JM FINN

No.47 *Summer 2024*

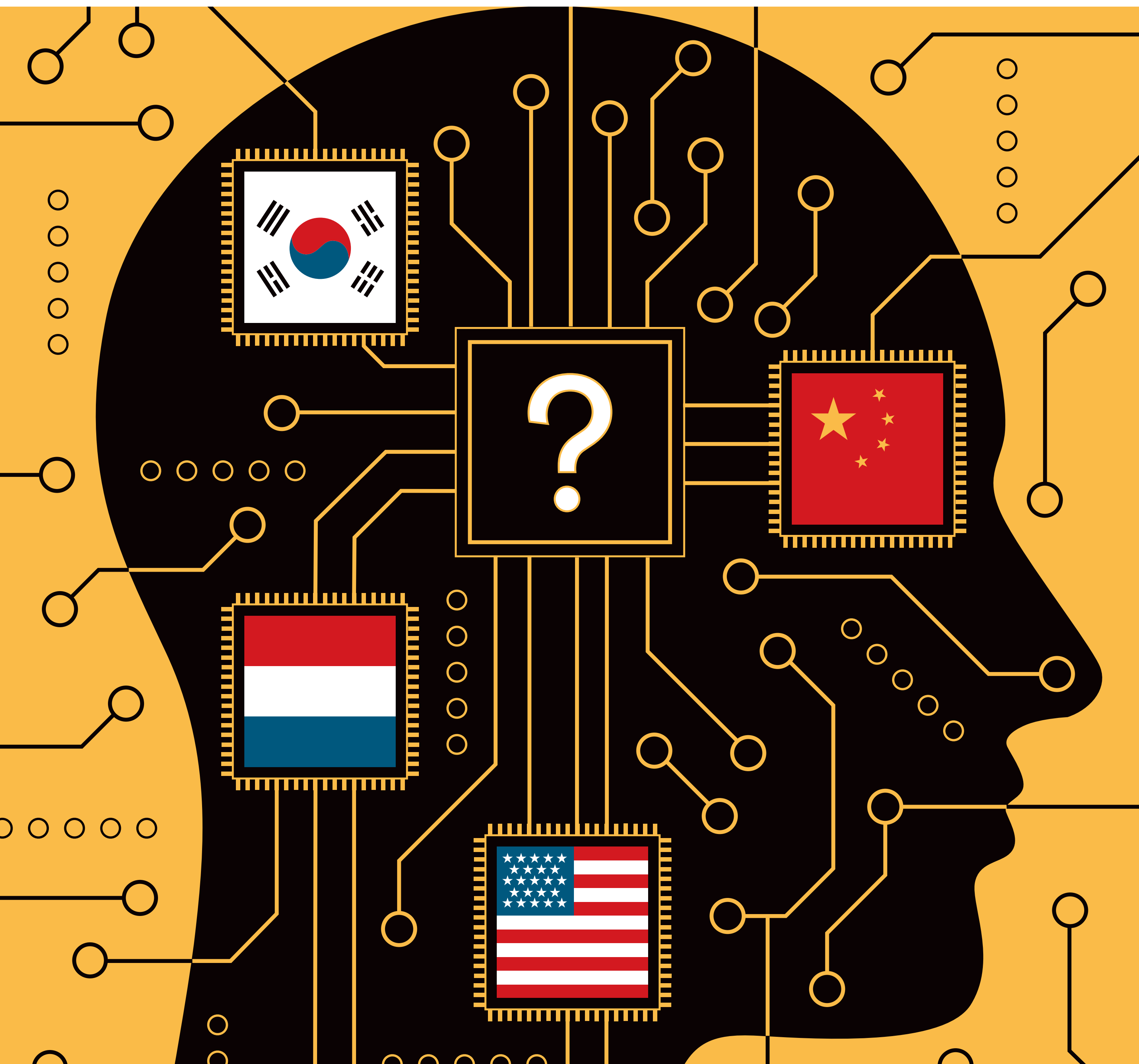
Prospects

The JM Finn Quarterly Periodical

UK election
All change at Number 10?

Semiconductors
Past, present and future

Capital Gains Tax
Time to bite the bullet?



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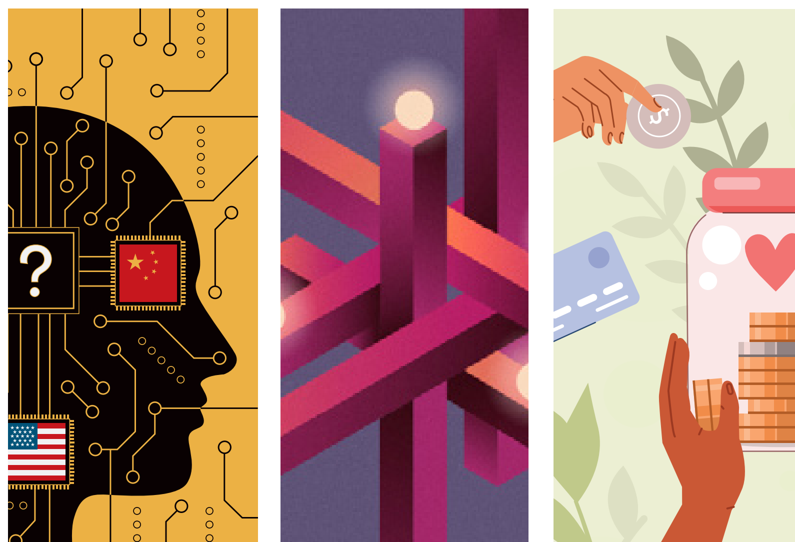

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Welcome

With the election now called for July, we could well have a new government by the time I next write to you in our autumn edition of Prospects.

