JM FINN

Prospects

Gilts
Back in vogue?

Life in the square mile
Then and now

State pensions
Could you boost yours?

The JM Finn Quarterly Periodical

No.44 *Autumn 2023*

No.44

Autumn 2023

Contents

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Cover Illustration:
Adi Kuznicki / Everything–Connected

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Welcome

While UK inflation has come down from a 41-year peak last October, at 6.8% the July rate remains stubbornly above the government's desired 2% figure. The Bank of England continues to walk the tightrope of maintaining higher interest rates for long enough to further reduce inflation, while simultaneously trying to avoid a recession.

In response to this ongoing balancing act market returns have remained inconsistent – this August alone, the FTSE 100 has traded between 7699 and 7258 – a reminder that while short-term blips in the performance of stock markets and investor portfolios are inevitable, it is important to keep a cool head and take a long-term view when investing.

When making investments for the future, pensions should be the bedrock of any retirement plan – and maximising one's pot is often a key objective. In addition to a private pension, we should all be due a state pension upon retirement, subject to the required National Insurance being paid during one's working lifetime. The deadline to top up missing years in National Insurance records has recently been extended to April 2025. On page 14, Rebecca Dawkins, a member of our wealth planning team, covers the key points on making voluntary contributions to potentially boost retirement income from state pensions. Our wealth planners specialise in pension and retirement planning, and are on hand should you require any advice in this area.

Developing and maintaining strong relationships with our clients has always stood at the heart of JM Finn's ethos, and our agenda of exclusive client events around the country present a great opportunity for clients and investment managers to get to know each other better in relaxed and informal settings. In October, we will host two private receptions for clients at The Affordable Art Fair in Battersea, London – which offers artworks priced from £50 to £7,500. Following the success of our partnership with Art For Cure in Suffolk, JM Finn is sponsoring Art For Youth North in York, an exhibition that supports the charity UK Youth though the sale of art – we will hold a drinks reception at the gallery in October. To round off the year, in December the Celebration of Christmas concert and reception will be held at the beautiful Winchester Cathedral to get everyone into the festive spirit.

Our longstanding industry commentator, Brian Tora, retires this month after a 60-year career in the square mile. I first worked with Brian back in the early 1990s at James Capel and have always been impressed with his clear and balanced analysis. In his final piece for Prospects on page 8, Brian reflects on the extraordinary shifts seen in the investing world during that time, and speculates that this rapid pace of change could well be set to continue.

As Brian leaves, so younger members of our team are stepping up. The eagle eyed among you may have spotted JM Finn investment directors Lucy Coutts and Freddy Colquhoun making TV and radio appearances recently, including on Sky and the BBC. They continue to have regular slots on the Wake Up to Money show on BBC Radio 5 Live and Today on Radio 4, and we wish them well as they continue to represent the Firm in the future.

Finally, thank you to the many of you who completed the survey included with copies of the summer edition of Prospects – your feedback is greatly appreciated and helps us to continually strengthen and tailor our communications to our clients' needs. We are currently collating the results and will give an update on the survey highlights in the next edition of Prospects.

Hugo

Hugo Bedford
CEO

Gilts: past and present

Sir John Royden
Head of Research

Illustration by Adam Mallett

As interest rates hit a 15-year high on the back of stubbornly high inflation, returns on certain gilts have been a ray of sunshine for some investors seeking an income. Sir John Royden, Head of Research at JM Finn, explores the world of UK government debt.

Following the hikes in interest rates this year, we see that investors are now looking at gilts again, as they have been most years since the gilt market first came into being, back in 1694. After William and Mary's Glorious Revolution of 1688, the new King William III needed cash to fight his wars and he sold gilts to raise the cash. William III's wife was Mary II, Catholic King James II's daughter who was raised as a Protestant on the orders of James II's elder brother, the then King Charles II.

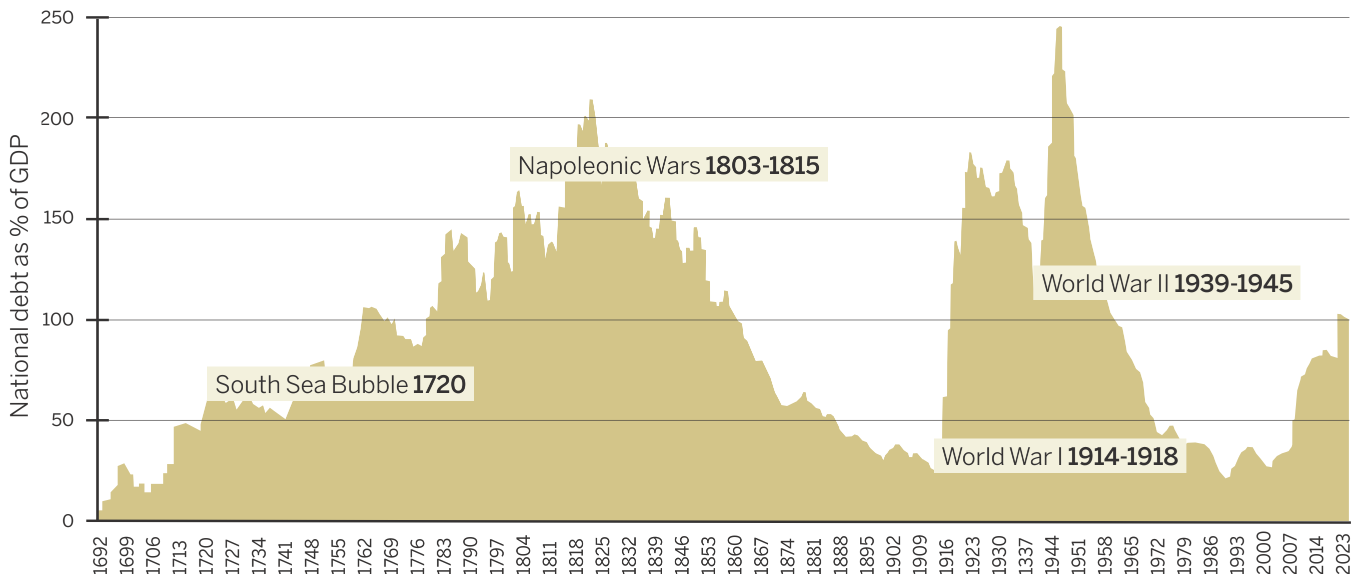
A brief history of gilts

Prior to 1688, the leading members of the English political class had become uneasy with a Catholic King –James II and his Catholic son James Francis Edward, and so they invited James II's Protestant daughter and her Protestant Dutch husband William to take the throne. When William and his army landed at Brixham on 5th November 1688, James II's army deserted and James II fled to France, vacating the throne for his daughter. Technically this was a bloodless coup d'état.

In 1694, the recently formed Bank of England gathered together 1,268 individuals to subscribe to buy £1,200,000 of stock (or gilts, as they would have been called today) yielding 8%, designed to fund William's war with France[1]. The bonds became known as gilts because the certificates had gilt edges to them.

In 1720, the South Sea Bubble episode required additional national finance – astonishingly, the debt for this was only paid off in full in 2014. Leaving aside the Bubble and, more recently COVID-19, it has tended to be wars that have driven the issuance of gilts and increases in our national debt. The impact of the Napoleonic Wars and then the two World Wars is clear to see on the historical chart of UK national debt, as shown below.

UK national debt as percentage of GDP, 1692 - 2023



Source: www.ukpublicspending.co.uk using data from B.R. Mitchell, British Historical Statistics, Office for Budget Responsibility Public Finances Databank, measuringworth.com and Office for Budget Responsibility EFO supp. economy tables.

[1] https://corporatefinanceinstitute.com/resources/fixed-income/gilts/

> The need to pay down government debt via taxes can lead to 'crowding out'.

Are there other forms of government debt?

Gilts are not the only type of government debt. Our current government has borrowed £1.3 trillion from the issuance of gilts and £40 billion from the sale of short-term three month (or less) treasury bills. £1 trillion has come from the Bank of England as well as £210 billion from National Savings[2]. The picture is less clear[3] when pension deficits, other commitments and debts of QUANGOs (government-funded bodies that are either partly or fully autonomous from the government) are included.

Government debt matters because at best we all have to pay taxes to pay the creditors back. In theory the government could print money to pay back creditors but that feeds through to inflation, which is often seen as another kind of tax. At worst, debt can spiral out of hand - leading to economically destructive high interest rates.

As a general rule, it is thought that keeping debt below 100% of GDP is a sound policy. Sadly, as of 2023, the UK's national debt has now risen above that 100% figure.

The need to pay down government debt via taxes can lead to 'crowding out'. This means that investment that would normally go into the economy is diverted to pay down debt, resulting in sub-optimal economic growth. And intertemporal substitution can mean that individuals save more money now with the expectation of paying higher taxes in the future – another source of sub-optimal economic growth.

Types of gilts explained

There are two main types of gilts, which drive the main terms and conditions of the debt. 'Conventional gilts' pay a coupon or interest rate at specific periods, often 6 months. Taking the 4.25% of June 2032 gilt as an example, it would have originally been sold at close to £100 when it was first created in 2000. It pays a coupon or annual interest of £4.25 per annum (paid half yearly) and in June 2032 the owner will get back the original £100 or nominal or par value. The other main type are 'index-linked gilts', which see the nominal or par value and the interest grow in line with inflation.

Why do the prices of gilts fluctuate?

When interest rates go down, gilts rise in value and when interest rates go up, gilts fall in value.

