide whether this is a second home and, if so, subject to the additional tax. It is not necessarily applicable to all.

In terms of the impact of this on the market, whilst it seems the ongoing view that second home owners are to be viewed as unwelcome is supported by various fiscal levers that are being pulled, it is interesting to note that the Pembrokeshire County Council – an early adopter who quickly increased Council Tax to the 200% level – has just announced it is to be reduced back to 150%.

So back to the question 'to sell or not to sell?': Broadly speaking, it is likely that the trajectory and future of interest rates are going to have a continued effect on the value of these type of properties along with the various other factors outlined here.

There are a number of further considerations, which can include matters such as:

— Differing ownership structures for second homes, to include individuals, a company or a trust.

— Stamp Duty Land Tax for a purchase, where in specific instances properties can qualify as 'mixed use' which can bring with it significant SDLT savings.

Those considering purchasing, selling or structuring the ongoing ownership of their second home should consult their accountant and solicitor and stress test any proposed purchase, sale or changes to ensure that from a tax and legal perspective, their structure fits best under the new regulations.

•

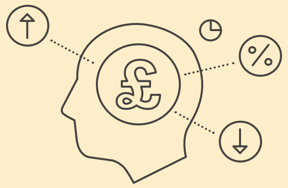
About BCM Wilson Hill

With offices in Hampshire, Petersfield, Oxford, and the Isle of Wight, BCM Wilson Hill are property consultants that specialise in advice on planning for second homes.

www.bcmwilsonhill.co.uk

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

Understanding finance



Accrual and Cash Accounting

Henry Birt
Research Analyst

Analysing financial statements is an analyst's bread and butter. The three main statements (cash flow, income and balance) link to each other and should always reconcile; however, the accounting methodology used differs. This is most apparent when comparing the income (profit and loss) statement and the cash flow statement. The income statement follows what is called accrual accounting where the aim is to record revenue as it is earned, and expenses associated with this revenue are recognised in tandem. This can, and often does, differ from the actual flow of cash in and out of a business. Reflecting this reality is the job of the cash flow statement which follows cash accounting.

Imagine a business enters into an agreement to sell a good to a customer and duly delivers that good immediately but does not invoice for the good for three months. Revenue will be recognised on the income statement when the good is shipped to the customer. The cost associated with making the good will also be recognised as an expense on the income statement; the net of these two numbers leaving profit. Turning to the cash flow statement, no cash has been received yet so we cannot reflect a cash inflow yet. Only once the customer settles the invoice will the cash flow statement recognise this cash inflow. We therefore often get a mismatch between profit and cash but over the long term, these two statements must match.

Since the value of a business is ultimately determined by its ability to generate cash in the future, we must remember that profit can differ markedly from cash in the short term. This simple distinction is often misunderstood and should remain front of mind.

Glossary of key terms

Book to bill – the ratio of orders received in a given year divided by revenue earned in the same year.

'Defensive' stocks/sectors – companies/sectors that tend to be more resilient during economic downturns. This could for example include consumer staples such as groceries, health care or utilities companies.

Disinflationary – something that causes a scenario where inflation continues to be present but the rate of inflation is falling. For example, disinflation would see inflation drop from 5% to 3%.

EBITDA (earnings before interest, taxes, depreciation, and amortization) – a company profit measure. It differs from operating profit in that depreciation and amortization have not yet been subtracted.

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

Net debt – A measure of a company's liquidity and financial health. To calculate net debt, the total debts of a firm are subtracted from its cash and cash equivalents. Used in conjunction with other measures (such as EBITDA above to show net debt/EBITDA).

Operating margins – operating profit is a company's earnings before interest and tax, calculated by subtracting operating costs from revenue. Operating margin is calculated by dividing operating profit by revenue.

Operational deleverage – typically happens when volume of units sold falls, this results in a company's unchanged fixed costs having to be spread across a fewer number of units sold, usually resulting in lower profitability.

