JM FINN

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Prospects

The JM Finn Quarterly Periodical

Celebrating 75 years of
investing for your future
1946—2021

No.35

Summer 2021

Equity prospects
JM Finn's insights into companies 07, 13, 21, 25.

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Welcome

Writing this from the office, it seems as if we are now entering a new chapter and one we must be thankful for. Whilst the City of London stills seems quiet, the most recent easing of restrictions has been met with relief.

For many, working from home has been a strange, if not unpleasant change to the norm, but I know that many have found the prolonged isolation hard. Equally, it goes without saying that returning to the office will present its own challenges as we now readjust to new working conditions.

We are of course hoping the June 21st deadline for the easing of all restrictions remains in place, but we will continue to monitor the updates as they come in. Either way, your investment managers will continue to be able to provide their usual services as we start shifting the emphasis back to working in the office and more importantly, resuming client meetings, which I know many readers will appreciate.

On the markets front, the trend remains upwards at the time of writing and the economic picture remains relatively positive. It was certainly encouraging to see the FTSE 100 breaking through the 7,000 level in April and then again in May. Brian Tora presents an upbeat picture in his regular Economics Focus piece, suggesting the flexibility and innovation that has been displayed in fighting the pandemic stands us in good stead as we look ahead. Of course, pressures remain and inflation is one that we will be keeping a close eye on.

An area that I have written about before, and one that is progressively high on our agenda, is the increased alignment of shareholder value with sustainability and our impact on the society in which we live. As we continue to evolve this area of our business, both at the corporate and investment level, John Royden presents us with a brief history of ESG (Environmental, Social and Governance investing) put in the context of how he has always assessed companies when considering an investment.

We also feature in this edition articles on SPACs (Special Purpose Acquisition Companies), about which much has been written in the press, the need to plan ahead when contributing to your ISAs and the usual investment outlooks, combining to create another interesting collection of insights from around the firm and externally.

We are also delighted to bring news of our latest sponsorship agreement. Many readers will know that we have been a corporate supporter of Surrey County Cricket Club for many years and, having been approached by the club, we have decided to take this support to a new level by taking the naming rights of the Vauxhall End stand at The Oval. This is an exciting opportunity for us to really stamp our mark on cricket and take our brand to cricketing audiences across the country.

As face-to-face contact resumes and we can begin holding events again, I do hope, as we start to fill our calendar for the second half of the year, that you get an opportunity to catch up with your JM Finn teams in due course. In the meantime, let us hope that the summer months do indeed bring more freedom for the country.

Hugo

Hugo Bedford
CEO

Editorial

The Evolution of ESG

John Royden
Head of Research

Illustration by Asa Taulbut

ESG (Environment, Social and Governance), about which so much is written today, had a difficult birth. Back in the 1970s the doctrine was one of pure capitalism. Make as much money as possible without worrying about being socially responsible; which was seen as the job of government. "A man cannot have two masters" was a popular chant. You can't work for maximum profit as well as maximum societal benefit.

Investment managers needed clarity which came from the common law doctrine that profit maximisation alone was the fiduciary duty of a fund manager. We were actually taught that the costs of behaving in an ethically responsible manner would outweigh the benefits. Capitalism should always trump philanthropy for the benefit of overall society. Capitalism generates the wealth which individuals can then charitably distribute if they so desire.

But then came some exceptions. In the late 1970s, it became legally permissible to decline investment opportunity in Apartheid South Africa for moral reasons. This was perhaps the first example of morality taking precedence over the common law doctrine of profit maximisation. At the same time there emerged the concept of social capital. A firm that invests in the well-being of its local community could do better on the back of a strong local community than a company that did not. However, the concept was still rooted to the idea of maximising profits.

“ **A firm that invests in the well-being of its local community could do better on the back of a strong local community than a company that did not.**

In spite of some nascent progress, the progression of ESG took a step back in the case of Cowan v Scargill (1985). Scargill, the then President of the National Union of Mineworkers and also a trustee of the National Coal Board's £3 billion pension fund wanted the pension fund to (patriotically) get out of overseas investment and stop investing in businesses (like oil and gas) that competed with coal. Cowan was part of the management team which opposed Scargill. The judge said that the best interests of the beneficiaries are normally their best financial interests and that you can't deviate from profit maximisation without the consent of the beneficiaries.

By the turn of the millennium, climate change was making headlines and we started to see the emergence of the idea that the "interests of the beneficiaries" or, in our case, our clients, might include having a planet fit for life. Interests thus grew in breadth to incorporate the E of ESG, alongside optimal profits.

Altruism and maximising profits appeared to be mutually linked rather than facing each other as adversaries.

The E and the S of ESG moved forward when empirical evidence began to emerge that companies that scored highly on environmental and social metrics actually produced enviable returns for their shareholders. Altruism and maximising profits appeared to be mutually linked rather than facing each other as adversaries.

This led to a Freshfields paper in 2005 which provided a legal opinion that there was a fiduciary duty to incorporate ESG metrics into investment analysis; a view that the Law Commission endorsed in 2014 and which a 2016 UN report echoed, saying that "failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty".

Investors have changed as well, with some research showing that the majority of investors would contribute more to portfolios doing social good rather than otherwise.

In the UK, the "G" or governance debate grew on its own with numerous codes of conduct. The main problem as I saw it, was that back in the 1990s the Takeover Code's Rule 9 had the unwanted side effect of silencing shareholders by effectively preventing them from speaking to each other about poorly run companies for fear of having to make a cash bid for the company being discussed. With weakened shareholders, standards of corporate governance waned; which the City tried to cure with a succession of codes of conduct and reports.

Cadbury (1992), Greenbury (1994), Combined Code (1998 and later frequently revised from 2003), Turnball (1999) and then the Corporate Governance Code of 2018 will be remembered by many, but particularly remembered by me, for addressing the symptoms rather than Rule 9, the actual source of the problem. The primary source of the ill has since been addressed with shareholders now more easily able to discuss poor corporate performance.

During this time we also saw an increase in mandates that positively screened out businesses that killed or harmed people. Arms, guns, tobacco and sometimes alcohol were popular restrictions although engagement was still in its infancy and many investors simply attempted to avoid the most controversial sectors without much interaction with offending companies to try and improve their behaviour.

Attempts to quantify and measure governance now include board diversity, executive and employee pay, ownership and control, and how the board of directors oversee the interests of stakeholders. These issues overlap with our understanding of what metrics to use for a high "S" score. A diverse set of employees is likely to reach into a deeper pool of talent. There are few of us who would want to be seen to be supporting an exploitative supply chain built by child labour or derived from miserable animals; just as the UK's PPI banking scandal leads us to want to see a responsible and mildly paternalistic attitude towards customers.

Environmental issues mostly concern climate change and the finite supply of natural resources as outlined in the Stern Review of 2006 whose conclusion was that benefits of early action on climate change would outweigh its costs.

Strong shareholder value creation is increasingly aligned with ESG metrics.

Pulling it all together in a quantitative fashion so that comparisons can be made is not without its challenges. Databases that seek to quantify ESG scores are helpful to a degree. But at the end of the day nothing quite beats meeting management face to face and being able to take an honest opinion as to whether the company is self-indulgently green-washing itself or is genuinely committed to making the world a better place and its shareholders richer in the process. I must also add that the overlap of ESG due diligence with mainstream due diligence is high. None of us would be rushing to invest in a country with an oppressive military regime or where management were earning outsized salaries compared to profits. Much of what we talk about now with ESG would have just been proper due diligence before.

My own thoughts on ESG are that strong shareholder value creation is increasingly aligned with ESG metrics; after all, new world technologies is where the growth lies and a focus on ESG tends to attract forward looking, caring and entrepreneurial cadres of younger managers and employees; which in turn drives operational efficiencies. Consider this: A bright young graduate with a first from Oxford; do you want to join a tobacco company or one making wind turbines? The alignment has meant that I have never been put in a position where I have felt the need to allow my aspirations for wealth creation to be trumped by green credentials. I hope and trust that this will remain the case for the foreseeable future.

DARKTRACE

Henry Birt
Research Assistant

PRICE
£3.44

52 WEEK HIGH-LOW
£4.48—£2.50

NET YIELD
0.00%

HIST/PROS PER
NA—NA

EQUITY MARKET CAP (M)
£2,507

Darktrace is a cyber-security platform that uses Artificial Intelligence (AI) to detect, investigate and respond to cyber threats in real time. What differentiates Darktrace from other cyber-security companies is its use of unsupervised machine learning to power its products. Essentially, the software 'thinks' for itself and can therefore detect and fight cyber threats as they arise without the need for human intervention. Darktrace was reportedly the first company to apply AI to cyber-security and thus it benefits from a first-mover advantage.

The Enterprise Immune System (EIS), which detects cyber threats using AI, was their first product. This was shortly followed by Darktrace Antigena, the software used to fight the threats detected by the EIS at rapid speed. The most recent addition, Cyber Analyst AI, mirrors a human security team and automates threat investigation and reporting.