Now the campaign is in full swing, Investment Director Andrew Mann analyses the potential implications of a Labour win from an investment perspective, while our guest editorial from Allen Simpson, longstanding adviser to the Labour Party, considers the wider political and economic impact. No matter what the outcome, our Investment Managers will continue to adapt to the prevailing conditions in the manner that has always held the Firm in good stead throughout the years of rule under many governments.

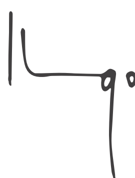
Whoever takes the helm at number 10, they will have to contend with the same obstacle: managing the UK's £121 billion budget deficit, the eighteenth largest since 1948. There are however many bright spots in the UK market and economy: at 2.3% in April, inflation is trending back down towards the desired 2% level – raising hopes of interest rate falls later in the year; and the FTSE 250, often seen as a barometer for the health of UK stocks as a whole, is currently keeping pace with the performance of the FTSE 100.

Regardless of a change in government, it is always prudent to review your wealth arrangements. Two areas of focus this edition are Capital Gains Tax and pensions. It might often be tempting to delay or avoid the sale of underperforming shares that would realise a tax on capital gains. Yet in some cases it could be wise to face the short-term pain of CGT to ensure that all the stocks held in a portfolio are earning their keep, as Associate Wealth Planner Charles Barrow and Senior Investment Manager Mark Rowe-Ham write on page 16. With the recent launch of the new government state pension checking service, Ryan Gordon gives a reminder on page 24 of the April 2025 deadline to 'top up' National Insurance gaps that date back to 2006.

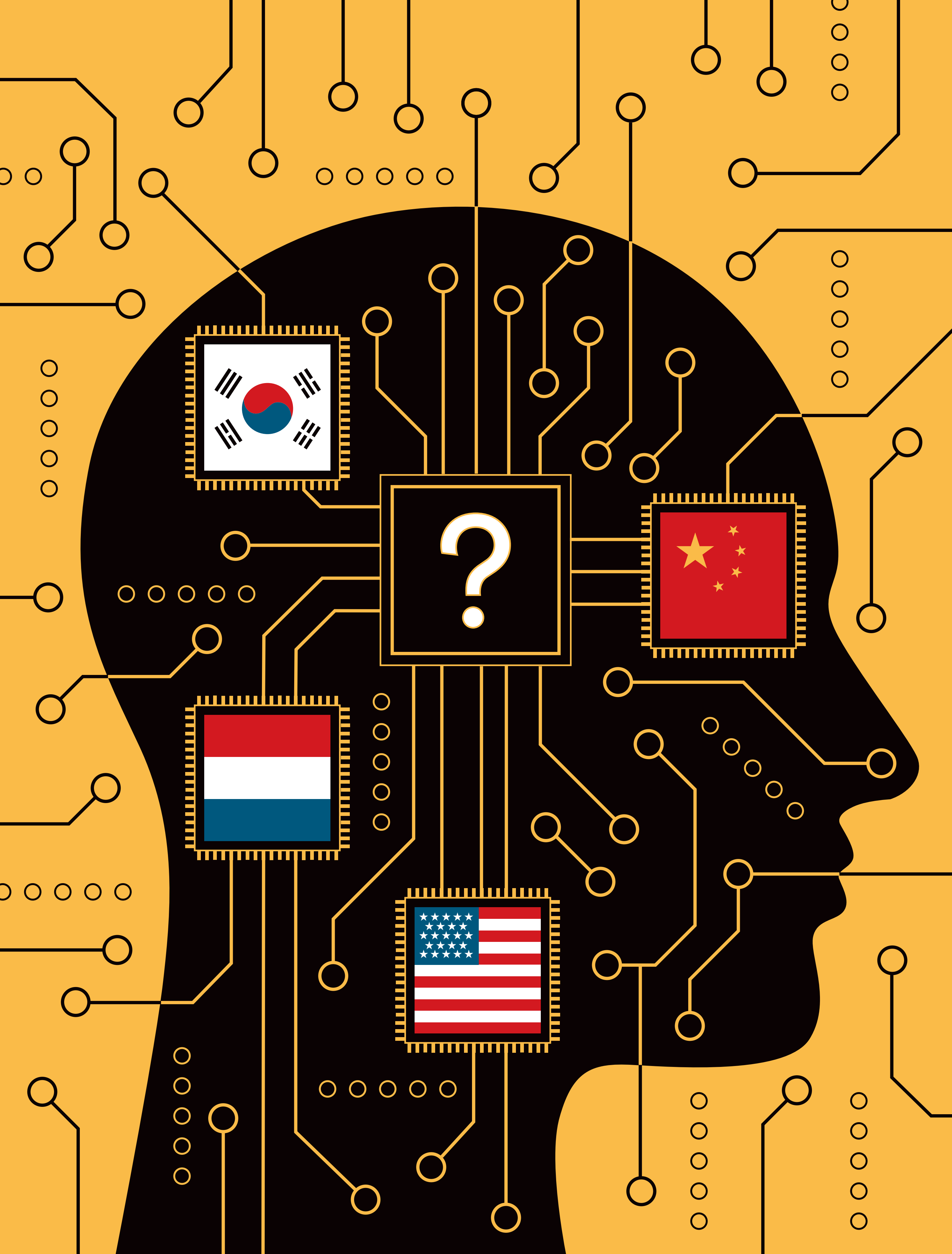
The seemingly unstoppable rise of the semiconductor chip is the subject of our editorial this issue: on page 4, Research Analyst Henry Birt delves into the evolution of chip production that has led to the highly complex manufacturing process it requires today. As the world's biggest economies vie with each other to lead the way in semiconductor development and production, geopolitical tensions have been triggered by this tiny device.