Reflationary – relates to an increase in the money supply or an increase in economic activity. The objective is to increase demand for goods and services.

Independent View

A BITTER PILL?

Zena Hanks, Partner at Saffery, is a leading authority on personal tax law in the UK. Here, she gives her opinion on the impact of the Budget on the landscape for personal taxation.

In the months leading up to the General Election promises were made that the 3 main taxes, income tax, national insurance and VAT would not be increased. There were various statements made to support the "working person" to satisfy them that there would be no increases to those main taxes.

Following the election, in the lead up to the UK Budget, speculation about potential changes was rife – without being able to raise the main taxes, where was the extra revenue going to come from?

Much had been spoken of the need for those with the broadest shoulders to carry more of the burden. I am not sure anyone can argue that isn't a fair principle, but care is needed to make sure the burden isn't unbalanced, so that those broad shoulders continue to generate wealth and employment opportunities, and support a vibrant, growing and dynamic economy.

So, what did the Budget contain?

Capital Gains Tax

The increases to Capital Gains Tax (CGT) were not as high as had perhaps been expected. This may be seen as the government's realisation of the need to foster a positive environment for entrepreneurship and encourage investment and risk taking to incentivise growth in the economy.

The rates of CGT increased from Budget Day, with main rates increasing from 10% and 20% to 18% and 24% respectively. There is a lower rate for transactions that qualify for capital gains chargeable under the Business Asset Disposal Relief rules or those chargeable under the Investors Relief rules – that rate which is currently 10% will increase to 14% for disposals made on or after 6 April 2025 and the rate will increase again to 18% for disposals made on or after 6 April 2026. So far not too bad.

> **Without being able to raise the main taxes, where was the extra revenue going to come from?**

“Currently the value of qualifying property can be relieved from IHT at 100%.

Inheritance Tax

The changes to the Inheritance Tax (IHT) regime are a different matter and for some families will be very significant.

The nil rate band for IHT, which has been frozen at £325,000 since 6 April 2009 is set to remain fixed until April 2030. The residence nil rate band which is relevant for estates worth less than £2 million and where the main home is left to direct descendants, will be frozen for the same period at £175,000. The expected inflation in asset values during those two years means that a further 4,500 estates are likely to fall within the scope of IHT than would otherwise have done so.

The Chancellor also announced significant changes to both Agricultural Property Relief (APR) and Business Property Relief (BPR). APR applies to land and property used for agricultural purposes while BPR applies to business assets, including partnership interests and shares in unquoted companies, providing they are not mainly carrying on investment activities. Currently the value of qualifying property can be relieved from IHT at 100%.

From April 2026 there will be two levels of relief available. The first £1 million of value will continue to be fully relieved at 100%. Any additional agricultural value or qualifying business property within the estate will be relieved at 50% of the value. This provides an effective rate of IHT of 20% on values above the £1 million threshold which would previously not have suffered IHT.

In addition, the value of shares which are not listed on a recognised stock exchange (currently qualifying for 100% BPR) will only qualify for 50% BPR. The £1 million 100% relief allowance will not be available. This will halve the amount of IHT relief available for shares held on the Alternative Investment Market (AIM).

“There is time before these changes take effect so a clear head and a calm review will be the order of the day.

The media has extensively covered the potential negative impact on the country's farmers, but these changes also impact the owner managed business (OMB). Generally speaking, it falls to the next generation to pick up the tab for an increase in the IHT exposure. It will take some time to work out how best to deal with that and for any business owners adapting to an increase in their exposure to tax, it will need a fresh approach and a clear head to work through the options.

It is likely that these changes will turbo charge succession planning conversations. It is still possible to make lifetime gifts to individuals, known as Potentially Exempt Transfers (PETs), and provided the donor survives 7 years, those gifts will fall outside of the estate for IHT purposes. Where assets are being gifted rather than cash, do be careful that a CGT and/or a Stamp Duty Land Tax liability is not triggered.