Disruption is endemic in the cyber-security industry but Darktrace has so far managed to keep ahead of the game. Leveraging the data they collect from customers to develop new capabilities, they believe helps protect their first mover advantage. But, to thrive in this competitive industry, they will need to remain constantly innovative.

Please read the important notice on page 1.

Guest Editorial

Cricket is all about partnerships

Richard Gould
CEO, Surrey CCC

Illustrations by Jordan Atkinson

In the 175 years of Surrey County Cricket Club, we have had many great partnerships but, in the modern era of the Club, none has lasted longer than the one between Surrey CCC and JM Finn.

Traditionally, they are formed on the field between titans of the game such as Sir Andrew Strauss and Sir Alistair Cook, Desmond Haynes and Gordon Greenidge and Jimmy Anderson and Stuart Broad.

In the 175 years of Surrey County Cricket Club, we have had many great partnerships but, in the modern era of the Club, none has lasted longer than the one between Surrey CCC and JM Finn, who have now supported us for sixteen years – and recently expanded and extended our association by acquiring the naming rights to the iconic stand at the Vauxhall End of The Kia Oval, which will now be known as the JM Finn Stand.

JM Finn will also support our county age group programme, meaning the next generation of players like Ollie Pope, Natalie Sciver, Sam Curran, Tom Curran, Rory Burns and Jason Roy will learn their cricket in shirts bearing the company's logo.

We have just announced a £1.2m loss before tax for the last financial year. In comparison, we made £6.3 in 2019 – when we staged matches in the ICC World Cup and the final Ashes Test Match – and £2.8m in 2018, when the aforementioned Sir Alastair Cook hit a century in his final Test.

The Club's turnover, £45m in 2019/20, sunk to £13.7m in 2020/21. This is as a result of the cancellation of The Kia Oval Test Match - the first time the ground has not staged a Test since 1945 - and a drop of £5m in non-match day sales for the Club's conference and events business, from £6.1m in 2019/20 to £1.1m in 2020/21.

As well as the invaluable support received from our Members, the backing of our commercial partners was incredibly important to us – and JM Finn's decision to extend and expand their backing of the Club was a huge boost for everyone and has given us a platform to start to build back brighter and stronger than ever before.

Covid-19 has clearly been immensely destructive across the board and cricket as a whole was badly hit by its effects. The ECB recently announced a loss of £16.1m for the last financial year – and this would have been almost unfathomably worse had it not been for the superb work they did in staging last summer's international programme inside 'biosecure bubbles' at The Ageas Bowl and Emirates Old Trafford.

Last year we became the first ground in the country to welcome fans back to live sport, hosting three trial events in July and September, and are expecting our first crowd of 2021 for the London Derby against Middlesex that will take place between May 20th and May 23rd.

Last year we became the first ground in the country to welcome fans back to live sport.

We hope from here on in we can continue to welcome fans back all summer – and after Monday June 21st we have sold games to our full capacity, now augmented by a further 2,700 seats that have been added as part of our new One Oval Square development, which also includes two large new suites, an extension to our Members Pavilion, another roof terrace, more debenture seats and hugely improved concourse facilities.

If we are able to welcome a fully sold-out crowd to the England v India Test Match that will take place at The Kia Oval between Thursday September 2nd and Monday September 6th, it will be quite an emotional moment for everyone associated with the Club.

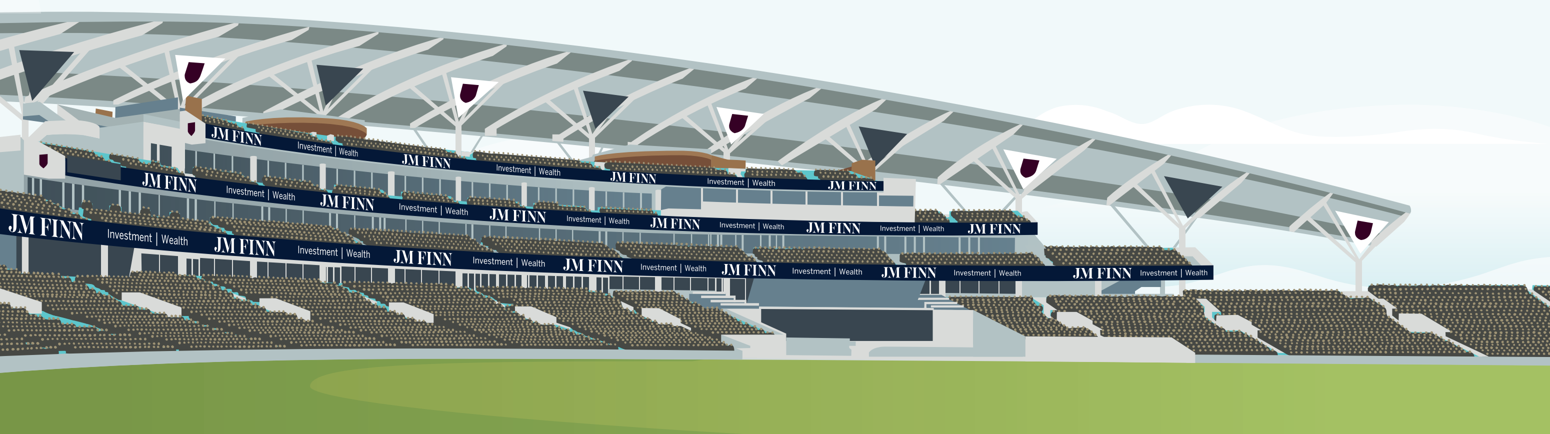
As we grow back, we also need to get creative with different ways to fill our ground. During the 2019 World Cup, we saw the diversity of modern English cricket audiences for ourselves. Our stands were packed with teeming Tigers from Bangladesh, a sea of blue Indian shirts and vast swathes of Pakistani green.

Meanwhile, on the other side of the cricketing world, the Indian Premier League has continued its exponential growth and is now considered almost on a commercial par with the American giants of the NFL, MLB and NBA.

Whilst some of this growth has been deleterious to our fortunes – losing world-class home-grown players for the first two months of the season is often difficult to take – the commercial opportunity it presents to us cannot be ignored.

The Kia Oval is a crown jewel in a capital city that considers itself the ‘sporting capital of the world’.

The Kia Oval is a crown jewel in a capital city that considers itself the ‘sporting capital of the world’. Attracting regular season IPL matches to London, in much the same way the NFL play at the wonderful new Tottenham Hotspur Stadium and the MLB have played at the Olympic Stadium, would be an extraordinary occasion – and would certainly be a huge marker in our Covid comeback.



The JM Finn stand at the Kia Oval

We are delighted to extend our partnership with Surrey to what is one of the finest stands in world cricket.

The Vauxhall end stand is now known as the JM Finn Stand until at least the summer of 2025. In a normal season it will host over 100,000 cricket fans watching sell out Test Matches, One Day Internationals and Surrey matches in the Vitality T20 Blast.

Surrey CCC and The Oval Cricket ground are two of the most historic institutions in world sport. Founded in 1845, the Club has won 20 County Championship titles and been represented by some of the finest English cricketing talents in history including Sir Jack Hobbs, Sir Alec Bedser, Peter May, Alec Stewart and Kevin Pietersen. There are currently thirteen male Surrey players that have represented England in different forms of cricket, as well as three female cricketers.

Surrey CCC and The Oval Cricket ground are two of the most historic institutions in world sport.

From the start of the 2021 season, the new deal will also see teams across the Club's hugely successful County Age Groups programme – the elite youth cricket academy that has recently given birth to new stars like Ollie Pope, Sam and Tom Curran, Rory Burns and Jason Roy – wearing kit branded with the JM Finn logo.

Richard Thompson, Surrey Chairman said: "As a Club with 176 years of history, we place huge value in loyalty and partnerships – and so for our longest standing partner to renew and increase their commitment to the Club is hugely appreciated and valued. Everyone at Surrey looks forward to working with the team at JM Finn for the next five years and hopefully long beyond."

JM Finn *News*

"Nothing great is easy"

– Captain Matthew Webb

Many of us took on hobbies, projects and challenges during the lockdowns but for one member of the JM Finn team, a personal challenge wasn't quite enough; managing something only eight people before him have achieved seemed a reasonable goal.

Many of our readers will recognise the name John Royden as a regular contributor to these pages and as head of research for the firm. Never one to stand still, John has reignited a passion for swimming and is taking on the challenge of swimming the length of Lake Geneva.

Overseen by the Lake Geneva Swimming Association, John estimates he will swim the c.70 km non-stop in around 36 hours. Swimming that distance would be a Herculean task by any measure, but unassisted and non-stop explains why only eight people have completed this; more people have walked on the moon, as John is keen to remind us.