When the 4.25% of 2032 was originally sold, interest rates would have been close to 4.25%. When interest rates fell after the Great Financial Crisis and again following the outbreak of COVID-19, the value of the gilt rose. At its peak value of £150 in 2016, the annual £4.25 would have given you a flat yield of 2.8% (£4.25 ÷ £150). However over the life of the gilt, from 2016 to 2032, you would stand to lose £50 because the gilt matures at £100. Roughly speaking, losing £50 over 16 years is like losing £3.125 (£50 ÷ 16 years) per annum or 2% (£3.125 ÷ £150). So the net effect of the flat yield of 2.8% of income less a capital loss of 2% approximates to a net 0.8% per annum. This 0.8% is often called the 'gross redemption yield'.

[2] https://www.icaew.com/insights/viewpoints-on-the-news/2022/sept-2022/chart-of-the-week-uk-public-debt

[3] https://en.wikipedia.org/wiki/United_Kingdom_national_debt#:~:text=The%20British%20government's%20debt%20is,a%20debt%2C%20of%20the%20government

> **As a general rule, it is thought that keeping debt below 100% of GDP is a sound policy.**

Why are gilts potentially more attractive to investors currently?

Once interest rates had been cut in response to COVID-19, gilts became unattractive. They paid out very low yields and investors faced the prospect of rates going up as we came out of COVID-19 rescue mode. And when rates go up, gilts fall in value. That 4.25% of 2032 now trades for close to £100, a fall of c.33%.

Some government gilts now offer an attractive array of gross redemption yields from 4.4% to 5.1% depending on the maturity date. Once more, as they did in the times of King William and Queen Mary, gilts may have a place in portfolios.

Please read the important notice on page 1.

CERES POWER

Jack Summers
Research Assistant

PRICE
£3.41

52 WEEK HIGH-LOW
£6.40—£2.73

NET YIELD
0.0%

HIST/PROS PER
NA/NA

EQUITY MARKET CAP (M)
£643

Ceres Power is a developer of solid oxide-based hydrogen power technology. Unlike alternative technologies, Ceres' solid oxide units can be set up as either a hydrogen fuel cell (SOFC) to provide power or as an electrolyser (SOEC) producing hydrogen fuel to replenish a fuel cell, all while operating at lower temperatures to rival solid oxide units.

The Ceres operating model is simple yet attractive: develop technology and licence the rights to produce it commercially to large industrial companies in exchange for royalty payments. This makes for a scalable, capital light business. Ceres' first SOFC royalty revenues are due in 2024 when Bosch and Doosan bring production capacity online; Weichai is on course to bring capacity online in 2025. The SOEC side of the business took a back seat role until recently, when Ceres signed testing agreements with Shell, Linde and Bosch. Agreements with large, blue chip companies indicate potential for Ceres' SOEC to produce cost-effective green hydrogen. The big risks for Ceres are that other technologies evolve faster and better, or that hydrogen plays a minimal role in energy decarbonisation.

Please read the important notice on page 1.

Guest Editorial

Embracing change

Brian Tora, Chartered Fellow, CISI
Consultant

Illustration by Adi Kuznicki

To mark his final Prospects article before he retires, Brian Tora reflects on his 60-year career in the investment world and the stark changes the industry has undergone. Brian joined JM Finn in 2007; he has been a longstanding contributor to Prospects magazine and JM Finn's market commentaries, as well as many other publications and media outlets. Prior to his tenure at JM Finn, he worked for a variety of well-respected city firms, spending his career variously between working as an investment manager looking after private clients, and an investment communications specialist.

It was in mid-July in 1963 that, armed with seven 'O' Levels and two 'A' Levels, I alighted from the Central Line tube at Bank station to start my first post-school job with stockbrokers Grieveson Grant. I had not decided that the stock market was where I wanted to start my career. This firm was one of three that offered me a job as I left school, the other two being a shipping company and the Totaliser Board. Grieveson simply offered the highest starting salary.

Such is the degree of chance that surrounds those decisions made as you start out on life's working journey. I have never underestimated the amount of luck that was part of this important decision, made purely on economic grounds. And my luck continued. Having started as a back-office clerk, marking punch cards for the firm's computer (Grieveson Grant was very progressive as computers were a rare commodity in those days), I was given the opportunity to move to the floor of the Stock Exchange as an unauthorised clerk, or 'Bluebutton'.

“The Stock Exchange floor was being demolished as I spent my last days in the Exchange, to make way for a more modern building.

We were termed unauthorised as we were not authorised to deal in stocks and shares on behalf of our firm. And we were known as 'Bluebuttons' because that was the colour of the badge we wore carrying the name of the firm we represented. Then, dealing took place face to face. Communications were slow and news often took days to percolate down to the floor of the exchange. And regulation was relatively light, with the Stock Exchange itself taking primary responsibility for policing its members, much on the basis of knowing where problems might arise.

Contrast how we went about things then with the way in which dealing in stocks and shares takes place today. Back in 1966, when I was asked to return to the office to take up a job talking to clients, I said I really didn’t want to go. I liked the camaraderie of the floor of the Stock Exchange, but the senior dealer in our firm told me in no uncertain terms that the future did not lie on the floor of the market. So I went, initially to support those brokers dealing with institutional clients – pension funds, insurance companies and the like – and then to deal with private clients, which remained my role in some form or another for the rest of my career.

How right that dealer was. The Stock Exchange floor was being demolished as I spent my last days in the Exchange, to make way for a more modern building. This didn’t last too long. Face-to-face trading survived a few more years, but dealing on the telephone was becoming commonplace and soon trades were being carried out automatically – computer to computer. Today by far the bulk of stock exchange transactions are carried out in this way.

Back in the middle of the 1960s, as a junior investment manager, the options for investment on behalf of my clients were relatively limited. The Exchange Control Act of 1947 (ECA 47) restricted the ability to invest outside of the United Kingdom. And the use of Open Ended Investment Companies (OEICs), then known as unit trusts, was comparatively rare. Today OEICs, along with investment trusts, are quite likely to play a significant role in portfolio construction for private investors, while the choice of investments is positively global, ECA 47 having been abolished by the Thatcher government.

In 1994 I wrote a book – The Second Financial Services Revolution. The first had taken place some eight years previously: known as “The Big Bang”, it transformed the City out of all recognition, ending fixed commissions and eliminating the divide between brokers and jobbers (known as single capacity). It also opened the door for other financial institutions, both domestic and foreign, to acquire City firms that had until just a few years before operated as partnerships, with the partners carrying unlimited liability.

> Embracing change is important for investment managers and their clients.

The revolution that I wished to bring to everybody's attention was the way in which technological advancement was changing the face of investment just as dramatically as those events of 1986. In carrying out transactions, monitoring portfolio performance, carrying out investment research and even determining which shares to buy, computers were playing an increasing role. At the end of this book, I wrote a rather self-indulgent chapter in which I posited how a private investor might be constructing a personal portfolio fifty years in the future, based on the opportunities thrown up by technology. We are not yet thirty years since this was written, but already many of the developments I thought might happen have come to pass.

Don't get me wrong. I'm not holding myself out as a soothsayer. I missed out on some aspects of investing and made mistakes in other areas. But the overall message was on the button. Change is inevitable and will continue. Embracing change is important for investment managers and their clients. One of my favourite quotes comes from the eminent economist, John Kenneth Galbraith. He said: "There are two kinds of forecasters - those who don't know, and those who know they don't know." I'll make one forecast with confidence: change will continue.

DOWLAIS

Jack Summers
Research Assistant

PRICE
£1.14

52 WEEK HIGH-LOW
£1.48—£1.05

NET YIELD
0.0%

HIST/PROS PER
N/A/8

EQUITY MARKET CAP (M)
£1,555

Eagle-eyed readers may notice a new name in the FTSE 250. Dowlais span out of Melrose and incorporates the former automotive arm of historic British engineer GKN. Dowlais is comprised of three divisions; Automotive (drive train components), Powder Metallurgy (heat forming powdered metal into components) and the currently nascent Hydrogen business (energy storage).

Dowlais is a market leader that supplies 90% of global light vehicle manufacturers. While COVID-19-induced production lags vs 2019 levels have been damaging to growth and more significantly margins, recovery is expected in the coming years. Management are targeting c.4.5% of margin expansion, as global production recovers, costs normalise and the automotive market evolves towards electrification – current margins are just 6%.

The electric vehicle (EV) transition will present both opportunities and challenges to Dowlais. On average, an electric vehicle has 2.4 sideshafts per vehicle vs 2.1 on internal combustion engines (ICEs), which presents a greater relative growth opportunity for the business. In contrast, Powder Metallurgy produces components almost exclusively for ICEs with no obvious EV alternative – this could make the segment a drag on growth as ICEs are phased out in the coming years.

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.

Henry Birt
Assistant Research Analyst
(SEGRO, Shaftesbury Capital)

Sir John Royden
Head of Research
(GXO)

CONSUMER STAPLES
Haleon, Ocado Group

INFORMATION TECHNOLOGY
Halma

FINANCIALS
London Stock Exchange Group, Aviva, Beazley

MATERIALS
Croda International, Hill & Smith, Rio Tinto

HEALTH CARE
Oxford Nanopore Technologies, Smith & Nephew, Dechra Pharmaceuticals

REAL ESTATE
LondonMetric Property, British Land Company, Shaftesbury Capital, Supermarket Income REIT, SEGRO

INDUSTRIALS
GXO Logistics, Raytheon Corporation, BAE Systems, Spirax-Sarco Engineering

UTILITIES
Telecom Plus, National Grid

1.

GXO

Price **$63.97**
52 week high-low **$67.57 – $32.10**
Net Yield **0.0%**
Hist/Pros PER **38 /24**
Equity Market Cap (M) **$7,608**

Industrials
Neil Shelton (Head of Investor Relations), Richard Cawston (President Europe)

GXO are in logistics. They make their money by being great at setting up and running automated warehousing for their clients, such as Nestlé.