JM Finn has a long history of supporting the arts, and this year is no exception: the Firm is currently sponsoring the National Treasures Exhibition at the York Art Gallery, in celebration of the National Gallery's bicentenary. The exhibition, which runs until 8th September, includes Claude Monet's timeless classic The Water Lily Pond. 2024 also marks the fifth year of JM Finn's partnership with The Affordable Art Fair UK, with a week-long May Fair in Hampstead and the Fair's 25th anniversary event coming to Battersea this autumn.

I hope you continue to enjoy reading Prospects. For those of you who may like to hear from us in digital form, we regularly post content such as market commentaries and JM Finn news on our website. There is also a quarterly email newsletter available with a roundup of the key insights and stories on our homepage. If you would be interested to receive this, please ask your Investment Manager to be added to the 'Insights' mailing list.



Hugo Bedford
CEO



Editorial

Semiconductors: past, present and future

Henry Birt
Research Analyst

Henry Birt explores the history of semiconductors and the global geopolitical tensions that have arisen from these nanoscopic devices.

Semiconductors, or 'chips', are tiny electronic devices which are the brains of any modern electronic device. Semiconductors are made primarily from silicon or germanium and their manufacture is arguably the most complex process ever mastered by humankind.

During the aerial bombing campaigns of the Second World War, a transition away from mechanical processes was required to increase accuracy, so gears were replaced with electrical charges. The key innovation was the vacuum tube: a metal filament enclosed in glass. Electrical current running through the tube could be switched on or off, with on representing 'one' and off representing 'zero'. Using this binary system of switches, any number could be created and thus the binary code – which remains the foundation of modern computers – was born.

Cutting-edge chips are essential to modern day life and modern militaries, but also essential to facilitating continued progress with technologies such as artificial intelligence (AI).

Vacuum tubes were a step forward, but were unreliable. They were also roughly the size of a fist and so were much too large to be portable. These drawbacks necessitated the eventual move to controlling electrical currents across the surface of silicon. The basic idea of a switch remained, but now these would be created on silicon. These switches were called transistors. The idea of assembling multiple transistors on one piece of silicon then created something called an integrated circuit or 'chip.'

The final significant innovation I will mention is photolithography – an integral ingredient in the miniaturisation of transistors, and arguably the most complex part of the whole semiconductor supply chain. Originally, the process involved shining light through a mask, which had been cut in the shape of a semiconductor design, at light sensitive material. The light cut many transistors into the silicon, rather than building transistors onto the silicon itself – allowing for much smaller, more detailed designs.

In the infancy of the chip industry, and for much of the 20th century, innovation promulgated from the US defence department and chip production supremacy was retained by the US. Up until the 1980s, companies known as integrated device manufacturers (IDMs), such as Intel, engaged in both design and manufacture of the most cutting-edge semiconductors. Post 1980 though, a new model emerged. In 1985 Morris Chang, formerly a Texas Instruments (TI) executive in the US, was recruited by the Taiwanese government to develop its chip industry.

Chang pioneered what is now the foundry business model: focusing solely on manufacturing for other firms which have already designed the chips. This allowed the emergence of 'fabless' chip design companies (such as Nvidia), which lack the fabrication plants (or fabs) necessary to produce the chips. Fragmentation of the industry allowed for increasing specialisation and the company which Chang founded, The Taiwanese Semiconductor Manufacturing Company (TSMC), is now the largest and most advanced foundry in the world.

IDMs are still prominent in the industry, however the most advanced chips are more commonly produced within the fabless / foundry model. Under this model, the design process requires two types of company: those that design chips (such as Nvidia and Broadcom) and those that produce the Electronic Design Automation (EDA) software used by chip designers (Cadence, Synopsis and Siemens). Both of these subsectors are still dominated by the US. The US holds c.60% market share in fabless design and holds c.72% of the EDA market. Once a manufacturer has designed its chips using EDA software, it then sends its designs to a foundry for production. Taiwan has a 65% share of overall foundry capacity. At the most advanced level of chip, Taiwan dominates, with c.88% of advanced foundry capacity.

To manufacture chips, TSMC relies on a number of equipment manufacturers. The US holds 42% market share in total equipment manufacturing although photolithography is a notable exception. Extreme ultraviolet (EUV) machines, required for the most advanced chip making, are only currently made by one company in the world – the Dutch firm ASML.