John's first foray into swimming was in 1993, when he swam the English Channel in just under 14 hours, raising just short of £100k for charity. Driven by the desire to push the envelope of human endurance and raising more money for charity, he committed to attempting Lake Geneva in 2020. This was scuppered by the lockdowns, but spurred on by the tales of daring do from Captain Matthew Webb, the first person to swim the Channel, in 1875 (in just under 22 hours swimming breaststroke), John resolved to continue his training and defer it to this year.

Lockdowns continue to present challenges to his training as public swimming pools have been closed, but the ever-resourceful John has been tethering himself to trees and swimming against the current in mill ponds, driving to Dover a few times a week to train with the next generation of Channel swimmers and even rigging up a "dry" training bench in an old shed in the garden.

Whilst the distance is significantly longer, there are some advantages over swimming the Channel, such as the absence of oilrigs, super tankers and jellyfish. The combination of the latter two stirs painful memories for John after a ship drove through a shoal of jellyfish in his path leaving him to swim through stinging jellyfish soup. John describes this experience as akin to crawling naked through a field of stinging nettles! He hopes the lack of salt water will be slightly less abrasive on his body, but is wary about the need to swim harder to make up for the lack of buoyancy in a fresh water lake.

Aside from the fact that John confesses to enjoying smothering himself in Channel grease (lanolin and Vaseline) to protect from chafing, John's motivation is primarily to raise money for charity and has chosen the Brain Tumour Charity as his beneficiary. Having lost his sister to a brain tumour aged 32, he has long wanted to do something to support the valuable work they do.

Brain tumours are the biggest cancer killer of children and adults under 40 in the UK, yet only garners 3% of the £600m annual spend on cancer research. There are over 8,000 people living with brain tumours in the UK today, yet treatments and survival rates have barely changed in 40 years. The Brain Tumour Charity has the ambitious goal of doubling survival rates whilst halving the harm on quality of life for patients. To date, John has raised over £140,000 for his swim, all of which will go towards the specialist research undertaken by the charity. He is also swimming in memory of his late colleague, mentor and former head of research at JM Finn, Geordie Kidston, who many readers will remember, furnished these pages for years with insightful thoughts on the state of the world's stockmarkets.

To follow John's training and swim, which takes place in July, or to support his fundraising, search for "John's mad swim just giving" on social media or visit www.royden.com. We wish John the best of luck and hope he won't follow the path of his hero, Captain Webb, who, whilst he did become a celebrity of his age, did let it get to his head and succumbed trying to swim the whirlpool rapids below Niagara Falls, a feat declared impossible.

Understanding Finance

EXPENSE VS INVESTMENT

Henry Birt
Research Assistant

In theory, the definitions of an investment or an expense seem quite clear cut. An investment, so the theory goes, is spending which creates an asset which will help produce profits over a number of years. Whilst an expense is a cost of operations that a company incurs to generate revenue but for only one fiscal year.

This distinction has important implications for how spending is recorded in a company's financial statements. An expense, as it ostensibly only confers value over the period in which it is spent, is recorded on the income statement as a cost in that period. Alternatively, if something is considered an investment, then it will result in the creation (capitalisation) of an asset on the balance sheet. It is then depreciated/amortised via future income statements over a number of periods.

Some spending, such as paying salaries, is clearly an expense and some, such as buying new machinery, is an investment, but in some cases it is less clear. For example Research & Development (R&D): whilst not all R&D will succeed, at least some portion of it probably will and thus it may help deliver returns over multiple periods.

The MedTech company, Intuitive Surgical naturally spends a lot on R&D, some of which incrementally builds upon its current products. However, as R&D isn't guaranteed to produce anything of value, Intuitive expense all of it. Using an extreme example, if Intuitive decided instead to capitalise all of their R&D spend in FY19 (pre-COVID), their operating margin would increase by a meaningful 12 percentage points, up to 43%. Therefore, what a company expenses and capitalises can have a big impact on its perceived profitability.

ETSY

Michael Bray, CFA
Research Analyst

PRICE
$164.73

52 WEEK HIGH-LOW
$251.86—$74.82

NET YIELD
0%

HIST/PROS PER
57.2—51.6

EQUITY MARKET CAP (M)
$20,937

When you think of online marketplaces, which provide a platform for third parties to sell their products and services on, most think of Amazon and eBay. For home buying, Rightmove. For cars, Autotrader. For handmade, vintage and craft goods...? Etsy!

Etsy is the leading global e-commerce platform for special occasion, handmade and vintage goods, spanning multiple product categories, including jewellery, apparel and accessories, wedding, home décor, and craft supplies. Etsy has built a differentiated marketplace and developed a number of key services to help improve seller efficiency and grow volume.

For example, following our recent house purchase, we realised we needed shelving storage. We visited Etsy, found a recommended UK vendor selling rustic hardwood shelves, contacted them with a number of questions and received a swift response. We placed a custom order built to size and colour specifications, that arrived within weeks. Such engagement/customisability is rare from an online marketplace!

The question for Etsy is whether it can drive more frequent visits to its website and become 'the' name that comes to mind when consumers think of artisanal/special occasion goods.

Please read the important notice on page 1.

Company Meetings

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

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

James Ayling, CFA
Research Analyst

Michael Bray, CFA
Research Analyst

Henry Birt
Research Assistant

COMMUNICATION SERVICES
Walt Disney Company

INDUSTRIALS
Diploma, Ceres Power, Ricardo

CONSUMER DISCRETIONARY
Ocado Group, Kering, SA, Wickes, Henry Boot

INFORMATION TECHNOLOGY
Darktrace

CONSUMER STAPLES
Imperial Brands,

MATERIALS
Rio Tinto, BHP Group, Givaudan SA, Croda International, Hill & Smith

FINANCIALS
Burford Capital, London Stock Exchange, Prudential Financial, TP ICAP Group, HSBC Holdings, Lloyds Banking, Natwest, GoCardless

REAL ESTATE
SEGRO, UNITE Group, Supermarket Income REIT

HEALTH CARE
Genus, Dechra Pharmaceuticals, GlaxoSmithKline

UTILITIES
Severn Trent

1.

Genus

Price **£50.50**
52 week high-low **£55.15 – £31.48**
Net Yield **0.59%**
Hist/Pros PER **81 – 50.2**
Equity Market Cap (M) **£3,324**

Health Care
Stephen Wilson, CEO & Alison Henriksen, CFO

We met management following strong half-year results in which the business showed no signs of slowing. As a specialist in high quality bovine and porcine genetics (selective breeding and gene editing), Genus was classified as an agricultural business of high importance, meaning operational performance was largely unaffected by COVID-19 restrictions.

Their North American porcine business has however seen some impact, as 'processing plants' experienced bottlenecks due to COVID outbreaks amongst workers. But management believe these issues have now largely been resolved. The bigger risk comes in the form of rising feedstock prices, which present a headwind to pig producer margins, whom Genus sell their genetics to.

Yet, management appear sanguine: Genus' porcine business is not directly tied to the fortunes of its customers when contracts are agreed on a royalty basis. With this model, a nominal revenue is generated for each piglet born by one of Genus' sows and is not linked to the financial performance of customers nor wholesale hog prices.

Although the proportion of total porcine volumes under royalty is highest in North America (97%), followed by Latin America (78%) and Europe, Middle East, Africa (73%), Asia remains underpenetrated (41%), particularly China.

Since 2018, pig herds in China have been decimated by the outbreak of African swine fever (ASF). Although an initial hit to the business, management see ASF as having a long-term benefit. Why? Because it is increasing the market share of larger 'technified' producers more likely to use Genus' genetics, and in turn its royalty model.

Management believe China should see a few more years of abnormal growth as it recovers from ASF but expect a downturn to follow.

2.

Ricardo

Price **£4.59**
52 week high-low **£5.62 – £3.10**
Net Yield **0.38%**
Hist/Pros PER **NA – 18.9**
Equity Market Cap (M) **£283**

Industrials
Dave Shemmans, CEO

Ricardo is an engineering and environmental consultancy business that specialises in transport, energy and scarce resources. On top of the consultancy business, Ricardo also has in-house engineering capabilities, delivering high quality, low-volume manufacturing for complex products.

Dave Shemmans, kicked off the meeting with a run through of the half year results which saw the non-auto section of the business account for over half the earnings. The results also signalled a renewed focus on M&A - following an equity raise which reduced debt to a comfortable level (1.8 net debt/EBITDA) - with a focus on higher growth, ESG-related areas such as clean energy, electrification and hydrogen. This is all reflective of Ricardo's drive to diversify away from automobiles and into more sustainable sectors, which will position Ricardo well to benefit from ever growing environmental regulation.

Following the results, Dave offered what, in hindsight, seems a prescient view of the progress of the automotive cycle, the last few months having vindicated his diagnosis that the industry was in recovery. Biden's spending plans were the other key macro theme discussed, Ricardo having just secured further deals with the US military for their Antilock Brake System (ABS) retrofit programme.

We also spoke on the collaboration in alkaline fuel cells technology with AFC Energy. Ricardo's focus on fuel cells over battery technology, explained Dave, derives from a belief that the commercial application of fuel cells will be greater in the long run than batteries. Whilst I am inclined to agree, the nascent nature of this industry means we will have to wait a while to see if this comes to fruition.