The IHT changes don't take effect until April 2026 so there is time until they come into force. In the meantime, anyone who thinks they may be affected should seek professional advice.

As a final comment on IHT changes, for non-UK domiciled individuals the Government has confirmed the move to a new residence-based test for IHT. From 6 April 2025, the test to determine whether non-UK situated assets are within the scope of IHT will be whether an individual has been resident in the UK for at least 10 out of the last 20 tax years. If they are considered a "long-term resident", they will be liable to IHT in respect of their worldwide assets. Where individuals leave the UK, a "long-term resident" will remain fully within the scope of IHT for a number of years, even after ceasing to be a UK tax resident.

It was the ultimate in Budgets. For those looking at the potential increases in the CGT rates, it wasn't as bad as feared, but for OMBs, those owning agricultural property and those with unspent pension assets, 30 October 2024 was not a good day. The 2020s have been a volatile decade so far, with a pandemic, inflation, and global unrest. A period of much less drama will be very welcome. Until then, there is time before these changes take effect so a clear head and a calm review will be the order of the day.

What does the long-term environment look like for personal taxes in the UK? We are told that the bad news was delivered on 30 October 2024 and there are no plans to increase the tax burden any further. Let's hope that the growth and increase in productivity that underpins those plans, materialises.

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.

About Saffery

Saffery is an award-winning firm of chartered accountants and business advisors in the UK. The firm acts for clients across a variety of sectors.

Asset allocation and sector focus

As part of our focus on providing a high quality, personalised investment service, our Investment Office 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 form an important element of our Investment Office, consist of research analysts and a number of investment managers. 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 from the Investment Office.

Asset Allocation

Overweight Neutral Underweight

North America

The US consumer has been remarkably resilient this year, supported by strong household balance sheets, strong wage growth and supportive fiscal and monetary policy. There have been periodic concerns about weakness in jobs growth but the pace of lay offs has been moderate and hiring intentions remain steady. Fed policy easing has been aggressive, but we expect the pace of rate cuts to slow in 2025, reflecting a policy adjustment to accommodate Donald Trump's reflationary fiscal policy.

UK

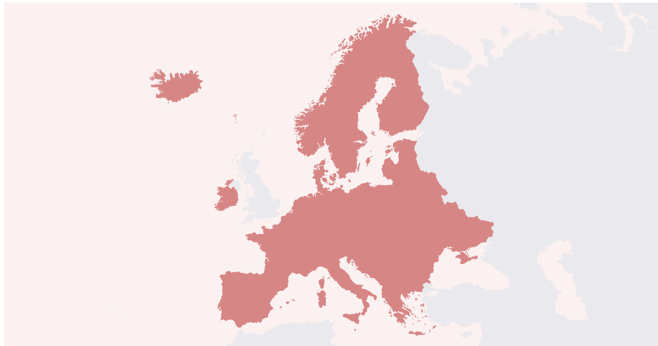
The UK economy has been resilient this year, with both the service and manufacturing sectors in growth mode. The labour market has remained healthy and wage growth has been solid. Falling inflation has given the Bank of England ample cover to continue to ease monetary policy and we expect a measured pace of rate cuts next year. The recent budget contained a higher level of borrowing than was expected and a significant front-loaded boost to economic growth. As a result, near term growth is likely to be firm.

Japan

We expect Japan to sustain a cyclical upswing during 2025. This will be driven by a combination of positive real wage growth, the conclusive end to corrosive disinflation, and ongoing reform of the corporate sector. These are clear tailwinds to the growth outlook. We expect the Bank of Japan to increase interest rates moderately over the next year, in contrast to the other major central banks.

Emerging Markets

Recent re-strengthening of the US dollar has been a short-term headwind for emerging markets. Much of the rally in the dollar which one would expect as a result of Trump's proposed tariffs has already occurred and any disappointment on the sequencing or delivery of his policy agenda is likely to see a reversal of dollar strength.