The US dilemma

Cutting-edge chips are essential to modern day life and modern militaries, but also essential to facilitating continued progress with technologies such as artificial intelligence (AI). China is equally ambitious in developing its capabilities in this area as the West. This presents two strategic problems which the US is trying to address. Firstly, if China can develop cutting-edge chips to rival those manufactured in Taiwan, there is nothing to stop it developing defence and intelligence technology with these chips that could pose a threat to the US.

Secondly, arguably the world's most strategic technology is almost entirely manufactured in a country which the US's greatest adversary claims as sovereign territory. An invasion of Taiwan risks a decade-long technological set back.

For a historical parallel, we need only look to the Russian invasion of Ukraine. The impact on the world economy was devastating and brought inflation which central bankers are still fretting about two years later. Taiwan is far more strategically important and an invasion of the country would represent one of the greatest threats to global economic stability.

The US response

The US began sanctioning China in 2017 and since then several export bans have been levied on critical chip-making equipment and advanced chips. The US has also pressured allies with key chip making technologies (e.g. The Netherlands and photolithography technology) to restrict China's ability to build or access cutting-edge chips. Chinese companies can no longer import Nvidia's newest AI-focused chip, nor can they order ASML's EUV machines or use its maintenance services.

The US began sanctioning China in 2017 and since then several export bans have been levied on critical chip-making equipment and advanced chips.

Since 2014 China has identified chips as a key technology to produce domestically and has thus poured billions of dollars into domestic manufacturing capacity. China is making a long-term bet on chips and to disregard its efforts would be unwise.

So, in addition to sanctions, the US is aiming to regain a foothold in leading-edge semiconductor manufacturing too, mostly obviously via the 2022 CHIPS Act. The Act appropriates US$53bn for the construction of US-based fabs and chip-making equipment, whilst also funding chip research. A similar European Chips Act was launched in 2022 in Europe.

Taiwan is far more strategically important and an invasion of the country would represent one of the greatest threats to global economic stability.