The meeting finished with gratitude directed towards Dave for his drive to diversify the business throughout his stint at the helm which, after 22 years, is coming to an end.

3.

Wickes

Price **£2.56**
52 week high-low **£2.88 – £2.36**
Net Yield **0.00%**
Hist/Pros PER **24.6 – 12.5**
Equity Market Cap (M) **£680**

Consumer Discretionary
David Wood, CEO, Julie Wirth, CFO & Fraser Longden, COO

Travis Perkins (TP) recently demerged Wickes, leaving investors to ponder which business to own; slimmer TP or Wickes. Choosing isn't obvious. TP is simplifying its corporate structure to focus on professional trade customers, while, Wickes is a more consumer focused do-it-yourself (DIY) or do-it-for-me (DIFM) retailer (the latter customer typically uses tradespeople to install purchased products).

An immediate concern with TP is linked to how they extend credit to their customers. They view offering trade credit as integral to their model. Yet, in economic downturns, I feel it overly exposes them to customer default risk, making their share price volatile in periods of economic weakness ... can they manage this credit risk or might a bank be better?

Wickes, though, historically underinvested across its stores. Independence will drive focused investment to rejuvenate stores which could improve fortunes. During the pandemic, Wickes' DIY customers shone through whereas its DIFM customers appeared more cautious. Whilst I view this as temporary , I believe understanding this customer base differential is critical.

On balance, I'd prefer TP. Ultimately I think younger clients will favour a tradesperson vs. DIY activities. For Wickes, this view highlights a fundamental internal struggle where DIFM growth will outpace DIY growth but overall, revenue growth may stagnate.

If I worked in private equity, I'd think differently. I'd seek to purchase Toolstation from TP. I believe it's the longer-term crown jewel; offering a digital-first setup, a scalable growth runway, better stock and logistics management and, most ironically, a greater willingness to cater to both trade and retail customers!

Please read the important notice on page 1.

Economic Focus

Beware the "V" word

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Jordan Atkinson

As I write this, a degree of normality does seem to have returned in England. Gatherings inside people's homes are now allowed, pubs and restaurants can welcome customers back indoors (a major plus, given May's indifferent weather) and thousands of people have jetted off on foreign holidays denied to them for so long. Travelling abroad may not be quite as straightforward as once it was, but at least it's a start.

What is all this going to mean for our economic wellbeing? So far the signs are encouraging. The company results season for the last calendar year and for the first quarter of 2021 indicates that businesses have managed the exceptional circumstances wrought by the pandemic rather better than we might have feared. There have been casualties, of course, but some firms have actually benefitted, while others have demonstrated a fleetness of foot that have mitigated some of the worst effects of the slowdown.

Even unemployment has not risen as much as forecast. Indeed, the latest figures showed a modest decline, while job vacancies are now back up to pre-pandemic levels. True, this reflects the difficulty in recruiting in the hospitality sector, where many have left the industry because of the uncertainty, while foreign workers are also in short supply, thanks to both COVID-19 and Brexit. The unemployment figures could take a turn for the worse as government support is withdrawn, but so far we are way short of the most pessimistic expectations.

On the wider economic front, we know much of the protection accorded to business has been at the expense of much higher borrowings, but the low level of interest rates has meant that the cost to the Exchequer has not been excessive. And although last year did see our economy contract by nearly 10%, all the indications are that the recovery is on track and that ground is already being made up, despite the lockdown continuing well into this year. It is estimated that UK households have some £130 billion in excess savings, thanks to restrictions. If a sufficient amount of this is released into the economy, we could return to pre-pandemic GDP levels by the third quarter of the year.

“Have you tried to get hold of a builder recently? Such is the demand for home improvement that it is one sector of the domestic economy that might be said to be a beneficiary of recent events.

All well and good, particularly as other indicators are also showing strong reasons to believe in the recovery. Broad money supply growth is running at 16% which matches previous credit booms, while house prices are also rising strongly. And have you tried to get hold of a builder recently? Such is the demand for home improvement that it is one sector of the domestic economy that might be said to be a beneficiary of recent events. The risk is a rekindling of inflation and, while most commentators still believe this is likely to be short-lived, if central banks have to step in, it will be a risk to keep an eye on.

Nor are we alone in seeing stronger economic conditions that we had any reason to deserve. In the US, the vice chairman of the Federal Reserve Bank has said he expects the economy to grow at between 6% and 7% in real terms this year, which is pretty much what the market has factored in. There are plenty of signs to support this, with house prices and building materials booming, while business surveys are also more bullish than for some time – something that is increasingly seen here as well.

So, what could go wrong? Inflation needs to be watched closely, of course, but there is another known risk that keeps cropping up. The development of new variants in the coronavirus strain that has been causing us so much grief may yet slow the return to normality that the government so wishes to implement. Because of the increasing presence of the so-called Indian variant on these shores, Prime Minister Johnson warned that it could result in a delay in implementing the final stage of dismantling restrictions. Indeed, by the time you read this, we may already know what will be happening at the end of June.

How seriously do we need to worry about the consequences of new variants developing? This is difficult to determine though, at the time of writing, the consequences are not looking too alarming. While investigations into the Indian variants still continue, it seems that the current range of vaccines remain effective, even if the transmission rate is faster. Given the progress made in implementing our vaccination programme, it possibly will not be seen as a great enough threat to derail the Roadmap, but even if it doesn’t, it could have consequences for overseas travel if other countries seek to prevent its importation.

Overall, I have confidence that the flexibility and innovation that has been displayed in fighting this pandemic will stand us in good stead for any future developments. We cannot be absolutely certain, of course, and there may yet be other consequences from this disease we have yet to fully encounter. Perhaps inflation will turn out to be the greater threat, but at present the future looks a lot brighter than it did just six months ago. Fingers crossed it continues this way.

SPACs

ARE WE MISSING OUT?

TONY DORKINS, SENIOR INVESTMENT MANAGER, JM FINN

As another acronym enters the lexicon of the financial pages, we asked Tony Dorkins to look at SPACs as an investment opportunity for private investors.

Short for Special Purpose Acquisition Company, a SPAC is a publicly listed firm with a two-year lifespan, during which time it is expected to find a private company with which to merge and in the process, bring it to the investing public.

For a private company it is a potentially faster route to market than the traditional IPO, Initial Public Offer. The sponsors also claim it is cheaper and provides more certainty as to pricing. Since the start of 2020 these "blank cheque" vehicles have raised more than $180 billion in the US. This is excellent news for the equity market and the companies involved but the trend has almost entirely bypassed London, which is suffering from a bad case of FOMO, Fear of Missing Out. Under present regulations trading of a SPAC's shares is halted when it identifies an acquisition until details of the deal are compiled and disclosed within a prospectus.

Hence the Treasury review, by former EU financial services commissioner Lord Jonathan Hill, has called for a relaxation of the UK's listing rules to capture our share of the SPAC boom as the current rules are a 'key deterrent' for investors. It urged the Financial Conduct Authority (FCA), to develop 'appropriate' regulation. Xavier Rolet, former head of the London Stock Exchange Group, has said the UK should strive to become a centre for SPAC activity in the wake of Brexit. Changes would encourage UK businesses to list at home and place London on the same footing as Amsterdam, which has emerged as Europe's SPAC hub. Anyone recall reading about the Dutch tulip bulb market bubble?

> **Since the start of 2020 these "blank cheque" vehicles have raised more than**
> **$180 billion**
> **in the US.**

The question we are concerned with is, are SPACs suitable for private investors?

Clare Cole, director of market oversight leads the regulator's response. Under the FCA's new proposals, in order to avoid suspension a SPAC will have to fulfil a number of requirements, including raising £200m when they list on the exchange and ensuring public shareholders' cash is ring-fenced to either fund an acquisition, or be returned to them. The FCA believes the proposals will both increase transparency and encourage larger SPACs with experienced management to list in the UK.

The question we are concerned with is, are SPACs suitable for private investors? Apart from those with a declared appetite for High Risk securities the answer is no. It may be too early to judge but despite the hype, performance has been mixed. An academic paper posted in November studied a cohort of 47 SPACs that merged with their targets between January 2019 and June 2020. They divided this into two groups, those with high quality sponsors (well-known funds or individuals with substantial expertise and credibility) and the rest.

The results were interesting. The average mean return on the cohort compared with the benchmark over six months was -10.9% and over twelve months that figure was -21.5%. However, the figures for the High Quality set were +22.5% and +9.7% whilst the others were shocking with -41.0% and -45.7%.

Stock selection is key but already the SEC, Securities and Exchange Commission have put the brakes on. It used a simple accounting change guiding that warrants, which allow executives and early investors to buy shares at a later date at a fixed price, the key incentives employed in most transactions, should be considered as liabilities on the balance sheet. The change could force many SPACs to restate their financials.