The Nestlé warehouse that I saw receives incoming goods from Nestlé's factories and then sends them out to customers' shops and warehouses. The warehouse is a vast and mostly robotically operated "big box" close to Derby. Other clients like LVMH and Nike use GXO to fulfil individual online orders and deal with returns; and this accounts for 35% of their business.

Nestlé could try to manage their own warehouse and distribution but it makes sense to outsource the job to specialists (like GXO). GXO have hundreds of clients and can share their expertise and learning amongst all their clients.

GXO's knowhow allows them to aspire to a 30% return on invested capital. They lease properties, but the cost tends to be passed through to the client. The company buy in robotics and automated warehousing systems made by companies like Swisslog but they do not own much of the IP or technology themselves.

GXO have strong revenue growth aspirations of 10% per annum out to 2027. They advised that tailwinds (factors that benefit a company's growth) include the fact that many supply chains are still not outsourced, which means that their total addressable market should grow from $456 billion to $660 billion by 2027. They conclude that the outsourced segment of that market will grow from $146 billion to $231 billion and so aspire to take their revenue from $8 billion to $17 billion over the same timeframe. This should drive a Compound Annual Growth Rate (CAGR) of 17%. The risks are that knowhow is a weak defensive moat which could allow margins to be squeezed.

2.

SEGRO

Price **£7.37**
52 week high-low **£9.68 – £6.69**
Net Yield **3.7%**
Hist/Pros PER **9.68/6.69**
Equity Market Cap (M) **£8,997**

Real Estate
Soumen Das (CFO), Claire Mogford (Head of IR)

SEGRO is a real estate investment trust (REIT) which specialises in urban and out of town warehousing. After a stellar two years in 2020 and 2021 following the pandemic-induced rush for warehouse space, property valuations were hit by rising interest rates. It was clear, then, that Das was pleased to report first half results that were relatively more sanguine. With interest rate rises having likely been baked into valuations, Das seemed more comfortable with where valuations sat. This was evidenced by a recent transaction where SEGRO was able to dispose of a portfolio of warehouses at a value above the December 2022 and June 2023 valuations. He expects future disposals will achieve at least current book values, giving him confidence that current values are broadly correct.

Aside from valuations, we also discussed the operational trends, which remain favourable even in light of the weaker macroeconomic environment. The period saw solid 5.1% growth in like-for-like rents and saw a 20% uplift on those leases coming up for review. Qualitative commentary from Das explained that the demand remains broad based, with the vast majority of tenants in good financial condition.

The big risk to the business remains the macroeconomic environment. If the most recent Consumer Price Index print transpires to be anomalous and core inflation reaccelerates, this would mean more interest rate hikes to come and more pain for SEGRO's property valuations. This is out of SEGRO's control though – and they seem focused on achieving good operational performance and improving the quality of their portfolio by using disposals of weaker assets to fund acquisitions and development.

3.

Shaftesbury Capital

Price **£1.18**
52 week high-low **£1.32 – £0.93**
Net Yield **2.7%**
Hist/Pros PER **NA/NA**
Equity Market Cap (M) **£2,277**

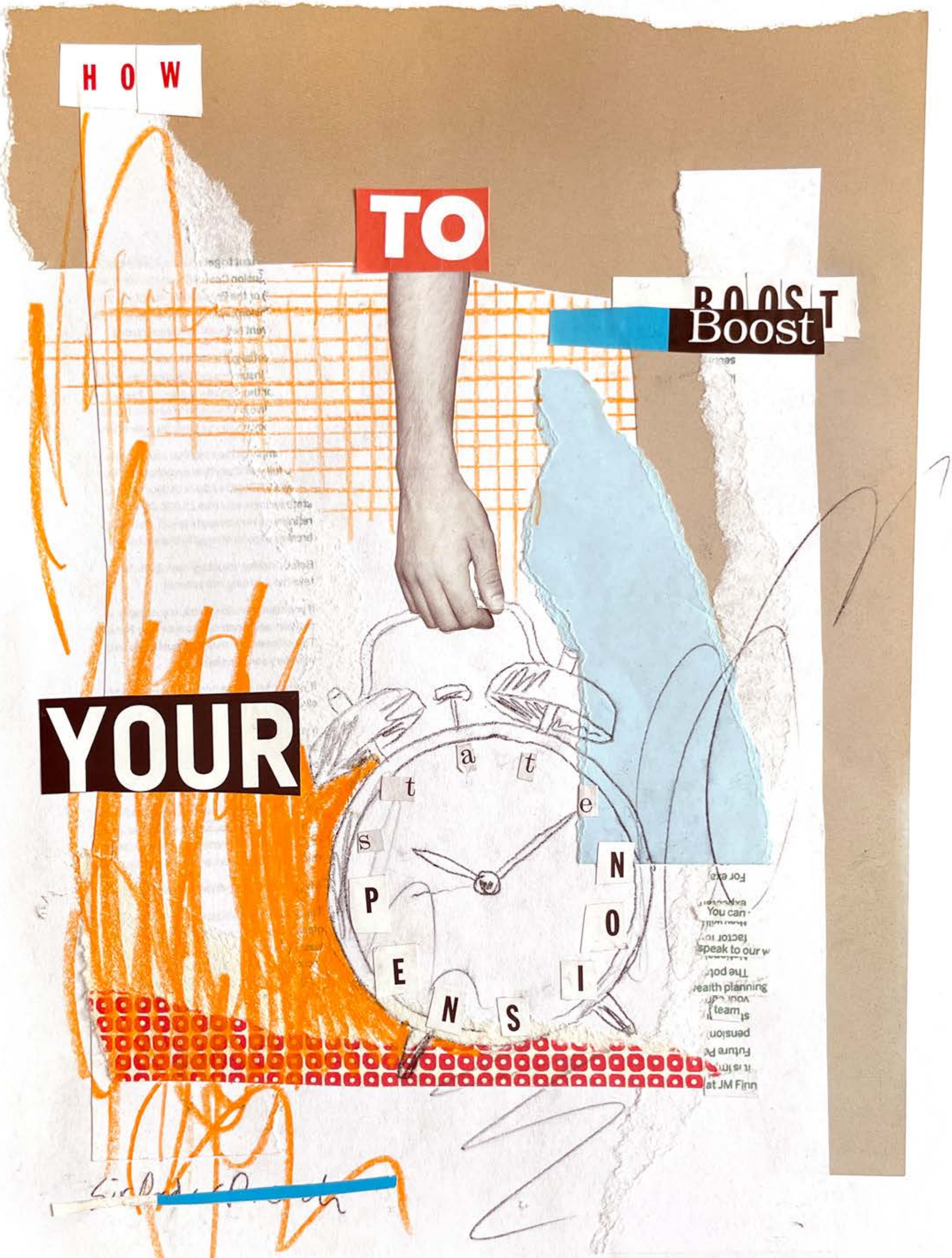
Real Estate
Ian Hawksworth (CEO), Situl Jobanputra (CFO), Chris Ward (COO)

Shaftesbury Capital was formed through a merger of two real estate investment trusts (REITs) at the beginning of 2023. Shaftesbury, a landlord which owned a £3.2bn portfolio in London's West End – including Carnaby Street and China Town – combined with Capital & Counties (CapCo), also a West End landlord, which owned much of Covent Garden with a £1.8bn portfolio. The continued integration of the two businesses continues to be a key topic in meetings with management.

Five months on, the integration appears to be going according to plan. One of the key benefits of the merger was £12m annual cost synergies and management were happy to announce progress on these and even increased the figure to £13.5m.

Shaftesbury Capital is not immune to the headwinds of rising interest rates and since the merger was announced the combined value of the portfolio has fallen from £5bn to £4.9bn. Falling valuations are all but inevitable when the cost of borrowing increases, but Shaftesbury Capital's relatively modest value decline can be attributed in part to the unique location of the land in its portfolio: as purse strings tighten it is surprising how resilient the West End continues to be. Sales at its underlying tenants are now 15% ahead of 2019 levels, driven by resilient domestic consumers and international customers. This helped the company increase its estimated rental values (a key input to valuations) enough to offset 10 basis points of yield expansion to leave the valuation unchanged since December. A key question for investors is whether this can continue. As interest rates continue to bite, we will be watching this closely.

Please read the important notice on page 1.


HOW
TO
BOOST
Boost
YOUR
state
PENSION

Wealth Planning in focus

Could you boost your state pension?

Rebecca Dawkins
Associate Wealth Planner

Illustration by Sir Radar Drench

Rebecca Dawkins, Associate Wealth Planner at JM Finn, explains the rules on topping up missing National Insurance years to potentially increase state pension income.

Many people have gaps in their National Insurance record, often due to career breaks or time out to care for children. Until recently it was only possible to pay to top up these gaps up to a maximum of 6 previous years; however, the government is currently allowing top-ups for missing years from the 2006/7 tax year to 2016 and has extended the deadline for this to April 2025.