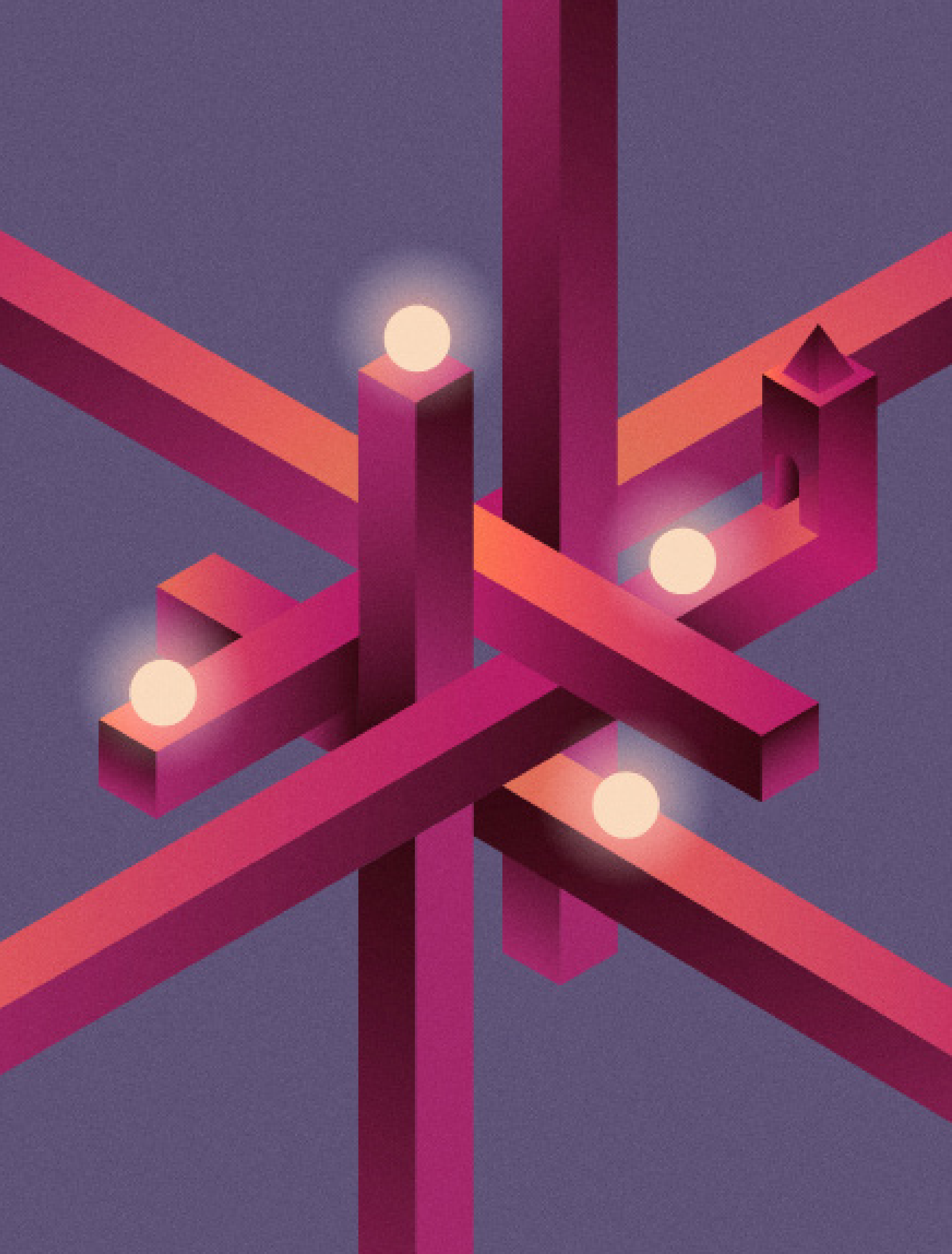
The future of semiconductors

The CHIPS Act does however come with caveats. Those companies wanting over US$150m in funding are subject to conditions such as stock buyback limitations, preference for union labour and profit sharing. These conditions are likely to make US fabs more uncompetitive with Southeast Asian fabs than they already are. Morris Chang (former CEO of TSMC) estimates US manufacturing costs would be 50% higher than in Taiwan. Leading-edge manufacturers seem unlikely to take up much of the funding and leading-edge production seems unlikely to materially reshore.

Yet sanctions on Chinese domestic production appear more effective. Whilst the release last year by Huawei (a Chinese technology company) of a more-advanced-than-expected chip worried many in Washington, their lack of access to EUV equipment from ASML will limit how much more progress it can make. Overall, the restrictions do look to have strangled Chinese access to semiconductors and stymied leading-edge production for the foreseeable future.

The larger strategic issue is the second detailed above, namely the risk to Taiwan. US protectionism isn't the panacea, even though it might be a vote winner. The answer more likely lies in diversifying chip sourcing as much as possible. At the leading edge, Samsung is currently the only option, although the proximity of its foundries to North Korea adds another concern. Yet with a combination of onshoring some critical supply and diversifying Southeast Asian partners, the US may be able to reduce dependency. Either way, we expect this to be a key geopolitical theme for many years to come.

Please read the importance notice on page 1.



Guest Editorial

All change at Number 10?

Allen Simpson
Deputy CEO, UKHospitality

With Labour widely tipped to take a parliamentary majority at the next election, Allen Simpson considers the potential economic impact of a Labour government.

Many of us invested in the UK markets have wondered what the upcoming general election might mean for our holdings – but with a polling lead of as much as 30% for the Labour opposition, many fund managers have already begun to assume a Labour win. If Keir Starmer gets the keys to Number 10 it seems unlikely that much would happen to the FTSE or the value of the pound that hasn't already been priced in.

Which gives us some spare time to ask a more interesting question – what would a Labour government actually do? Who are these people who seem to be gliding into power with an ease of a jumbo jet on a sunny day?

Incoming governments are shaped by three things; economic realities, political realities and moral instincts. Although manifestos and policy announcements get the headlines, it's in these three that we can find the best guide to what a government could do. Two set the limits of action, one sets the shape of the ambition.

If Labour win the next election, they will be taking power in parlous economic circumstances. You can choose your preferred piece of data to make the point – economic output per person in the UK is barely higher than it was before the financial crisis, productivity is markedly lower than our major industrial rivals, and the sheer cost of housing is sucking capital out of the productive economy in an ever-growing rate.

When Darren Jones sits down at his desk as Chief Secretary to the Treasury, he will be looking at the fiscal result of this low growth UK – a real question of how affordable our state is. We talk a great deal as a society about how we address the demographic timebomb of a generation settling into far longer retirements than they saved for. There are unfunded challenges elsewhere too. The current government's forecasts assume they put fuel duty back up, but no one thinks that's politically realistic. Where do we find the £15bn to fund the expected cost of that freeze by 2029? Nor do the forecasts reflect the approaching risk of mass failure in local government or in our universities, the combined costs of which could run well into the billions.

Questions of social fairness are likely to define the political project as much as social mobility.

The point of this gloom-mongering is to say that regardless of who wins, there's little room to spend. Even if a new government achieves the rare economic trick of expanding the economy through investment, much of that money will be needed to simply meet existing exposures. So there's our first constraint. There is, to quote a famous note left by a previous Chief Secretary to the Treasury, no money.

What about the political constraints? One mid-May YouGov poll had a lead for Labour which could translate into a Conservative party on fewer than 15 MPs. Even if that seems dubious, the venerable polling expert John Curtice puts the chances of a Labour win at 99%. For years all roads in British politics led to Brexit. But today, while Labour have a higher percentage of remain voters than in 2019, the Leave vote has crumbled away from the Conservatives to Reform, to non-voting, and in many cases back to Labour.

Which means that Labour are faced with a route to a huge majority, but one that runs through many Brexit supporting communities across the country. It is unlikely that a Labour Government would be more likely than a Labour opposition to significantly revise our relationship with the EU, or pursue a materially different immigration policy. Nor for that matter should the Party's defence of the pension triple lock be a surprise. And here we have our second constraint – the political realities of holding together a coalition of voters that delivers Bristol and London, but also gave them a 26% by-election swing in Brexit voting Blackpool South. There will be conflicts and compromises on the way, and that winning coalition may quickly feel less solid.

So what about the moral instincts of a Labour government? Or to put it another way, who is Keir Starmer? He is (as he occasionally mentions) the son of a toolmaker and a nurse who rose to become a knight. As a young lawyer Starmer travelled the Commonwealth litigating death penalty cases back to the UK to end capital punishment. He first came to public attention in the UK defending activists in the McLibel case against the fast food giant. His time as Director of Public Prosecutions - subject to the inevitable political debate now - saw him move from private practice into less lucrative public service.