Stock selection is key but already the SEC, Securities and Exchange Commission have put the brakes on.

Back in the UK, the second hand car retailer Cazoo has announced it will be going public on the New York Stock Exchange via a $7 billion merger with a SPAC called AJAX1. The merger will generate $1.6 billion of which $1 billion is going to the company and $600m is for existing shareholders cashing in some of their stake. They will still own 79% of the company after the deal, SPAC investors 10%, the private investors 9.9% and the sponsors 1.1%. The pro forma value of all the shares in the company will be $8.1 billion – it was last valued at $2.5 billion in October. An exceptional return for the existing shareholders in a company not expected to make a profit until 2024. As for the investors in the SPAC, there are better alternatives in the industry.

[1]Klausner, Michael D. and Ohlrogge, Michael and Ruan, Emily, A Sober Look at SPACs (October 28, 2020). Yale Journal on Regulation, Forthcoming, Stanford Law and Economics Olin Working Paper No. 559, NYU Law and Economics Research Paper No. 20-48, European Corporate Governance Institute – Finance Working Paper No. 746/2021, Available at SSRN: https://ssrn.com/abstract=3720919 or http://dx.doi.org/10.2139/ssrn.3720919

JM Finn News

Good Money Guide Award

We are very proud to be the recipient of the "Best Wealth Manager" award at the 2021 Good Money Guide Awards.

The Good Money Guide Awards aim to champion financial services firms that excel in innovation, product, and customer service. Throughout the year, clients have been voting to help others make smarter decisions about who to invest with and provide valuable feedback to improve the online investing, trading, and currency transfer industry.

Many thanks to those clients who did vote for us and leave such glowing feedback, some of which we have shared below. Whilst there are a number of awards across the industry, we do take note of those that incorporate an element of client voting, as listening to what our clients are saying, via an independent source, is a very useful and constructive tool in terms of ensuring our services are meeting our clients' requirements.

"JM Finn are very professional yet personable"

"The team are friendly, approachable and flexible, providing a very personal service. I feel confident my investments are in good hands."

"The service is excellent - I can't recommend highly enough."

"The team on the Coleman Street Investment fund are professional, likeable and intelligent. More importantly, when you want to speak to them, they're available. Highly recommended."

"The team are helpful and responsive and really go above and beyond."

"...inbuilt robust processes mean all communication is handled in a professional and efficient manner. Can't recommend JM Finn enough, trust them implicitly."

RIGHTMOVE

James Ayling, CFA
Research Analyst

PRICE
£6.03

52 WEEK HIGH-LOW
£6.90—£5.23

NET YIELD
0.74%

HIST/PROS PER
47.9—30.5

EQUITY MARKET CAP (M)
£5,258

For the last year and a half, the UK's property market has boomed. Record low interest rates, temporary government cuts to stamp duty on purchases up to £500,000 and a competitive UK mortgage market - where deposit requirements remain low price – have all played their part.

Yet, given the economic uncertainties posed by COVID-19, the property market strength is economically surprising. House prices rose annually by c. +7% across the UK (according to Nationwide) to the end April - one of the fastest annual increases in nearly two decades.

Rightmove seems an obvious beneficiary of the 'boiling' UK market with its two-sided marketplace. Rightmove benefits from a powerful network effect whereby the more agents listing properties , the more potential customers view properties on their website, which drives a strengthening proposition – more choice and more views results in more Rightmove led sales.

If you distil Rightmove's business model down to a simple classification, it is an advertiser. Yet, its value-add, for me, is primarily dealing with a fairly illiquid asset class in an asset-light approach. However, be warned; if inflation returns and interest rates rise, I suspect housing market volumes will decline. Despite its asset-light approach, I would expect Rightmove to be vulnerable.

Please read the important notice on page 1.

Wealth planning in focus

Why it is important to plan ahead when investing into your ISA

Anthony McManus
Wealth Planning Assistant

Illustration by Emily Nault

You will likely often hear of better investment strategies, and more effective ways to maximise returns, but one absolute that can always be relied upon is that time is what you really need – Time is on your side.

A little forward thinking can go a long way, as a longer time horizon allows you to consider taking on more risk with your money than you might be comfortable with under a shorter term investment, with the aim of producing higher returns.

ISAs are a fantastic savings tool in which investors benefit from not paying tax on dividends, capital gains or interest earned in the account. The government offers a maximum £20,000 allowance each year with an annual deadline at the end of the tax year on the 5th April.

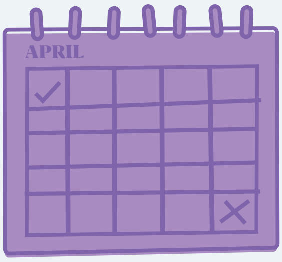
“ ISAs are a fantastic savings tool in which investors benefit from not paying tax on dividends, capital gains or interest earned in the account.

In excess of 300 days, it may feel premature to think about your ISA contribution right now, but the earlier you invest, releases the opportunity of compound returns – investment and interest. Of course, it is dependent on whether or not you have the monies available at the time, compound return is less about how much you can afford to put aside, and more about how long your money has to grow.

Should you invest

£20,000

on the first day of the next tax year as opposed to the last day for the next 10 years, you would gain an extra



£13,604

Should you contribute

£20,000

at the age of 21, assuming a 7% annual return, your fund will be worth £40,000 by age 31 and

£80,000

by age 41.

Many people do not have £20,000 cash to invest at once, but it is still advantageous to drip your money into the market through regular investments.

As a point of reference, assuming a 5% average annual return, following an initial investment of £20,000, should you invest £20,000 on the first day of the next tax year as opposed to the last day for the next 10 years, you would gain an extra ~£13,604. Note that this does not take account of any dividends that may be reinvested.

Likewise, using the same principle of investing early as opposed to late in the tax year, over a period from the age of 21 to 65 you could potentially gain a further ~£163,459 through compound interest. This is of course assuming an average annual return of 5% and an initial investment of £20,000. There is also a good chance the annual ISA allowance will change from £20,000 over the next 44 years!

Investment timing aside, compounding growth of 7% per annum from a single £20,000 contribution will see it more or less double in 10 years and quadruple in 20 years. As such, should you contribute £20,000 at the age of 21, assuming a 7% annual return, your fund will be worth ~£40,000 by age 31 and ~£80,000 by age 41.

It is greatly important to consider what wrapper to invest in. We've already noted that an ISA is beneficial in that you will pay no tax on dividends, capital gains or interest earned in the account. In contrast, a wrapper such as an Onshore Investment Bond will see all growth initially taxed at 20%. Using the same variables of a single £20,000 investment and 7% annual growth, over a 10 year period an investment in an Onshore Investment Bond will be more than £6,500 worse off than having invested in an ISA.

Many people do not have £20,000 cash to invest at once, but it is still advantageous to drip your money into the market through regular investments rather than saving up elsewhere and committing a lump sum later on.

The higher your account's balance and the longer your money is invested, the more opportunity it has to compound in value over time.

The higher your account's balance and the longer your money is invested, the more opportunity it has to compound in value over time.

Investing is subject to the fluctuations of markets, and it should be stressed that there is always a risk that you could lose money, but by investing over a longer timeframe, riding out market volatility along the way, over time, your funds should grow. Markets rarely peak all in one go and there is often short term volatility along the way.

Many people tend to hold their savings in a regular savings account with a bank. Savings account interest rates are notoriously low, prompting the Daily Mail to print the headline "what is the point of saving?" Whilst we cannot condone this sentiment to savings, considering the benefits discussed earlier in this piece, we believe holding as much of your savings as you can afford to invest in an investment ISA as opposed to a bank savings account or cash ISA should prove incredibly beneficial to your savings returns.

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

WINGSTOP

Michael Bray, CFA
Research Analyst

PRICE
$142.68

52 WEEK HIGH-LOW
$172.87—$112.47

NET YIELD
3.90%

HIST/PROS PER
181—99.9

EQUITY MARKET CAP (M)
$4,242

There is little doubt that the demand for plant-based fast food is on the rise as consumers become more environmentally and ethically conscious. Yet, there is still a big market for meat, particularly healthier, flavoursome, white meat, like chicken wings.

The ambition of Wingstop, which hails from Dallas, Texas, is to become the McDonald's of the chicken wing world. They specialise in cooked-to-order, hand-sauced and tossed chicken wings. Their unique flavour profiles, such as Spicy Korean, Hickory Smoked BBQ and Garlic Parmesan, appeal to a broad consumer demographic.

Primarily US focused, with a smaller presence in Mexico, Indonesia and the UK, Wingstop are targeting 3,000 global store locations, up from their current c.1,500.

The business has achieved 17 consecutive years of same store sales growth through attracting franchisees with its highly profitable model. Wingstop say that by year two of operations, new franchisee stores should generate cash-on-cash returns of approximately 35% to 40%.

Wingstop has undoubtedly benefitted from the lockdowns as consumers sought more takeout options. However, this presents a headwind to year-over-year growth figures as we exit the pandemic.