Europe

The European Central Bank (ECB) has continued its monetary easing policy as incoming activity data remains disappointing. The downshift in Chinese demand has been a particular challenge for the export sector and domestic vehicle production has faced considerable headwinds from Chinese competition. Looking into 2025, the prospect of US tariffs on all imports is a material concern for investors, and there will be increased pressure on the ECB to deliver further monetary policy stimulus. All points considered, we move to underweight for Europe.

Asia Pacific

Recent monetary policy easing by the People's Bank of China in addition to liquidity support for highly indebted local authorities are likely to foster a moderate upswing in economic activity as we head into 2025. However, the overhang of unsold inventories continues to put pressure on the broad real estate sector. Elsewhere in Asia Pacific however, with regional growth still solid and scope for central banks to ease policy from currently restrictive levels, we are more optimistic on the growth and earnings outlook ex-China.

Please read the important notice on page 1.

Sector Focus

Overweight · Neutral · Underweight

Communications

The communication services sector is broad but many of the large constituents are exposed to ad spend which in turn has exposure to the economic cycle. In the US, the probability of a recession seems lower now. Valuations in this sector look more stretched and the increased threat from AI technologies could exacerbate this.

Consumer Discretionary

Inflation has been falling, but the performance of the sector is likely to continue to be driven by sluggish macroeconomic data in Europe and China. The non-essential element of products/services has made them less resilient to a downswing. With consumer savings from the pandemic largely depleted, we nonetheless feel that further policy stimulus in Europe and China should support reasonable consumption growth in 2025 and with more attractive valuations we upgrade our view to neutral.

Consumer Staples

Input costs have been a headwind for the sector; however, given abating inflation, this should start to reduce. Non-discretionary demand provides defensiveness. We are seeing a divergence between over-and underperforming brands due to their ability to push through volume growth, as consumers are still wary of budgets, limiting the sector's ability to push price increases. 2025 could provide a rebound in growth, and it would remain wise to focus on the longer term.

Energy

Brent started the quarter at U$87 per barrel, but has since fallen throughout the quarter. The UK oil majors broadly followed the oil price downwards whereas the US majors held up better relatively. Looking forwards from current levels we see both upside and downside risk to supply. Risk to the upside comes from ongoing geopolitical risk in the Middle East; downside risk comes from the ability of supply taps to be turned on elsewhere. We therefore retain our neutral stance.

Financials - Banks

The prospects for US banks are muted by expectations that the US economy is about to cool off and that rates will fall. Lower interest rates put pressure on banks' net interest margins which is the difference between the rate that they lend at and what they pay depositors. Rate declines for UK banks are expected to be lower than in the US. With buoyant non-life insurance rates and the prospect of a soft landing, we retain a neutral view on this sector.

Health Care

Biopharma valuations have compressed recently. The appointment of RFK Jr as health secretary in the US introduces uncertainty in US policy outlook. Longer-term demand remains resilient, and the structural drivers associated with an ageing population are unchanged. However, considering the uncertainty triggered by the US election, we downgrade to neutral until there is more clarity.

Industrials

The performance of industrials of late has picked up with some very early signs that demand weakness and destocking will recover in 2025 as has been guided. Nevertheless, earnings delivery remains quite weak relative to other sectors. G7 industrial production and manufacturing PMI data continue to be unimpressive, but with a strongly reflationary stance in the US and UK and further policy stimulus expected in China and Europe this leads us to believe the cycle will turn positive in 2025.

Information Technology

Performance has been choppy, however the election of Donald Trump has injected positive share price performance. Valuations still look rich compared to historical multiples. The sector is interest rate sensitive and remains driven by several very large companies. The lack of margin for error provided by valuations and the increasing capital intensity of AI players drives our shorter-term rating, yet we remain attracted to the sector longer term.