Here we find the moral core of the Starmer project that will help set the terms of their governing ambition. Questions of social fairness are likely to define the political project as much as social mobility. Both Starmer and his Shadow Chancellor Rachel Reeves are pro-industrial strategy, and believe in a role for the state in setting the economic agenda. Consumer protection and unlocking investment will be big, and to some degree conflicting, ideas. In some ways we should expect a government in the tradition of Clement Atlee (who Starmer perhaps most personally resembles) as much as the 1997-2010 government.

This is the context of ambitions and constraints in which to understand the five missions for government which the Labour Party published in 2023. In mercifully shortened form they are: growth, green energy, healthcare, safe streets, and opportunities for all.

The highest profile element of 'opportunities for all' seems likely to be a flagship 'New Deal For Working People' which includes the right for workers on zero hours contracts to ask for a contract that reflects the hours they work, a commitment to the living wage, and reversing the anti-strike legislation of the post 2010 governments. Despite recent press chatter that this agenda has been watered down it remains a substantial increase in workers' rights.

Regardless of who wins, the economic and political realities facing our government are stark.

For investors there is an ambition to reinvigorate London's capital markets, including making it easier for institutional investors like our pension funds to invest in venture capital. Consumer protection will focus on financial inclusion issues like Buy Now Pay Later, but the Party appears largely comfortable with the current government's proposals to soften regulations on capital market investment to, for example, allow companies to maintain greater control when they join the stock market, at the expense of investor power. It will be interesting to see how a Labour government balances these apparent contradictions of investor protection and cutting investment red tape.

Elsewhere we should watch for two cross cutting issues which are likely to prove just as important as the five missions.

Firstly, 'securonomics', which is Rachel Reeves' response to the problem of our lack of economic resilience, which has been so palpable from the effect of external shocks like Ukraine, the pandemic and the conflict in Gaza. It will mean a greater focus on domestic industrial capacity, strategic investments in energy and a greater role for the state. Close Biden watchers will recognise what is in some ways quite a substantial break from the economic orthodoxy of recent decades where efficiency through slim supply chains has trumped the security of excess capacity and onshoring.

And secondly, fixing public services. Labour's view is that while a lack of investment has damaged services profoundly, a combination of increasing evidence that productivity is stagnant in the public sector and the economic realities faced by the UK mean that reform will be as much a part of the package as investment.

Labour are approaching a general election as the favourites for the first time in 19 years. Regardless of who wins, the economic and political realities facing our government are stark – it will be fascinating to see what voters make of the Starmer project's ambition to push beyond those constraints.

Allen Simpson has been close to Labour Party policymaking in financial services and broader industrial strategy for nearly two decades. He has served in a number of government roles within the UK Parliament and civil service. He formerly ran Labour in the City, the membership group for Labour members in financial and professional services. Allen has twice been a parliamentary candidate, doubling the vote and moving the Labour Party from fourth to second in Maidstone and the Weald.

In 2024 he was appointed Deputy CEO of UKHospitality, the trade body for the £140bn hospitality sector. Allen regularly provides advice to the Shadow Cabinet, and contributed to the recent Anderson Review into Business Relations commissioned by the Shadow Business Secretary.

Company Meetings

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

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

Jack Summers, *Research Assistant*
Sir John Royden, *Head of Research*

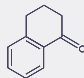
CONSUMER DISCRETIONARY
Compass Group, LVMH, Persimmon

CONSUMER STAPLES
Barry Callebaut, Nestlé, Ocado Group, Unilever

FINANCIALS
Beazley, NatWest

HEALTH CARE
AstraZeneca, Genus, GSK

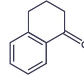
INDUSTRIALS
Experian, IMI, Spirax Group



MATERIALS
Croda International

INFORMATION TECHNOLOGY
Darktrace, Esker

UTILITIES
National Grid, SSE

1. 

Croda International

Equity Market Cap (M) **£6,373**

Materials
Steve Foots, CEO and David Bishop, Head of Investor Relations

Croda is a specialty chemicals producer which principally develops and supplies high quality functional ingredients into niche market sub-segments. Such ingredients allow customers to make 'front of packet' claims such as 'anti-ageing' or 'natural'.

A classic Croda product produced at its Rawcliffe Bridge site is acid-chloride derivatives, used as surfactants for sensitive applications such as baby shampoo or skincare cream CeraVe. They are produced by reacting a fatty acid with an amino acid. Whilst not difficult, the chemistry is fiddly, and customers often require non-standard container sizes. Mass scale commoditised players don't compete here as a result, making the product high value and high margin for Croda versus traditional alternative surfactants.

Croda was a pandemic winner, but those tailwinds became headwinds in 2023, with destocking and lifesciences weakness still prevalent in 2024. Despite these challenges, Steve retains optimism on the strategic growth opportunities Croda is exposed to across the portfolio. Croda credits its both proactive and reactive in-house research and development (R&D) operations as the key to newly emerging market niche opportunities.

NatWest Group

Equity Market Cap (M) **£27,607**

Financials
Alexander Holcroft, Project Director and Claire Kane, Director of Investor Relations

The UK government still owns 22.5% of NatWest Group (NWG) and is planning on selling down the stake that it acquired as a result of shoring up The Royal Bank of Scotland during the Great Financial Crisis in 2008.