Please read the important notice on page 1.

Stock in Focus

Johnson Matthey

Rheanna Filmer
Assistant Research Analyst

Johnson Matthey (JM) began life over 200 years ago as a successful gold assay business. Since then the British company has broadened its expertise to match the specialty chemical needs of the moment. Today, JM is a multinational company split into four divisions: Clean Air, Efficient Natural Resources, Health and New Markets.

The Clean Air division accounts for 60% of group revenues, developing and producing emission control technologies with a particular focus on catalytic converters for automotive vehicles. Catalytic converters reduce or eliminate harmful emissions produced by combustion engines. JM is the market leader in catalytic converters fitted to light duty trucks and heavy duty diesel vehicles. The Clean Air division might appear to be a beneficiary of progress towards a lower emission world, but the continued phasing out of combustion engines entirely (particularly diesel engines in Europe) is expected to reduce revenue in the medium to long term.

In 2020, the Clean Air division saw a decline in revenues as the automotive industry came to a standstill due to COVID restrictions. However, in the near term, increased emission regulation globally does play in its favour. Therefore, the longer it takes for electric vehicles to replace traditional vehicles, the better for the Clean Air division.

The Clean Air division also highlights one of JM's competitive advantages: their expertise in catalysis chemistry. Catalysts are substances that accelerate chemical reactions without being used up, and so can be used to materially improve speed, efficiency and sustainability of a chemical process. Catalysis chemistry is widely applicable and catalysts also play a big role in the Efficient Natural Resources (ENR) division.

ENR is JM's highest margin division and accounts for c. 25% of group revenues. The focus of ENR is the conservation and recycling of scarce resources to "achieve greater efficiency and optimal yields in the use of these natural resources" according to the company. JM's ENR Division is the largest secondary refiner of Platinum Group Metals (PGM) in the world, extracting PGMs (platinum, palladium, etc) from waste products to 99.95% purity. Much of this refined PGM is then used to manufacture catalysts but some of it is also sold on.

PRICE
£30.46

52 WEEK HIGH-LOW
£33.63—£19.79

NET YIELD
1.68%

HIST/PROS PER
28.6—13.3

EQUITY MARKET CAP (M)
£6,020

The market leader in catalytic converters fitted to light duty trucks and heavy duty diesel vehicles.

The odd one out is the Health Division, which accounts for c. 5% of group revenues. This division was born out of the use of platinum in medical treatments and now uses JM's expertise in complex chemistry to manufacture ingredients used to develop pharmaceuticals. Though this business utilises some of JM's strengths, it does not play a role in their long term strategic vision as a green technology and chemicals company. Furthermore, the division has been contracting since 2015 with a 5YR CAGR (compound annual growth rate) of -21%. As a result, JM announced a strategic review of the Health business in early 2021 citing an objective of maximising value for shareholders. Expectations are for the business to be sold at a valuation c. £2bn, though this is purely speculative.

A potential sale of the Health business would give JM the capacity to focus more heavily on its main long term growth driver, its New Markets division (c. 9% of group revenues). The New Markets division works on a multitude of growing technologies, but the star of the show is Battery Materials. JM are currently in the process of commercialising their enhanced lithium nickel oxide (eLNO) battery cathode material, for use in electric vehicles. eLNO claims 20-25% higher energy density and longer cycle lifetime than the market leading NMC 622 battery material, while also reducing expensive cobalt content. Reducing cobalt is crucial to the progression of battery electric vehicles (BEV) so as to reduce the cost to the consumer; the battery alone accounts for approximately a third of a BEV's price.

Despite these claims, their concept has yet to be proven at scale. JM have put their money where their mouth is and are developing manufacturing plants in Konin, Poland and Vaasa, Finland (Liberum estimate at a cost of c. £200m each plant). Most recently JM also opened a new battery material plant in Oxfordshire. They forecast the Polish plant will produce a maximum capacity of 10,000 tonnes of eLNO, enough for 100,000 BEVs, with production beginning in 2022.

However, JM is far from the only player in this fast growing market. Competitors have also been developing low cobalt battery materials (e.g. Tesla's lithium iron phosphate (LFP) battery). Fortunately, the transportation sector is extremely varied and the expectation is that differing battery materials will each be able to find a place. For example, JM have suggested that the eLNO battery will be particularly useful for long range vehicles. There should be room for all competitors to grow as the market grows.

Ultimately, Johnson Matthey's USP is its established expertise in very complex chemistry that is applicable across a multitude of fields. They have chosen to focus their talents on the global effort towards a greener, more sustainable world. In many ways, we all stand to benefit if they succeed.

Collectives Commentary

Cheer up it might never happen

James Godrich, manager of the JM Finn Coleman Street Investment Funds suggests the recovery may not be accurately priced in by the markets.

James Godrich
Fund Manager

Illustration by Jordan Atkinson

In financial markets it is just as important to know what you think is going to happen, as it is to know what the average person thinks is going to happen. Investment performance is driven not by correctly estimating for how long or how fast something might grow, but by correctly estimating that something will grow at a different pace or for a different length of time than is currently 'priced in'.

The economist, John Maynard Keynes covered this point in 1936 where he described investment as being like choosing the winner of a beauty contest saying, 'it is not a case of choosing those (faces) that, to the best of one's judgement are really the prettiest, nor even those that average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be.'

Today, one of those seemingly 'average opinions' is that we will see a rebound in GDP and inflation in the coming years followed by a return to the slow and low growth that has characterised much of the early 21st century.

That initial rebound is almost guaranteed as a result of the base effect; this is the idea that any numbers now will be compared on a year-on-year basis against a time where economic activity was nearly non-existent. However, more than being the average opinion, the industry appears at times unanimous in thinking that this dramatic pace of rebound and corresponding inflation will be temporary.

The Monetary Policy Committee of the Bank of England takes the view that 'in the medium term, the pace of expansion in UK GDP slows, as supply growth returns to subdued longer-term trends and the effects of some factors boosting demand growth wane'. Jay Powell at the Fed agrees as he continues to trot out his phrase of the moment that any pickup in inflation will be driven by 'transitory' factors and should therefore be ignored. And it appears that investment markets too agree – the expected average inflation in the US over the next five years (ie 2021-2026) is currently priced in to be higher than the expected five year average inflation in five years' time (ie 2026-2031).

It is extremely unusual for investment markets to price in lower expected inflation in the future than in the present, and as good as confirms the view that the average investor sees a rebound in growth followed by a return to a slow and low world. Sensible positioning in this environment means owning businesses that either (a) offer steady and predictable growth such as Fast Moving Consumer Goods (FMCG) companies or (b) offer supernormal growth such as tech companies.

But what happens if that view isn't correct? What happens if pent up savings leads to higher spending which leads to increased employment and wages and even higher spending? What happens if the Covid era marked the end of fiscal austerity and we should now expect to see sustained periods of ever increasing Government deficits? What happens if creative destruction during a time of crisis sees a new era of productivity that drives growth rates ever higher? Sensible positioning in this environment looks very different with a skew towards businesses whose growth is less predictable and more cyclical – it would certainly not make sense to pay premium valuations for businesses who are more likely to deliver growth in a world where every business delivers growth.

> **“Sensible positioning in this environment looks very different with a skew towards businesses whose growth is less predictable and more cyclical.**

We do not know exactly what the future holds, but we do have a good idea what the average investor expects. Perhaps the bar to beat that dreary longer term outlook is not too high and remember, investment performance is driven by correctly estimating that something will grow at a different pace, or for a different amount of time, than is currently ‘priced in’.

James manages the JM Finn Coleman Street Investment funds, a choice of three portfolios with different investment objectives that pools your assets with those of others.

Independent view

Inheritance tax and capital gains tax: will the Chancellor be bold?

Robert Knight, a probate and estate planning solicitor at Keystone Law, looks at the Chancellor's options for changes to both CGT & IHT.

Robert Knight
Consultant Solicitor, Keystone Law

Illustration by Adam Mallett

In advance of this year's Spring Budget, there was considerable speculation the Chancellor would make changes to and/or increase rates of inheritance tax (IHT) and capital gains tax (CGT). However, it soon became clear the Chancellor would not be making any significant changes within the Budget.

Tax professionals and commentators were not the only ones causing speculation. The Office of Tax Simplification (OTS), an organisation created by the Government, made recommendations in 2018 and 2019 to reform IHT and in 2020 to review CGT. Rishi Sunak himself asked the OTS to carry out the CGT review in 2020, only a few months before the Budget.

In addition, the all-party parliamentary group produced a report in 2020 which made further recommendations to reform IHT.

The consistent theme is that IHT is in desperate need of modernisation due to the current legislation being more than 30 years old. Over the years, successive Chancellors have added layers of complexity. It is of note, however, that Chancellors have always retained the death rate of 40 per cent (unless gifts are made to charity) and since 2009 the IHT-free sum (the 'nil rate band') has remained firmly stuck at £325,000 despite inflation and house price increases.