If you have missing years in your National Insurance contributions, then you might be able to take action by paying Class 3 voluntary National Insurance contributions to potentially boost your state pension entitlement. You may benefit from making voluntary contributions if you are:

— Planning for retirement and looking to fill gaps in your National Insurance record;

— Employed but with low earnings;

— Unemployed and not claiming benefits;

— Self-employed but have not paid contributions due to small profits; or

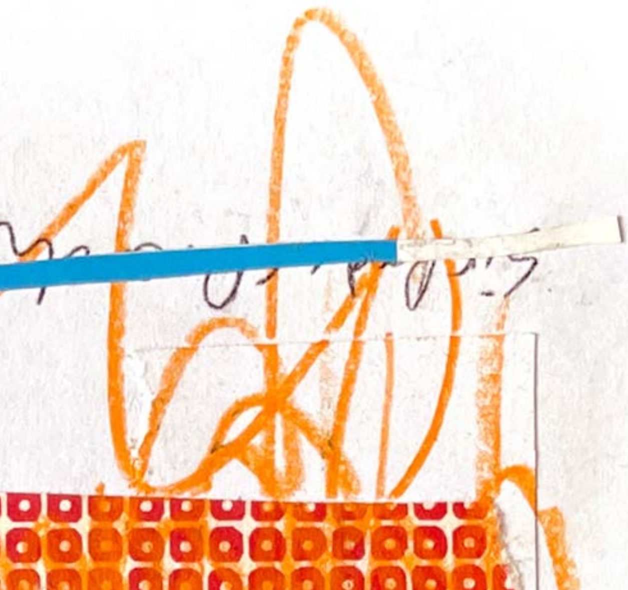
— Living or working outside of the UK.

The option to pay voluntary contributions should be carefully considered – it is not always the case that making payments will increase your state pension. They also cannot be refunded, so make sure you confirm prior to contributing. Whether you are below or above state pension age, it may be possible for you to top up missing National Insurance credits.

You will be able to claim the new state pension if you are a man born on or after 6 April 1951 or a woman born on or after 6 April 1953. The earliest you will be eligible to receive the new state pension is from state pension age. For those in their 40s to mid-60s the state pension age is currently between ages 66 and 68, depending on when you were born. You can check your state pension age here: https://www.gov.uk/state-pension-age, however the state pension age is now being regularly reviewed and linked to life expectancy.

You will usually need at least ten qualifying years on your National Insurance record to get any state pension. They do not have to be ten qualifying years in a row. The number of qualifying years on your National Insurance record affects how much state pension you will receive. In general, you need 35 full years of paying National Insurance to get the maximum state pension. The full new state pension is currently £203.85 per week or £10,600.20 per year.

> **You will usually need at least ten qualifying years on your National Insurance record to get any state pension.**



> **If you are aged roughly between 45 and 72, you may have the opportunity to 'buy back' any missing National Insurance years from 2006 to 2016.**

If you are aged roughly between 45 and 72, you may have the opportunity to 'buy back' any missing National Insurance years from 2006 to 2016. The deadline was extended from 5 April to 31 July 2023, and has now been further extended to 5 April 2025 due to overwhelming demand. In addition, the cost of paying voluntary National Insurance contributions will remain frozen until 5 April 2025. Class 3 voluntary contributions currently cost £17.45 per week or £907.40 per year. Topping up a partial year will cost less than £907.40 to make it a full year.

Previously, it was only possible to buy back up to six years of voluntary National Insurance contributions; however, when the new state pension was introduced in 2016, transitional arrangements were put in place to let you plug gaps back to 2006.

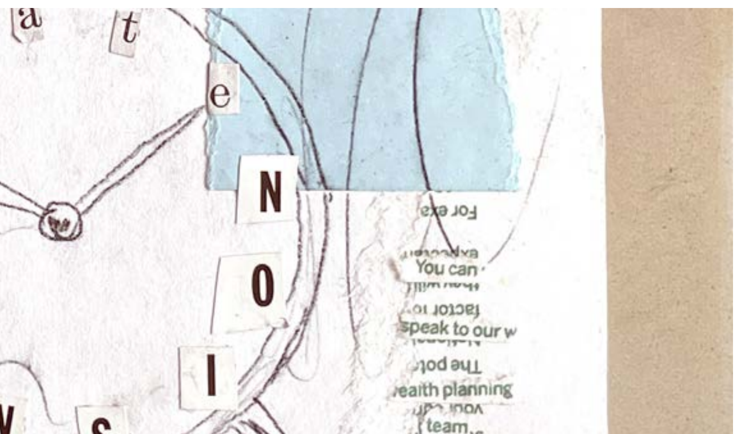
Firstly, you need to check whether you are missing any National Insurance contributions since 2006 here: https://www.gov.uk/check-national-insurance-record. If you have years missing, then you should use the state pension forecast here: https://www.gov.uk/check-state-pension to check your current entitlement and how much you are likely to get. You can then check free of charge if you can plug the missing National Insurance credits. There are a range of scenarios that build up National Insurance entitlement automatically, for example (though not limited to): caring for a child in the family, statutory sick pay, employment and support allowance, or jury service.

The potential gains to be made from buying voluntary National Insurance contributions are huge; however, a key factor for those thinking of using this option is whether they will live long enough to benefit: health and potential life expectancy should be taken into consideration.

For example, in the case that someone wanted to top up 10 full years' worth of contributions, they would have to pay £9,074 (10 x £907.40). The annual boost to their state pension would be £3,026.40, which over a 20-year retirement would equate to just over £60,000, with a breakeven point of roughly 3 years before tax.

Before making voluntary contributions, it is important to take the following into account:

- If you claim Pension Credit, any increase in the state pension would normally reduce your Pension Credit award. This often means that you could be no better off paying voluntary contributions.
- If you die before reaching state pension age, you are not eligible to any state pension.
- If you are in very poor health, or have a short life expectancy, because it normally takes a number of years to break even on your initial payments, you might not receive the benefit of an increased state pension in relation to your payment.
- You might be able to use contributions from your spouse, civil partner, late spouse or civil partner, or former spouse or civil partner, to improve your basic state pension, without the need to pay voluntary contributions.
- A higher state pension may mean you pay more tax.



"The triple lock ensures your spending power will not diminish over the course of your retirement.

The state pension is guaranteed by the 'triple lock', which means it will not lose value in real terms, and it increases at least in line with inflation. To make the guarantee even more secure, the state pension will increase in line with whichever is highest of three separate measures of inflation; average earnings, prices as measured by the Consumer Price Index (CPI) or 2.5%. Retirement can be for a period of 25 years or more, and over such a length of time, prices can increase dramatically. Therefore, the triple lock ensures your spending power will not diminish over the course of your retirement.

If you are below state pension age, contact the Future Pension Centre (here: https://www.gov.uk/future-pension-centre) to find out if you will benefit from voluntary contributions. If you have reached state pension age, contact the Pension Service (here: https://www.gov.uk/contact-pension-service) to find out if you will benefit from voluntary contributions.

You can speak to our wealth planning team at JM Finn for advice on whether topping up your National Insurance contribution payments could be the right option for you. Please contact your investment manager for further details.

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. All sources and figures quoted are accurate as at the time of publication.

JM Finn *News*

Plain sailing?

Ace of Blades preparation continues

Lizz Watson
Ace of Blades

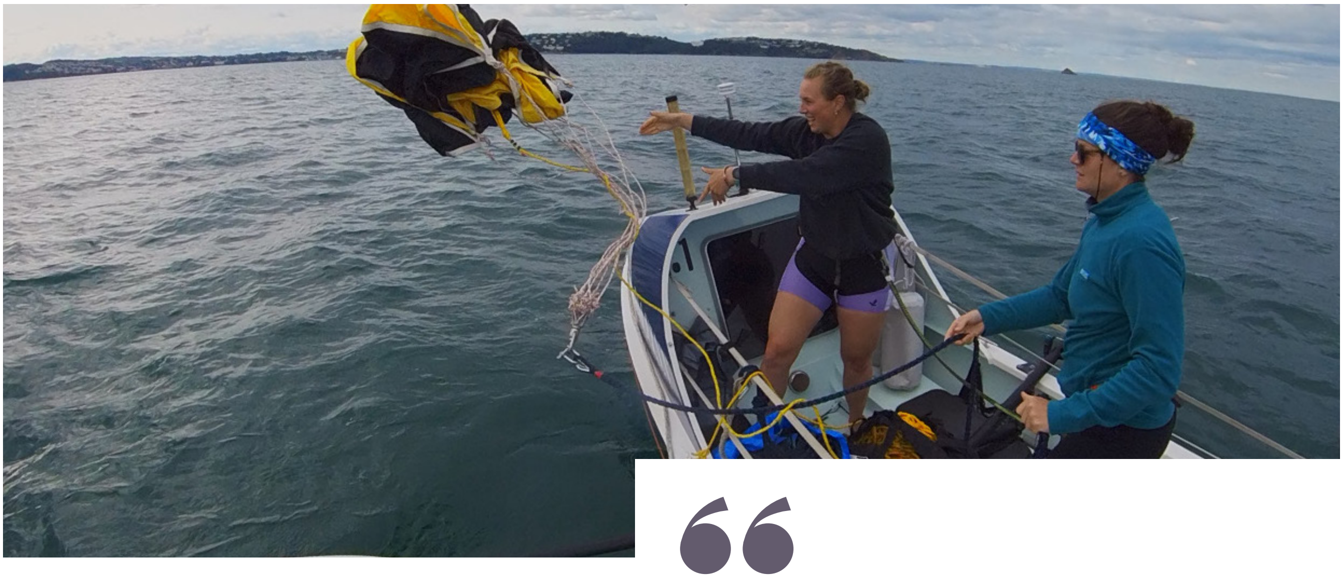
In the last Prospects, JM Finn Investment Manager Laura Langton covered the mental and physical preparations the team are undertaking for their upcoming 3,000 mile transatlantic row. This issue, teammate Lizz Watson gives an update on fundraising and their progress with meeting requirements for the minimum time spent at sea before the challenge begins.

We now have just a month or two until we start our Atlantic row, and only weeks until our boat ships to the start line in La Gomera in the Canary Islands. The pressure is well and truly on as we prepare for the World's Toughest Row – Atlantic 2023, and it's been a very busy couple of months since Laura Langton's first update in Prospects.