Claire indicated that NWG was likely to have robust financials going forward. Most UK banks have what they refer to as their "structural hedge". As base rates rise, banks' earnings are boosted due to current accounts not paying interest to customers. Banks reduce this volatility by taking out five year hedges (or swaps) which lock in interest rates. For example, NatWest has been receiving an average of 0.8% from their hedge agreements that are rolling off this year. These hedge contracts were put in place when interest rates were much lower, and are being replaced with hedge agreements at higher rates, averaging c.3.1% (given the increase in base rates), boosting earnings going forward.

NWG expect rates to fall and that (a) recent hedges over the past two years should become profitable and that (b) hedges put on during the Covid era at very low interest rates should unwind. Alexander also said that the bank was not seeing stressed borrowers and that it had estimated low impairments (losses on loans) at the most recent results.

We were also told that the bank was more interested in keeping returns on assets (and to shareholders) high and that they were not interested in low return growth opportunities.

NWG's stance on the possibility of a retail offer by the government in the future is that such an offer would need to be priced at an optimum level that retail investors find attractive, but not so attractive that they would immediately sell their shares.

RadNet

Equity Market Cap (M) **$4,349**

Health Care
David J. Katz, Executive Vice President, Chief Legal Officer & Corporate Secretary

RadNet have received some enviable accolades recently: Top 100 in Information Week's 500 Most Innovative Companies, voted one of the "most wired" imaging companies by Imaging Technology News and reported as the #1 Imaging Center Chain by Radiology Business Journal.

They are the largest provider of fixed-site outpatient diagnostic imaging in the USA, with more than 365 centres delivering MRIs, CT scans, PET scans, X-rays and more. The company has a focus on breast, lung, prostate and brain scans, which are augmented with AI to help their radiologists achieve a precise diagnostic result in a cost-efficient manner. Historically, their lower cost relative to in-hospital scans has driven their strong growth. AI has made a further notable contribution to the mammogram analysis and positioned RadNet at the front of this evolving field.

Importantly, in the USA they have strong relationships with every major healthcare plan in the market, which facilitates cash collection from invoices. David advised that RadNet has favour with insurance payers because RadNet operates scanning centers which are located outside hospitals, and which are much cheaper to operate. The competitive costings incentivise insurance companies to steer patients to RadNet. Looking forward, there appears plenty of long-term runway to continue growing sales. David identified the capture of market share as a significant growth driver given the compelling nature of RadNet's offering for insurance companies in the USA. The downside is that the company is perhaps overly valued. It is trading on a prospective price/earnings ratio (P/E) of 84, forecast to fall to 62 by end 2025 but with a 5-year average revenue growth rate of 10.7% p.a. (including a -7% contraction in revenues due to Covid in 2020) and evidence of strong operational leverage, this is understandable.

Please read the important notice on page 1.

Wealth planning in focus

No pain no gain

Charles Barrow
Associate Wealth Planner

Mark Rowe-Ham
Senior Investment Manager

Charles Barrow, Associate Wealth Planner and Mark Rowe-Ham, Senior Investment Manager explain why it might sometimes be best to sell underperforming shares and incur Capital Gains Tax.

Capital Gains Tax (CGT) is a wide ranging and complex tax that is levied following the disposal of certain assets based on the increase in value over the tenure in which the asset has been held. Typical assets impacted by CGT are investments (unless held in a tax-efficient environment such as an ISA or pension) and properties that are not your primary residence.

The current tax rates depend on your overall taxable income and the assets you have disposed of. For higher rate taxpayers, CGT is 24% on residential property and 20% on stocks and shares. For basic rate taxpayers, if their total level of income is within the basic rate income tax band (£12,571 to £50,270) then CGT rates are lower at 10% on stocks and shares and 18% on property, up to the basic tax rate level. After this they are taxed at the same rates as higher rate taxpayers.

There are various reliefs and exemptions available to mitigate a CGT liability, most notably the Annual Exempt Amount, the CGT allowance which every individual is annually entitled to and currently stands at £3,000 for 2024/25 (having reduced from £6,000 in 2023/24).

Don't let the tax tail wag the investment dog.

How could CGT rules change under a new government?

CGT allowances and rates have been moved by numerous Chancellors over the years and with a new government there is the risk that the rules could change again. It should however be noted that Rachel Reeves, Shadow Chancellor, recently said she has "no plans to equalise capital gains tax rates with income tax." We will continue to monitor this as we acknowledge it as one of the possible changes a new government could implement.

Actions to consider

Ensure that you use the annual CGT allowance. Similarly, maximise use of tax efficient ISA wrappers: all investments in an ISA are exempt from CGT.

If possible, utilise both spouse allowances where relevant; HMRC regards disposing of an asset as selling it, giving it away as a gift, swapping it for something else or receiving compensation for it (such as an insurance payout). However, CGT may not have to be paid when gifting between spouses or civil partners. Gifting to a spouse can transfer the book cost and gain and it can then be crystallised in their name when sold.

Review losses: if you make a loss, the amount is deducted from gains made in the same tax year. Selling an investment at a loss could offset a gain that you may want to take elsewhere. Losses can also be carried forward from previous tax years and used to offset net gains taken today. Previous losses do need to be reported to HMRC and this can be up to 4 years from the tax year when the loss was taken.