Did the Budget make any changes?

The Chancellor made two rather insignificant announcements at the Budget:

- From 1 January 2022, over 90 per cent of non-taxpaying estates will no longer have to complete IHT forms to obtain probate.
- Physical signatures will not be needed on all IHT returns.

Both announcements have been welcomed but, as they simply affect the administration of probate and IHT, they fail to address the perceived unfairness of IHT and the complicated and arbitrary IHT rules.

Rishi Sunak followed the path of all Chancellors since Alistair Darling in 2009 and froze the IHT-free sum at £325,000 for another five years. This will cause the 40 per cent main rate of IHT to affect more of the population every year.

Despite tremendous hype prior to the Budget, the Chancellor ignored the calls for CGT rates to be aligned with income tax rates. Many consider this to have been the right decision whilst we were in lockdown and before the actual economic impact of the pandemic can be assessed.

The Chancellor is in an unenviable position, especially due to the effects of COVID-19 on the economy.

The Chancellor also gave further opportunity for entrepreneurs to secure the 10 per cent rate of CGT in specific circumstances on their first £1 million of capital gains. This resulted in sighs of relief metaphorically being heard around the country from investors, business owners, second homeowners and those considering their estate planning options.

Will there be future changes?

While critics have said the Chancellor missed an opportunity to reform IHT and CGT, the reality is that the Treasury receives so little from IHT and CGT that it is hardly surprising both taxes were untouched. The Office of Budget Responsibility's latest forecast states that in 2019/20 IHT raised £5.3 billion, and CGT raised £9.8 billion. In total this represents a fractional 0.6 per cent of national income.

The Chancellor is in an unenviable position, especially due to the effects of COVID-19 on the economy. If he makes any changes which are perceived to benefit the traditional Tory voter, then he risks alienating those new voters. Conversely, if the Chancellor increases IHT and/or CGT, he risks rebellion and disquiet for the sake of, say, a further 0.2 per cent of national income. It is a political hot potato in trying to strike the right balance, and perhaps it could be argued that the easy option is simply to retain the status quo.

However, there are signs that the Chancellor will make changes to IHT before the next general election. The Government has committed, at least to the OTS, to respond to their 2019 IHT recommendations "in due course". This is likely to mean plenty more speculation, leaving taxpayers eagerly wishing to estate plan and capture the valuable reliefs of business property relief and agricultural property relief before they potentially disappear or are restricted.

The Chancellor needs to be careful with any CGT changes as many taxpayers choose, and are not forced, to pay CGT. If it is made unattractive for taxpayers to trigger a CGT liability, then some taxpayers may delay selling or gifting assets, or choose not to invest. At a critical time for the country in a post-Brexit and pandemic world, these decisions may have real impacts on the British economy.

Every Chancellor's priority will be to take steps to balance the country's books. The real question for Rishi Sunak is whether he is prepared to be bold and to take some difficult decisions to address perceived unfairness and to simplify IHT and CGT.

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

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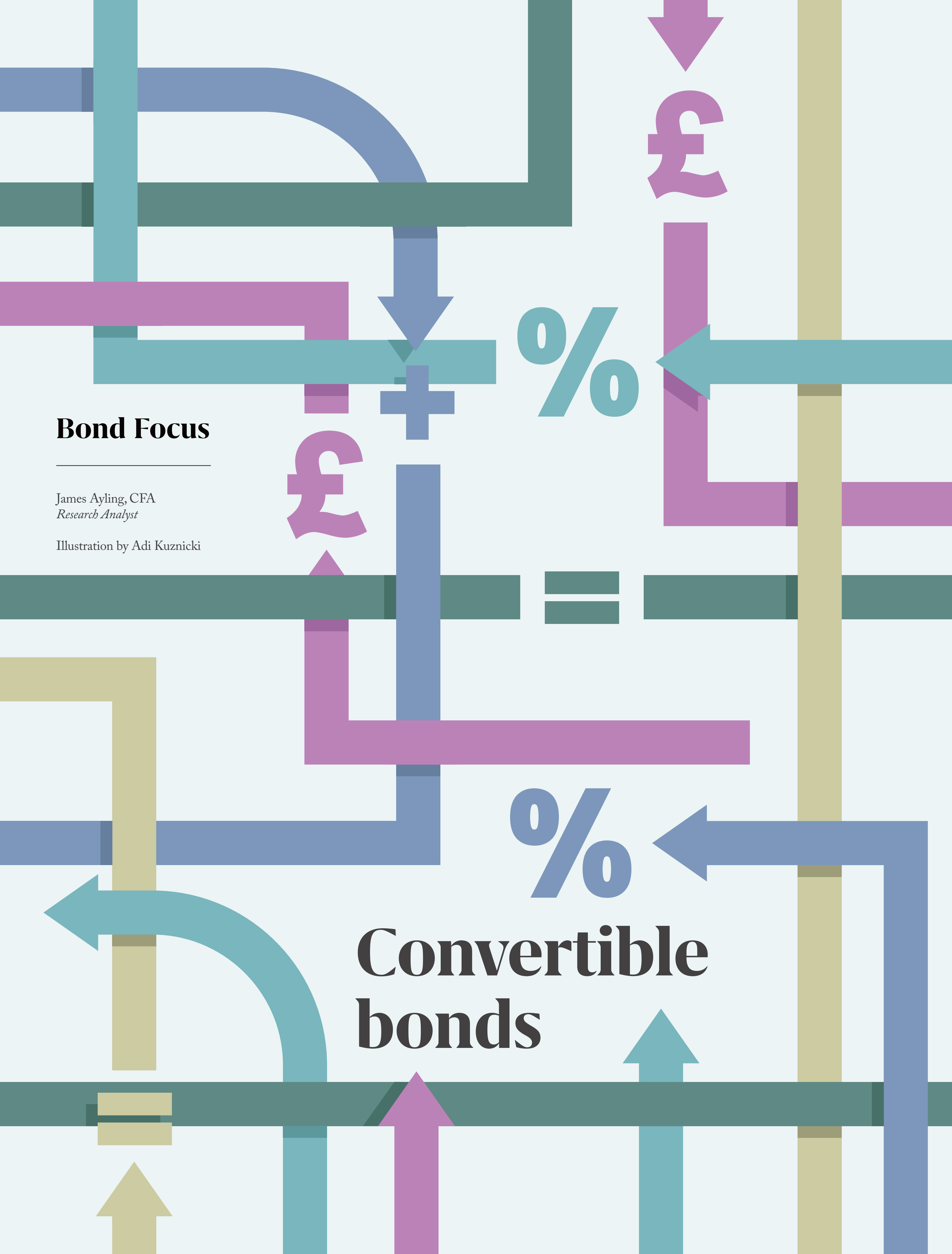

Bond Focus

James Ayling, CFA
Research Analyst

Illustration by Adi Kuznicki

Convertible bonds

Convertible bonds (convertibles, also termed convertible notes if shorter in maturity) are, all too often, an overlooked financial instrument. They provide investors and corporate executives with useful optionality and hence, greater funding flexibility.

In its simplest form, a convertible is a fixed income loan instrument that can, in a pre-determined manner, be converted into equity. As a loan instrument, assuming no conversion, it aims to provide investors with a return through interest payments alongside the eventual return of principal at maturity. Yet, once converted, investors switch from holding a debt instrument to holding equity and hence, participate in the upside fortunes of a company's successes or vice versa, the downside from weaker share price performance or, eventual failure.

Small early stage higher risk private companies, say in venture capital, typically raise some of their first external capital by issuing convertibles. Using this debt instrument, instead of equity, means that investors don't have to explicitly value such an early stage business; this issue can be pushed down the line, to when a start-up may need to raise further capital. At this later point, if we assume the corporate has matured, it should mean there is more data on the company to analyse – investors may therefore be capable of inferring a more reasonable company valuation.

Yet, the convertible bond instrument itself offers some more immediate advantages: the use of a convertible isn't immediately dilutive to a founder's equity stake and hence could be repaid like a traditional loan if conversion terms aren't achieved. Also, for founders, convertibles don't by default grant debt investors voting rights unlike some equity instruments. Meanwhile, for investors, the debt nature of a convertible gives investors greater seniority over a company's assets should the company need to shut.

In the summer of 2020, during the COVID-19 pandemic, Reuters highlighted that the issuance of convertible bonds by companies in coronavirus impacted sectors reached its highest peak since the Global Financial Crisis. Regional trends were similar and although convertibles are more prevalent in the US, European issuance also rose during the pandemic.

> **As a loan instrument, assuming no conversion, it aims to provide investors with a return through interest payments alongside the eventual return of principal at maturity.**

That's because COVID-19 brought volatility and volatility makes optionality more expensive. That, in turn, made convertibles more expensive which made selling them (by companies) more attractive.