Throughout June and July Ace of Blades were on a road trip of sorts with our boat, the SS1. First, we visited the Cheltenham Science Festival, where we captured the imagination of countless children and young people with just how many aspects there are to an adventure like ours. Next, we headed to the Henley Royal Regatta, which proved very successful from a fundraising perspective. We were able to sell lots of raffle tickets, and we're very grateful to our sponsors JM Finn and Knight Frank for donating some excellent prizes for this (head to teamaceofblades.com/raffle for more information).

We completed the road trip with a sponsored row hosted by JM Finn in Queen Square, Bristol. This was an excellent opportunity for us to meet more of the JM Finn team, as well as others who live and work in and around Bristol. We had a busy lunchbreak as people flocked to ask questions about the boat and our challenge. The refreshments provided by JM Finn were gratefully received, especially by those who jumped on the rowing machines to help us cover 75 miles, our average daily target for our Atlantic row.

Events complete, Ace of Blades have since been focused firmly on training, spending as much time as possible on our boat. There is a minimum number of hours we must achieve to take part in the challenge: 120 for each person, 72 hours as a full team on board, at least one 36-hour row, and 24 hours of rowing at night.



At the time of writing, we are well over halfway to meeting these minimum requirements, but there have been some frustrations. I'm sure everyone is aware how terrible the weather has been throughout July and into August! While we don't shy away from heavy rain and the cold, we do have to be mindful of the wind during training rows.

Strong winds will be unavoidable during our Atlantic crossing and there is no doubt we will encounter them going in the right and wrong directions. Logic would dictate that we should learn to deal with these conditions during training. However, put simply, there are no rocks to hit in the Atlantic. The safety officers for the race organisers, Atlantic Campaigns, are very clear in their messaging that rowers should not put themselves at risk during training. If you need to be rescued by the RNLI, not only have you endangered yourselves, but also the lifeboat crew. Previous rescues of ocean rowing boats have inevitably ended up on local, and sometimes national news. It's not a good look for the team, World's Toughest Row, sponsors or the sport in general.

We are very lucky to be keeping the SS1 in Exmouth Marina. The Harbour Master, Steve, is also a Coxswain for the Exmouth RNLI and his advice on whether to head out on the water has been invaluable. With the option of training out of Exmouth or towing the boat round to Torquay, we have had good options when considering wind conditions and tides. I think we've done exceptionally well to get the hours under our belt without putting ourselves at risk unnecessarily, and our plan is still to surpass the minimum time requirements by as much as possible.

> **There is a minimum number of hours we must achieve to take part in the challenge: 120 for each person, 72 hours as a full team on board, at least one 36-hour row, and 24 hours of rowing at night.**

While on the boat we have been learning and practising using different equipment such as our electrical systems, para-anchor and steering systems. We're also working out what lives where, who sleeps where, and going through processes such as man overboard drills, power management and cooking.

I'll finish with some excellent news: Ace of Blades have been working hard to secure more partners to help fund our campaign, and we have now been able to pay off the remaining balance on our boat! We only have a little way to go until we are fully funded. Once we are, all of the money we raise from selling on our boat and equipment will be donated to our charities, getting us very close to our £60,000 target for Macmillan, Prostate Cymru and the Outward Bound Trust. This will make this gruelling challenge all the more worthwhile.

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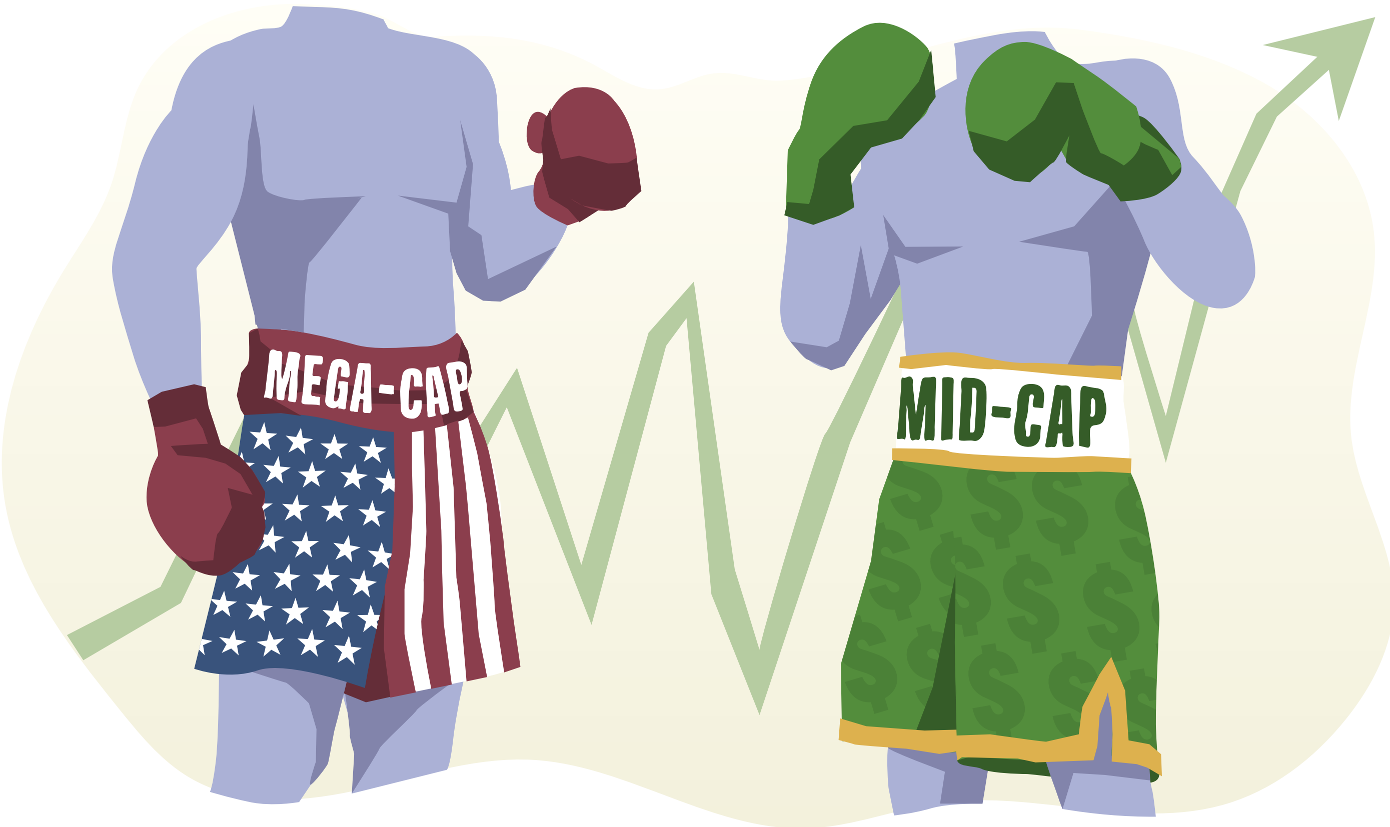
Follow us @teamaceofblades on Instagram, Facebook and LinkedIn, and we will post details of how to track our passage across the Atlantic on teamaceofblades.com.

Collectives commentary

Mighty mid-caps



While a handful of global heavyweight US companies currently dominate the headlines, market conditions could benefit the less glamorous US mid-cap sector in the future.

Jon Tredgett, Portfolio Manager
Findlay Park Partners LLP

Illustration by Adam Mallett

Understanding US company 'cap' sizes

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

Mega-caps: companies with a market capitalisation (value) of US$200 billion or higher.

Large-caps: US$10 billion–US$200 billion.

Mid-caps: US$2 billion–US$10 billion.

Small-caps: US$250 million–US$2 billion.

In the US, just 8 companies known as the 'Mega Cap 8'– Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, NVIDIA, and Tesla – currently represent roughly 60% of the total performance of the 1000 largest companies in America, which are tracked on the Russell 1000 Index. Against this backdrop of extraordinary concentration, it has become increasingly important to try to find diversification in equity investing.

The narrowness of the market's performance so far in 2023 reflects the excitement around artificial intelligence (AI) that has dominated headlines and driven the technology-heavy Nasdaq Index up 38% year-to-date. By contrast, the S&P Midcap 400 and Russell Midcap indices are both up by a more modest 13%.

The Mega Cap 8 compounded revenue at an average of over 25% per year over the last decade. Should that continue, their revenues would expand from about $1.7 trillion today, to almost $17.7 trillion in ten years' time – up elevenfold. For comparison, total US GDP currently stands at $26.8 trillion today. Growth among the Mega Cap 8 could potentially be lower in the future however, due to factors such as regulatory scrutiny (which is an increased focus for the current US administration) and competitive intensity – as companies increasingly challenge each other in the same areas of evolving technology applications.

We believe that better risk-adjusted opportunities can be found elsewhere in the US. Mid-cap companies have underperformed their larger cap counterparts for the past decade, particularly in the past 5 years. Valuations of mid-caps have become more attractive, with the relative price-earnings (P/E) ratio of the Russell Midcap Index versus the Russell 1000 Index continuing to decline since its peak in 2013. It now sits near its lowest level since 1999.

Sources:
All performance data as at 31st July 2023.
Mega Cap 8 revenue data from FactSet using last 10 fiscal years.

There are a number of other factors at play that are likely to benefit mid-cap companies in the future. Biden's steely vision to establish the US as a self-sufficient economy has led to the enactment of a comprehensive set of legislation, aimed at addressing a broad set of priorities. The Inflation Reduction Act has supercharged investment through Federal government incentives into America's industrial base. The most obvious beneficiaries of this are 'real economy' companies – i.e., companies that tend to be more mid-sized and domestically focussed, feeding products and services into the wider economy.