Materials

China remains the largest medium-term influence. The country looks set to undershoot prior expectations with regards to stimulus and without a property specific stimulus package, we struggle to see China being a short-term tailwind for the sector. Longer term, we continue to see the attractiveness of the copper market and a possible bull move in the commodity super cycle remains supportive. For the shorter term though, we struggle to see the sector outperforming considering a weak China outlook.

Real Estate

High interest rates saw volumes of commercial real estate transactions plummet, as valuations fell with heightened borrowing costs. Recent rate reductions help to stimulate activity and investors to reduce their 'risk off' position. The market remains fragile, with risk of inflation reacceleration and delayed rate cuts, but on balance we believe an uptick in the real estate sector is due on the back of easy comparatives and an improving economic landscape.

Utilities

The quarter saw Thames Water's financial condition deteriorate, with its parent Kemble Water Finance defaulting on a bond payment. A key component of the UK's energy transition will be reform of energy infrastructure, which should be supportive of asset base and earnings growth for UK power names. For this reason, we prefer power utilities, which have a more attractive regulatory and operating environment than water.

Please read the important notice on page 1.

Meet the manager

Rebecca Barrett

Wealth Planner

Lives Tooting, London

Family Husband

Started at JM Finn March 2023

Hobby/pastime Skiing, playing tennis and padel, and watching the Harlequins at The Stoop

Favourite holiday Ski holiday

Favourite film Shawshank Redemption

If you weren't a Wealth Planner Police Officer

Favourite sporting moment Harlequins winning the Premiership in 2021

Fondest memory Celebrating my marriage with friends and family in August 2024

Preferred music Anything and everything from Queen to Taylor Swift

You joined JM Finn in 2023 - how has your career developed since you started with the firm?

Since March 2023, I have progressed from being an Associate Wealth Planner to a Wealth Planner. I am continuously developing my knowledge and expertise across the industry and have been able to deal with more complex client cases. I am involved with more aspects including pitches to prospective clients, Court of Protection cases, and presentations to intermediaries.

What are the goals of the Wealth Planning team for the next year?

It is an exciting time for Wealth Planning: we are increasingly busy and with that comes growth of our team. We would like to be more involved in prospective client and client meetings and grow our presence within the business. We pride ourselves on efficient and accurate work and strive to consistently provide an excellent service for our clients.

What are your top 3 wealth planning recommendations for clients in 2024?

1. If your income is such that you are losing your personal allowance, consider whether you can increase contributions to your pension to reduce your adjusted net income and regain some/all of your personal allowance.

2. Speak with your employer about making pension contributions via salary sacrifice. This will lower your National Insurance and income tax liability.

3. If you are nearing state pension age and do not have enough National Insurance credits to receive a full state pension, obtain your state pension forecast and consider making top ups prior to April 2025.

Out of all the changes in the Autumn Budget, which was the single most surprising policy?

The inclusion of pensions within estates for inheritance tax purposes from April 2027. As advisers, we will need to spend some time adjusting our thoughts on financial planning, specifically inheritance tax planning. Each case will be client specific, and we will work with our clients to develop a long-term plan to be as tax efficient as possible.

Our Offices

London

25 Copthall Avenue

London EC2R 7AH

020 7600 1660

Bury St Edmunds

60 Abbeygate St.

Bury St Edmunds

Suffolk IP33 1LB

01284 770700

York

Hudson Quarter

Toft Green

York Y01 6JT

01904 235 800

Bristol

22-24 Queen Square

Bristol BS1 4ND

0117 921 0550

Winchester

Regency House

13 St. Clement Street

Winchester SO23 9HH

01962 392 130

Follow us on:

info@jmfinn.com
www.jmfinn.com

RECYCLED Paper made from recycled material FSC® C006518

PROSPECTS is printed in the UK from 100% recycled stock certified to FSC® standards.