However, there were two underlying convertible bond issuance trends. On the one hand, you had negatively impacted companies (such as cruise liner, Carnival Corporation) seeking out emergency capital to alleviate near term liquidity risks to try to help ensure their longer term survival. Whilst, on the other hand, you saw companies (such as Ocado) which were benefitting from the pandemic actually tapping convertible bond markets as a more flexible route from which to generate capital for growth investment purposes.

For convertible investors, actually accepting a lower short term interest rate on the financial instrument, to compensate for the potential upside offered by equity conversion, may well prove to be a savvier longer term investment decision - if the global economy continues its economic recovery and lockdown conditions further ease as vaccine rollouts widen.

Asset allocation and sector focus

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

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

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

Here we present a snapshot of the current views.

Sector Views

Overweight Neutral Underweight

Materials	Short term drivers include sustained high commodity prices and the growth-to-value rotation. Long term, the sector is in flux from the more traditional to the new green economy commodities.
Consumer Staples	We like the sector for its defensive attributes and high quality businesses and it has shown its resilience recently. However, it is viewed as a bond proxy so vulnerable to rising rates.
Consumer Services	More normalised consumer spending patterns provide near term tailwinds. Longer term we continue to favour e-commerce names and those business further along their digital transformation journeys.
Financials ex Banks, Life Insurance, Property	This includes a broad range of stocks which are generally geared to investment markets. Valuations not at a level to turn more positive.
Financials Banks	Banks are benefitting from steepening yield curve but tend to operate in the sub-five year space where the yield curve is flat. They have played their part in the COVID-19 crisis as part of the solution rather than the cause, so we should see less onerous tax and regulation.
Financials Property	Whilst acknowledging the structural difficulties on the high street and concerns over liquidity in open ended vehicles, we do see value in some areas. We would rather see more visibility from the impact of easing lockdowns before becoming positive again.
Financials Life Insurance	A problem is a lack of growth for companies without exposure to Asia with perhaps the exception of L&G which has carved out a niche in the bulk annuity segment for itself.
Real Estate	Global real estate may offer better value. Caution on bond proxy status and COVID-19 impact.
Health Care	Growth and defensive attributes and global demographic tailwind. Distinguish between pharma/healthcare/biotech sub sectors. Remains a key theme for medium term, reinforced by current crisis.
Industrials	We see increasing evidence that economic activity is improving and see this broadening out over the coming months.
Energy	Structurally the sector remains under pressure, but short term catalysts lead us to be more constructive.
Information Technology	Long term we like the structural tailwinds that provides support for the sector. However, near term we believe heightened valuations are susceptible to rising bond yields. We favour more cyclically exposed names that are likely to benefit more as the economy unlocks.
Communication Services	Changed consumer behaviours could persist in these segments and see further growth. Equally, digital advertising names have cyclical upside potential as a strengthening economy and lockdown easings are expected to support a revival in marketing activity.
Utilities	Sector has seen some safe haven support however is not immune from the slowdown as business customers suffer.

Asset Allocation

Overweight Neutral Underweight

UK EQUITIES	
UK	Potential for relative improvement. Positives: Cheap on a PE basis. Great vaccination programme. Negatives: Brexit risk from logistics (all be it receding ~ but watch Jersey-like scenarios). Heavy on cyclicals but these are ESG poor (oils and miners) as Shell's Dutch court case highlights. Risk of GBP weakness.
INTERNATIONAL EQUITIES	
North America	Fears of over-heating could deter investors. But support comes from huge stimulus package. Positives: Slow global COVID-19 recovery could draw out tech rally. Strong stimulus and supportive Fed as employment is low. Strong earnings season. Negatives: Rotation out of growth/ tech into value ~ US is growth heavy.
Europe	Eurozone is a global cyclical and value play, trading cheap. Their Recovery Fund will start to be implemented in the summer and the labour market is resilient. The value trade is likely to help the region. Positives: €750 billion support package. Negatives: Slow COVID-19 vaccine roll out. Too much ESG focus could increase cost of capital. Chinese demand for European products might be weak on tight Chinese monetary policy. The doom loop for local banks is a black swan that we watch.
Japan	Japan is a traditional global cyclical play, with a positive correlation to bond yields and to PMI direction. Japanese valuations appear attractive and positioning looks light. Positives: The yen always has the potential for reverting to safe harbour mode if COVID-19 variants allow this episode to drag on. Japan is OW industrials and consumer discretionary for the value trade. Negatives: We are cautious of much needed corporate reforms delivering on their promises and driving higher ROEs although more share buy backs will help. The vaccine roll out has been unimpressive.
Asia Pacific	China still appears fundamentally attractive. Positives: China is not imploding under a debt burden as many once feared. Instead, leverage is supportive for Asia Pacific equities unless tightening is too strong. China was first into the COVID-19 pandemic and should be first out in a way that leads the region. Korea and Taiwan should benefit from the surplus of semiconductor chip demand. Negatives: Rebound in USD through to Q321 might hurt emerging markets in this region. Regulatory crackdown (Alibaba and Meituan).
Emerging Markets	We have a preference for China and other countries with sound macro-economic policies, such as Korea, Russia, and Mexico. EM should do well in 2H, given global growth convergence and easing in trade uncertainty. The near term risk is focused on Latin America if USD strengthens (short term) and if China's tightening leads to stalling commodities. Positives: USD weakness seems likely in the long term (post rates adjustment) and a gradual improvement in commodity prices (linked to a Chinese infrastructure stimulus) could help those emerging markets more sensitive to commodity exports. Negatives: Brazilian and Indian COVID-19 is a worry and raises the risk premium. A slow vaccine roll out in the region is not helping. Russian sabre rattling at Ukraine (tanks on the border) is not good for the rouble.
BONDS	
Conventional	The prospect of inflation, driven by the temporary impact of base effects and demand being fed into a sub-optimal supply chain continues to be a concern.
Index Linked	Pricey inflation hedge. Positives: Hedge against inflation increasing from loose monetary and fiscal policy. Negatives: Expensive negative yield curve in the UK.
Corporate bonds	Given our overweight equity position, we would prefer to be underweight corporate bonds. There is a possibility that corporate spreads could reduce further but we continue to think the upside from spread contraction has probably reached its limit.
CASH	
Cash	Cash has a poor yield but keep some on the side-lines for a possible pullback.
PROPERTY	
Property	Real estate lies somewhere between equity and bonds and we still prefer equities. Choose exposure with care and avoid poor quality retail.
ALTERNATIVES	
Alternatives	We prefer to make more precise calls in equity, cash and fixed income. We like infrastructure and gold as diversifiers within the sector.

Meet the manager

Clare Gore Langton

Investment Director, London

Lives South West London and Somerset

Family Widowed in 2000. Twin boys (one in the Army and one at Lloyds Bank)

Started at JM Finn 1 July 2020

Favourite Book Anything by William Boyd – particularly *Any Human Heart*

Hero The Queen

Passion Italy for its art, food, spectacular scenery, sun and snow

Favourite Music Mozart, Puccini and The Rolling Stones

Most looking forward to An efficient and effective roll-out of the COVID-19 vaccination programme worldwide.

As a recent joiner to JM Finn, can you tell us what it was that made you want to come here?

I wanted to join a company which was smaller, more collegiate and less bureaucratic than my former employer. I had met some JM Finn people over the years and liked the sound of the culture here. Luckily so far, despite the almost unprecedented difficulties in joining a new organisation in the time of COVID-19, my new colleagues have been welcoming and supportive. I would like to give particular thanks to the IT department and to the Post Room!

What areas of the industry do you think need the most attention from practitioners and regulators alike?

I think practitioners have had no choice but to get to grips with the increasing demands of regulation and compliance. We all accept that, provided these demands meet the standards required in protecting our clients' interests perhaps rather than our own. I would, however, like to see firmer action from the Financial Conduct Authority (FCA) on the rogue operators such as London Capital & Finance. Every time there is a problem caused by a company which, arguably in many cases should not have been allowed to be in operation in the first place, the rest of the industry has to pick up the bill by funding the Financial Services Compensation Scheme (FSCS). The associated charges are unfortunately often transferred ultimately to our client base, the very people the regulators are trying to protect.

What is it that you enjoy so much about wealth management?

First and foremost the contact with clients and building up relationships over the years, sometimes with three generations of the same family. It is a great privilege to be able to make a contribution to building up the long-term security of people who trust you.

As a major part of the job, we are required on a daily basis to get to grips with the ongoing political, economic and commercial events of the day. As we all know, a good example of the constantly changing world which of course impacts on the investment world too, are the technological advances made in recent years which have been truly stunning. As Ben Rogoff of Polar Capital has said, the mobile telephone with all its functionalities is perhaps one of the most important inventions since Caxton's printing press. It is amazing to think that this development has occurred within the last 20 years!

In the investment world, we constantly have to try to understand and evaluate new challenges coming along, such as the current hydrogen revolution and electrical vehicles (and all the implications that stem from this). It is a fascinating world and we are lucky to have the opportunity to explore it in such depth, supported as we are by the analyst community and, indeed, our own research department, on behalf of our clients.

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