The US government's efforts to onshore more manufacturing activity are likely to disproportionately benefit smaller and mid-sized companies that have not built out their global supply chains to the same extent as many larger companies. While the Mega Cap 8 navigate the increasing complexity of global supply chains and diverging global regulation, domestically focused mid-cap companies are well positioned to benefit from generous government financial support – with a huge market of domestic consumers, and US energy independence keeping costs competitive. There is also a remarkable degree of bipartisan political consensus behind the commitment to reindustrialise America.

Moving down the market cap spectrum does not necessarily come at the cost of quality. Mid-caps offer diversified exposure to the broader US economy – an economy that continues to prove its resilience through its deep capital markets, abundant labour supply, and energy self-sufficiency. Many of these companies are well traded, liquid, and are often under-researched.

Whilst shorter-term market headwinds may continue, the next decade could look quite different to the last, where the performance of the US equity market may broaden beyond a few dominant growth companies.

Please read the important notice on page 1.

Stock in focus

Danaher

Michael Bray, CFA
Senior Research Analyst

Illustration by Emily Nault

Danaher was established in 1984 and initially consisted of a group of discrete manufacturing businesses.

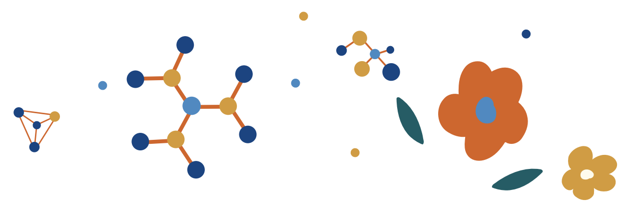
The underperformance of a subsidy, Jacobs Vehicle Systems (JVS), proved to be an 'eureka' moment for the group. JVS had been suffering from quality challenges and intensifying competition. To rectify these issues, management travelled to Japan to shadow and learn from the best in lean manufacturing at that time –Toyota Motor Corporation.

Toyota employed a business philosophy of continuous improvement, known as Kaizen. When JVS' management applied Kaizen, the improvement in operating performance was dramatic, far exceeding expectations and made them one of the first US companies to adopt lean manufacturing.

The implementation of these practices led to the development of the Danaher Business System (DBS). Part cultural philosophy, part managerial platform - DBS drives the business through a never-ending cycle of change and improvement. Underpinning it are the four "Ps": exceptional *people* develop outstanding *plans* and execute them using world-class tools to construct sustainable *processes*, resulting in superior *performance*. Superior *performance* and high expectations attract exceptional *people*, who continue the cycle.

This system of planning and execution remains fundamental to how the company operates today, and over time has been supplemented by growth and leadership tools. Danaher views DBS as its ultimate source of competitive advantage, allowing it to continue to improve the operations of both its existing businesses and the businesses it acquires. Over the past five years, revenue and earnings per share growth have compounded at +11% and +22% respectively. Around two thirds of its growth has been organic and the remainder has come from mergers and acquisitions (M&A).

Today, Danaher is a very different business from its start in the industrial sector. It is now a global science and technology conglomerate with more than 20 operating companies focused on biotech, life sciences and diagnostics. The Environmental & Applied Solution division is expected to be spun off in the fourth quarter of 2023. These companies develop, manufacture and sell thousands of different products and services to many different customers, providing the group with a diversified sales base.



> **Aside from their large size and high growth rates, Danaher's decision to operate in science and technology markets is due to their fragmented nature: many niche markets and no one player dominating.**

PRICE
$265

52 WEEK HIGH-LOW
$294.60—$221.22

NET YIELD
0.4%

HIST/PROS PER
31/30

EQUITY MARKET CAP (M)
$195,663

The pivot to these sectors has meaningfully improved Danaher's business quality from debt-heavy cyclical industrials to more predictable, structurally growing science and technology companies. Supporting its growth is the biopharma industry's increasing investment in the development and use of biologics (more targeted drug treatment), cell and gene therapies (treating inherited diseases), and molecular diagnostics (analysing the genome to identify the potential emergence of disease).

Such businesses also have good earnings visibility: over 80% of Danaher's revenue is recurring thanks to a largely razor/razor blade business model.[1] For example, Cytiva (a business which sits in Danaher's biotech division) sells chromatography systems – used to separate components of a mixture for chemical analysis – and generates recurring revenue from the resin needed for each use of the system.

Aside from their large size and high growth rates, Danaher's decision to operate in science and technology markets is due to their fragmented nature: many niche markets and no one player dominating. Such market structures allow Danaher's competitive advantage, DBS, to have an outsized impact versus smaller peers who have neither the scale nor experience to match Danaher's rate of innovation and profitability.

Danaher navigated into these markets with a shrewd M&A strategy. When entering a new market, Danaher typically starts with a large platform acquisition (i.e. scaled business which is already performing well) which serves as a centre of gravity for making smaller, bolt-on acquisitions.

When the COVID-19 pandemic hit, the biopharma industry raced to diagnose and treat the virus, massively increasing their demand for equipment and consumables: Danaher saw its organic sales rise c.44% from 2019 to 2022. What was a tailwind for the business has now become a headwind[2]. Many biopharma firms boosted their inventory levels during the pandemic, in anticipation of more sustained demand, but with the pandemic over, they are running down their excess inventory and are reducing order sizes. This has not been helped by the rapid hike in global interest rates over the past year and a half, which has caused funding for early stage biotech firms to dry up. These headwinds have been more pronounced than even Danaher's management had expected, forcing them to downgrade 2023 financial guidance in each of the last two quarters; consensus now expects earnings per share to decline by -18% this year.

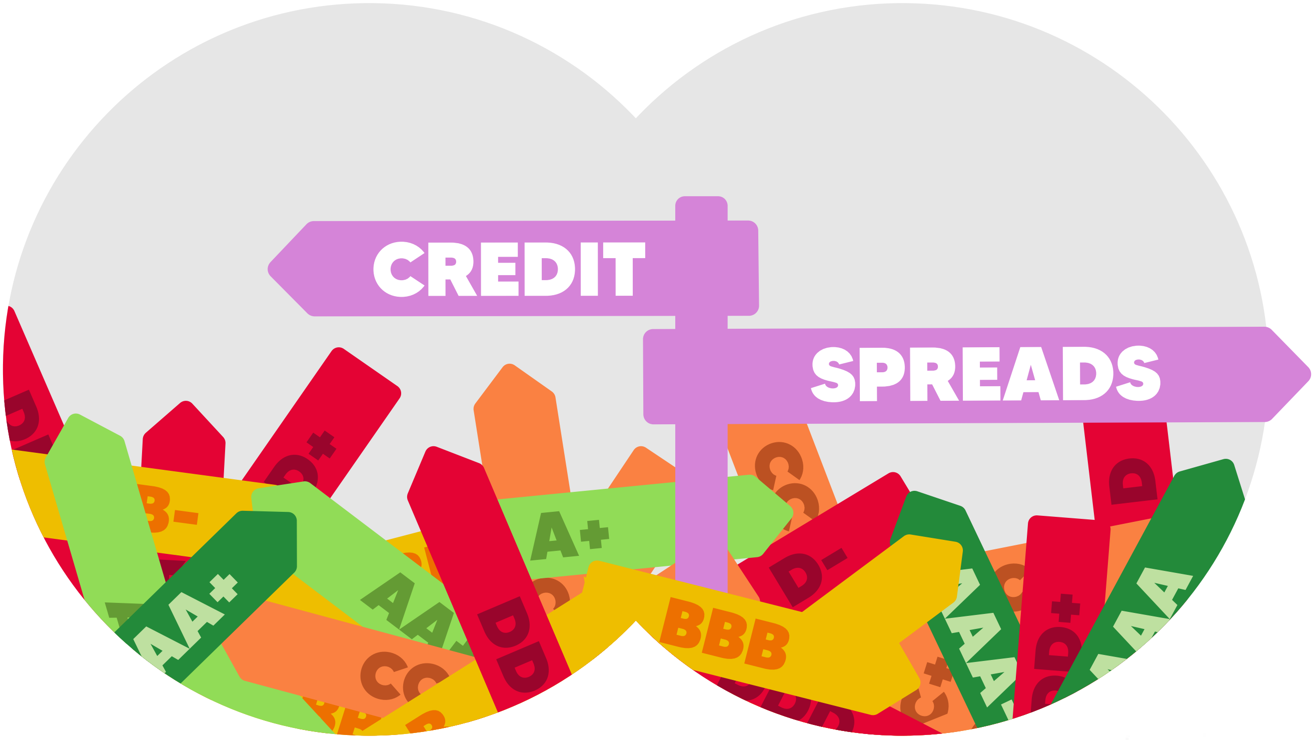
Although the long-term outlook for Danaher's end markets remains encouraging, there is still uncertainty over when the near-term headwinds will ease. With a valuation of 29x December 2023 earnings, such concerns do not appear to be fully reflected within shares.

Please read the important notice on page 1.

[1] A razor/ razor blade business model is one where a product or service is sold at cost or at a low price, while a secondary product or service needed to facilitate regular use of the original product is sold at more elevated prices.

[2] 'Tailwinds' are factors or events that have a positive impact on growth in a company or sector. Conversely, 'headwinds' have a negative impact.

Bond Focus



Jack Summers
Research Assistant

Illustration by Darren Richards

Hard or Soft Landing?

In the last edition of JM Finn Prospects (Summer 2023), Head of Research, Sir John Royden, discussed bond strategy, explaining how credit ratings split bonds into investment-grade and high-yield categories and how investors might look to position themselves through the economic cycle. Given the 10-year gilt yield currently sits at 4.38%, are credit spreads wide enough to warrant reaching for the extra yield given by investing in corporate bonds?

A 'credit spread' is the difference between the yield on a corporate bond and a government bond with equivalent duration. The additional yield from corporate bonds compensates the investor for taking on the additional risks associated with corporate debt compared to sovereign debt, which is often seen as lower risk. The lower the credit rating, the wider the spread and vice versa. For example, the 3-5 year UK Corporate Bond Spread is currently at 1.03% or 103 basis points for AAA-rated corporate debt securities, and 228 basis points at BBB. Credit spreads widen and narrow through time to reflect market views on implied default rates[1], corporate ability to service debt and the attractiveness of owning comparatively lower risk government debt. In 2009, amidst the Global Financial Crisis, the UK 3-5 year spread on A-rated corporate debt reached 800 basis points. In contrast, during 2021 ultra-low interest rates and ample COVID-19 support cash in the economy, we saw the same UK 3-5 year spread on A-rated debt narrow to just 72 basis points or 0.72%.

[1] 'Default rate' is the percentage of all outstanding loans that a lender has written off as unpaid after a prolonged period of missed payments.

What do we think of credit spreads right now? First let's consider the two main widely discussed outlooks for the economy: a hard landing or a soft landing. The 'hard landing' view is that the current interest rate hiking cycle being employed by central banks to stamp out persistent inflation has been so aggressive that it causes a deep recession. 'Hard landers' would argue that spreads are not wide enough – a deteriorating economy will cause a corporate earnings recession which will lead to a higher rate of corporate debt defaults. As a result, credit spreads would widen due to the perception of increasing corporate risk (corporate yields increase) and greater demand for government bonds as a safe haven asset (sovereign yields decrease).

In contrast, the 'soft landing' theory is that central bankers have judged rate rises well enough to dampen inflation and that an elevated R* (real neutral interest rate[2]) and resilient economy could combine to avoid a deep recession. This scenario would be relatively more favourable for corporate debt than a hard landing, as there would be fewer defaults. 'Soft landers' argue that current credit spreads are wide enough and that with the market forecasting interest rate cuts from central banks shortly, no meaningful recession imminent and corporate balance sheets well-fortified, investors should be locking into the yields currently available in the corporate debt market.

At present, credit spreads, particularly investment grade BBB and high yield, appear to be pricing in a soft landing. Spreads are currently narrower than we would expect if a deep recession was expected. With the macroeconomic outlook uncertain and economists split on its direction, time will tell if the corporate bond market has got the soft landing call right.

[2] The 'real neutral interest rate' is an estimated rate of interest (excluding inflation) that exists when there is full employment and stable economic growth.

TELECOM PLUS

Henry Birt
Assistant Research Analyst

PRICE
£15.90

52 WEEK HIGH-LOW
£25.30—£14.42

NET YIELD
5.1%

HIST/PROS PER
18/15

EQUITY MARKET CAP (M)
£1,262

Telecom Plus is better known by its trading brand, Utility Warehouse (UW). UW offers energy, broadband, mobile and insurance services. UW provides a simple platform on which consumers can track nearly all of their utilities. To offer this, they partner with utility providers and white label their service.

UW is distributed through word of mouth and has a referrals program instead of a large sales and marketing team. They have found this to be the best way to get users to commit to the arduous transition away from their existing providers and they consider this network to be a competitive advantage.

UW argues that by operating in four markets, compared to their competitors operating in one or two, they gain a structural cost advantage by spreading the cost over multiple services.

Before the war in Ukraine sparked the spike in energy prices, UW had struggled with irrational pricing from new entrants in the energy markets. Now though, following the exit of many suppliers in 2022, this problem has faded. We wait to see if UW's customer numbers benefit.

Please read the important notice on page 1.

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

Communications

We have seen a faster than expected unwind in digital demand from peak levels reached during COVID-19. Online gaming spend is expected to moderate as player engagement reduces. Digital advertising spend is also contracting. The telecommunications subsector may prove more resilient, but represents a small weighting over the overall sector.

Consumer Discretionary

Consumer sentiment is weak. The cost of living crisis is squeezing disposable income, with higher necessary outlays on food and energy hitting discretionary spend. Higher interest rates are pushing up mortgage and rental costs in addition to the cost of unsecured borrowing, which is discouraging credit card spend.

Consumer Staples

Sector valuations look fair. Whilst the sector faces rising input cost inflation, which has hurt gross margins, we have seen evidence of inflation passing through to customers. Rising bond yields have the potential to hurt valuation multiples, but the deteriorating macroeconomic backdrop is of more concern, so focus is more on the earnings resilience of the sector.

Energy

Investors are focussed on short term supply as Russia faces ongoing constraints on its exports of oil and gas. Economic uncertainty has increased during the year, and with energy prices heavily correlated to GDP, we are now less constructive on the performance of the sector. Capital returns to shareholders should nonetheless remain strong.

Financials - Banks

The fear of contagion from the succession of bank failures has diminished, which leaves us once more with the balancing act of understanding the negative drivers of higher credit losses into an economic slowdown vs the prospect of more persistently high interest margins. Interest rates look to be close to peaking, leaving us with a near-term net positive view for this sector.

Diversified Financials

We change our stance to neutral in light of higher inflation and interest rates, which we expect to dampen financial assets.

Insurance

Normally, life insurance performs better with higher interest rates as long-term liabilities are lowered and prospective fixed income investment returns increase. The yield curve is currently inverted, meaning investment returns are lower. General insurance also appears to be benefitting from stronger insurance pricing, leaving us neutral on this sector.

Health Care

The resilience of global healthcare spend means this sector offers growth and defensive attributes. The sector has outperformed over the past year, and should continue to, as pharmaceutical and medical technology companies exhibit good relative earnings growth at reasonable valuations.

Industrials

Geopolitical uncertainty has benefitted the earnings outlook for defence exposed names. Yet, a higher proportion of companies have more cyclically exposed industrial end markets, and these firms have held up better than expected. Recent earnings results confirm a strong industrial backdrop, resulting in our more positive view on the sector.

Information Technology

Many technology names are increasingly viewed as non-discretionary, however valuation will be the bigger short-term driver of performance. The recent sector rally means valuations are elevated. Higher levels of inflation could persist and many expect to see further interest rate hikes. Given the sensitivity of the sector to interest rates, we believe it prudent to be positioned underweight.

Materials

The short-term outlook is very uncertain, however the markets have rallied on Chinese reopening optimism. At company level, balance sheets remain strong. Longer term, we remain bullish on energy transition metals, e.g. copper, but flag short-term weakness. The neutral rating is driven by the expectation of strong dividends.

Real Estate

The rise in interest rates is now feeding through to valuations. As rates rise, so do property yields and this is offsetting any growth in rental income as a result of inflation-linked leases. It seems likely there will be further valuation declines to come, although much of this has already been priced in, hence our neutral stance.

Utilities

The sector has inflation protection built into regulatory models, which should protect companies from input cost increases and margin pressure. Yet we are cognizant of the bond proxy nature of the sector and, with the uncertainty surrounding interest rates, remain neutral and would want to see peak rates before becoming more positive.

Asset Allocation

Overweight Neutral Underweight

UK EQUITIES	
UK	The UK trades at cheaper PE multiples than its international peers. The FTSE All-Share is on 11x next year's profits compared to the S&P500 on 19x and Europe on 14x. Higher UK inflation is an issue because it drives higher interest rates and slower growth. UK inflation is on course to peak higher than US and Europe and to decline with a lag behind the others.
INTERNATIONAL EQUITIES	
North America	The American market looks expensive. The jury is still out on whether the USA is heading into a recession or whether the consumer supports the economy enough to avoid a recession and growth stocks being hit with persistently higher rates. Downgrades to the credit ratings of US banks serve to remind us of the fragility of this sector.
Europe	Monetary policy is tightening gradually and the labour market has spare capacity, which means that rates should peak at a lower point relative to others. Europe is also helped by reshoring back to the continent's traditionally strong manufacturing economy. The largest potential risk to a European recovery is higher gas prices as we move into the winter, which would stall industrial output.
Japan	Japan has had a weak quarter and we have now upgraded back to overweight. The Bank of Japan has recently moved its yield curve control for the ten-year bond from 50 basis points (bps) to a range of 50 bps to 100 bps, which should support the yen. High inflation expectations should also help the yen. Japan is a beneficiary of an exit from deflation. Dividends and buybacks are accelerating as companies return cash to shareholders. Inflows could increase further.
Asia Pacific	Asia Pacific is heavily influenced by China and recent Chinese data has been poor, so China may act to stimulate the economy. The Chinese look as if they will miss their 5% GDP target for 2023. Vietnam continues to be the primary beneficiary of the diversification of supply chains from China.
Emerging Markets	Equity valuations look cheap relative to developed markets. Central banks have tightened policy ahead of developed markets and should be first into a recession. A strong USD would be a headwind for emerging markets.
BONDS	
Conventional	It looks as if we are close to the peak of interest rates, and there may be some attractive high yields available in short-dated gilts. That said, buying longer-dated gilts could also act as a recession hedge.
Index Linked	With a positive real return, linkers are once more a valid protection against inflation. If inflation proves stickier over the medium term, shorter-dated inflation-linked bonds should do well.
Corporate	Spreads of corporate bonds over government bond equivalents have stabilised at a point where they appear unlikely to discount the effects of an economic slowdown or recession on default rates.
CASH	
Cash	We are now underweight cash as we see good opportunities in the equity and bond markets.
PROPERTY	
Property	The expectation of regular income from rent is a positive. But on the other hand, fear of recession, tenant defaults and lower demand for property keep us underweight.
ALTERNATIVES	
Alternatives	Less correlated opportunities and more market neutral hedge fund investments could be sought after. These could include gold as a diversifier, inflation hedge and a way to reduce currency debasement risk.

Why choose a retirement mortgage over equity release?

Alastair Hazell
Banking Director at Hampden & Co.

Illustration by Adi Kuznicki

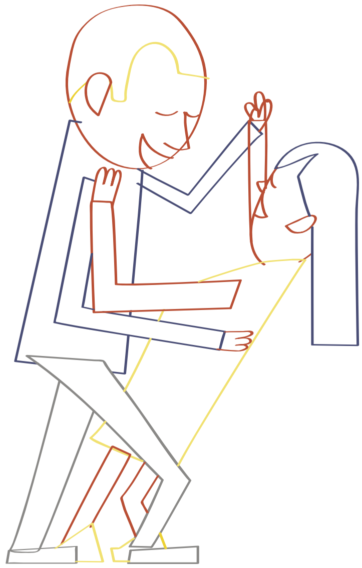
When people in later life borrow money against their property, should they opt for traditional equity release or an interest-only retirement mortgage? It depends on their circumstances, says Alastair Hazell, Banking Director at Hampden & Co. If they're borrowing out of choice rather than necessity, he believes it's retirement mortgages all the way.

For more than three decades, scientists at Finland's University of Jyväskylä have been carrying out tests on people in their late 70s. Every time they check a new cohort, they note significant advances – findings that are backed up by research elsewhere in the world. Men and women aged 75-80 now have significantly stronger muscle strength, reaction speed, reasoning abilities and working memory than previous generations. Most 75-year-olds today are much 'younger' than their grandparents were at the same age.

What has this got to do with retirement mortgages? Well, in the UK, older high net worth clients are often living a full life and are less inclined to downsize from their family home. In terms of their finances, they may have a strong investment portfolio or the sort of final salary pension scheme that their children or grandchildren could only dream of. And in many cases, they may still be working – not because they need to, but because they enjoy it.

Meanwhile, as property price inflation continues to outstrip salary increases, they see younger members of their family struggling to get a foot on the property ladder – and they want to help.

That could mean cashing in on some of their investments. However, the return on those investments may be something that they're reluctant to abandon, particularly when capital gains tax comes into play. So, attention may then turn to what is often their biggest asset – their home, and the option of equity release.



“Most 75-year-olds today are much ‘younger’ than their grandparents were at the same age.

We know that traditional equity release is attractive for those who need to raise money for their retirement, perhaps through a pension shortfall. But clearly, it can come with risks and caveats. Obviously, the interest rolls up, and you end up paying interest on interest, which can prove significant as it eats into the equity of your property. Indeed, if someone taking out equity release in their 60s lives into their 90s, there may be nothing left to hand on to the next generation when their life comes to a close.

For clients in the fortunate position of approaching later life borrowing through choice rather than necessity, it would be difficult to suggest that traditional equity release is a good option to pursue. In these circumstances, a much more attractive alternative is an interest-only retirement mortgage, where the client retains the certainty of protecting their equity.

Of course, with this product, they will initially pay a higher rate of interest than is charged on an equity release mortgage, but they will pay less interest in the long term. Furthermore, for many of our clients, the interest they pay on a retirement mortgage may be lower than the return being generated on their investment portfolio, making it a better choice than cashing those investments in.

That frees them up to gift money to children or grandchildren, and the reassurance of knowing the equity that is left in their home helps significantly with general financial planning and practical conversations with the wider family.

Incidentally, when I’ve arranged retirement mortgages for clients, I’ve often worked closely with their wealth manager. If good financial planning is all about helping people to get to wherever they want to be while protecting their wealth, this type of mortgage fits in well.

A number of the clients that have approached me about interest-only mortgages had also initially been knocked back by mainstream lenders. For instance, they may have taken out an interest-only mortgage several years ago and are then instructed to repay the balance at the term’s end. When they ask for a mortgage extension, they’re told that they’re too old – even though they may still be working and have a good salary or a strong and enduring income stream which is not dependent on employment, typically from their investment portfolios.

Larger lenders will probably say that they need these cut-off points due to the sheer volume of mortgages they’re processing. But people fall through the gaps, which is where smaller, more flexible lenders can help.

In our case, clients who are still working in later life can take out an interest-only mortgage. And if they’ve retired, they can take out a retirement mortgage. The rates are similar and there's no cliff edge when it comes to the number of candles on their birthday cake. After all, the research shows that 80-year-olds are sharper now than ever.

www.hampdenandco.com

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

Understanding Finance

OPERATING LEVERAGE

Henry Birt
Assistant Research Analyst

When screening companies we often look for something called operating leverage. A business has a high degree of operating leverage when a high proportion of its costs are fixed: whether the company sells one item or 20, these fixed costs don't change much. As a business grows, its cost base won't grow proportionally with sales and so the costs are spread over a greater number of units sold and thus the cost per sale falls. This leads to rising margins and has the effect of letting profits grow faster than sales.

For an example, imagine a fictious software company. Software companies often exhibit operating leverage as the fixed cost of producing the software – think research and development (R&D) costs – are relatively high, but the incremental variable cost associated with selling one more software license is almost nothing. As the software company sells more licenses, the cost of producing the software is spread over more and more units and thus the cost per unit falls and margins increase.

To flesh this out, imagine the software company makes £100m sales in year one and has £30m of fixed costs and £50m of variable costs. In year one, profit is £20m, so the margin is 20% (£20/£100m). If sales increase 10% per annum over five years and we assume variable costs grow in line with sales, but fixed costs remain the same, sales will increase to £161.1m but costs will only increase to £110.5m, leaving profit of £50.6m or a 31% margin. If instead we assume the same total costs but only £10m are fixed with the remaining £70m variable, that same 20% starting margin only expands to 24% over the five-year period.

SYNOPSYS

Michael Bray, CFA
Senior Research Analyst

PRICE
$458.89

52 WEEK HIGH-LOW
$468.03—$267.00

NET YIELD
0.00%

HIST/PROS PER
69/41

EQUITY MARKET CAP (M)
$69,790

Technological progress is being driven largely by advancements in semiconductor chips, which allow ever more computing power to be utilised. The most advanced integrated chips contain hundreds of millions of transistors, the positions of which have been carefully designed to optimise performance. It would be difficult to design and test such chips without software from Synopsys, or peer Cadence Design Systems, which collectively command over 60% market share in the electronic design automation market.

Synopsys also sells semiconductor intellectual property, which customers use as components of larger chip designs rather than designing those circuits themselves – offering optimised applications for specific requirements such as mobile and cloud computing. By automating highly complex chip designs and reducing defects that could lead to costly errors, Synopsys' tools have become mission critical for chip designers, allowing the business to enjoy high recurring revenue from 'sticky' customer demand. A potential risk to the business could come from open source software, but with Synopsys' research and development budget at 35-40% of its revenue, the barriers to would-be competitors remain high.

Please read the important notice on page 1.

Meet the manager

William Smyth-Osbourne

Senior Investment Manager, London

Lives Shepherd's Bush, London

Family Married to Sally, and expecting our first child as this magazine goes to press!

Started at JM Finn November 2013

If you weren't an investment manager Professional Polo Player – I played growing up and the sport is exhilarating and addictive. But, despite the perceived glitz and glam, it doesn't pay the bills

Favourite sporting moment Sunday 14th July 2019 – England won the ICC Cricket World Cup, Djokovic and Federer battled out an epic five set Wimbledon Final, and Lewis Hamilton won the British Grand Prix. It was also the day I met my wife

Dream dinner party guests Daniel Kahneman (psychologist), Cicero (Roman statesman), Susie Wolff (former motorsport driver)

Preferred music Indie rock of the 1990s/2000s – Arctic Monkeys, Two Door Cinema Club, Alt-J, Guillemots

Hobby/pastime All manner of sport, but particularly golf, tennis, running, and increasingly padel

Fondest memory My wedding day in January 2022, at my parents-in-law's home in the foothills of Mt. Kenya

In addition to being a Senior Investment Manager, you are also Chair of JM Finn's Young Investment Managers Forum and Chair of the firm's Collective Investments Committee. What do those roles entail, and how do you balance your responsibilities?

Research of third party collective funds is done by the Investment Managers at JM Finn. Chairing the committee involves ensuring consistent and high quality research, and encouraging the committee members to discuss and debate their research with Investment Managers across the company.

JM Finn's Young Investment Managers Forum (YMIF) gives the firm's emerging talent a platform to bring forward ideas and learn from our peers. As Chair, my role is to develop and lead the schedule of events and seminars.

I see both roles as enhancing my job as an Investment Manager, so it's less a case of balancing responsibilities and more of embracing the breadth of my role.

You have been with JM Finn for 10 years – how has your experience been?

What always strikes me is the strength of the relationships that Investment Managers at JM Finn are able to build with clients. In that time, I've discussed investing for the future of newborns, shared in the delight of clients purchasing a first property, invested the proceeds of company sales, and sadly, attended the funeral of a client who phoned me to discuss the market and more, every working day. It is a true privilege to earn the trust of clients and I hope that 10 years is just the start.

What has been the most significant moment of your career so far?

The start of the pandemic exacerbated the inflationary pressures that led to 18 months of interest rate rises and a fundamental change to the investment landscape that I had experienced hitherto in my career. The rollercoaster of market movements during that period was an invaluable experience and taught me a great deal: world equity markets fell over 30% in four weeks during February and March 2020, before recovering fully by that November – showing the strength of staying invested through periods of volatility and trusting in the quality of the companies in the portfolio.

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