While it might be tempting to avoid or delay paying CGT, it can be wise to keep a wide perspective: CGT arises because profits have been made on investments. Investors should therefore consider this a 'winner's tax.' "Don't let the tax tail wag the investment dog" is a phrase often used to focus investors on the bigger picture and not let tax control the investment decision process. Review your portfolio and don't hold on to an asset just because it would lead to a tax liability if you were to sell it. This could be restricting your capital from investing in better opportunities. Review assets with big gains and ensure these are performing or in sectors you still want to invest in. If an asset with a large gain is underperforming, it may be best to accept the tax on the gain and use the proceeds to invest in better performing sectors and regions.

It is also worth bearing in mind that CGT tax rates are currently lower than income tax rates. For higher rate taxpayers, CGT is 20% on stocks and shares, whereas the income tax rate for these taxpayers is 40%. There is a risk that CGT rates may increase under future governments and therefore investors may want to crystallise gains when rates are at current relatively low levels.

Finally, it is important to note that on death, asset values are uplifted to probate values and therefore capital gains/book costs are effectively reset with no CGT to pay. This should be considered when undertaking CGT and estate planning.

We often recommend that specialist advice should be sought if you are unsure if a disposal may give rise to a CGT liability. Please speak to your Investment Manager for further information.

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.

Market update

A Labour landslide?

Andrew Mann
Investment Director

Investment Director Andrew Mann analyses the possible effects of a new government on investors and the different sectors comprising the UK investment environment.

With the UK general election only a few weeks away, Labour's lead in the opinion polls suggests the strong likelihood that we will soon have a new government, perhaps ushering in a new period of both political and economic stability.

Even though Labour governments have historically received a relatively tepid response from the stock market in their first few weeks of office, the current leadership under Keir Starmer appears to be much more centrist than we have experienced in recent times – and there is a good chance that markets will react positively. The more domestic-oriented FTSE 250 has tended to outperform the FTSE 100 around Labour party wins – so for all of its challenges, and there are certainly many of them, the UK market feels in a better position than it has been for a number of years.

It is normal of course that uncertainty over longer-term changes to tax, regulation and stronger employment rights will create some nervousness around the election outcome, with the possibility of higher wage costs for example remaining a drag on the retail and hospitality sectors in particular.

With UK interest rates seemingly staying higher for longer, the outlook should remain relatively unchanged for UK banks, with no indications of any tail risks when it comes to unexpected tax or policy changes.

From what we currently know, Labour has indicated there will be no immediate increase in either the rate of capital gains tax, or the top rate of income tax. Neither does the introduction of a wealth tax seem to be on the cards. This should be reassuring for the savings industry, and a simplification of the ISA system also seems likely, with a view to it becoming easier for retail investors to understand and participate in. One negative here though could be the reintroduction of the pension lifetime allowance, abolished by the Conservatives last year.

Housebuilders could come into sharp focus, with both parties focusing on boosting affordable homes and reforming the planning system. Labour have suggested cutting red tape to expedite the approval process for new build properties which might be good for those home builders geared towards the lower end of the market, but regardless of who wins, the housing market will undoubtedly remain a key talking point.

For aerospace and defence, both parties look committed to strong levels of spending. As an island nation the nuclear submarine fleet remains an important focus. The current spending commitment to this seems unlikely to be reversed, despite the fact that a large number of the Labour leader's team voted against Trident's renewal in 2016. Whilst the Conservatives have committed to increase defence spending to 2.5% of GDP by 2030, it is possible that Labour will be more cautious, with Keir Starmer suggesting that spending will increase 'as soon as resources allow'.

Elsewhere, a Labour victory will likely be seen as a negative for some businesses in the oil and gas sector. The Tories have already been surprisingly tough on taxation here and Labour have indicated that amongst other things, they intend to increase the Energy Profits Levy (a levy on the profits of companies producing oil or gas in the UK). That said, the likes of BP and Shell produce only a relatively small amount of oil and gas in UK waters, which should limit any effect.

Housebuilders could come into sharp focus, with both parties focusing on boosting affordable homes and reforming the planning system.

It is not expected that either party will campaign for the nationalisation of utilities in this election and both are likely to support the UK's Net Zero ambitions, with Labour's plan possibly involving major investment into both wind farms and nuclear power. A wider decarbonisation of our electricity supply should be positive for a number of businesses, but one of Labour's flagship policies is the creation of Great British Energy, which would be a new, publicly owned clean energy company. The idea would be to make the UK more cost-competitive through the introduction of state-funded competition. This could be negative for existing providers, but could also be used to provide funding towards the development of new technologies.

What seems likely is a continued pressure on water companies, with a focus on both their environmental performance and shareholder returns at a time when the regulator is being tasked with setting bills for 2025-2030. Investors might therefore need to be mindful of a possible reduction to dividend payouts as a result.

We will continue to monitor events closely throughout the election, and then review the potential implications of any policies that are implemented post-election by the successful party.

Please read the important notice on page 1.

Stock in focus

LVMH

William McCubbin
Assistant Research Analyst

LVMH (Moët Hennessy Louis Vuitton) may be a young company in itself, founded in 1987, however, the heritage of its brands stretches much further back, with Château d'Yquem - the oldest brand under the LVMH umbrella - established in 1593. Today, LVMH is the world's leading luxury group, encompassing 75 prestigious houses across five business groups, employing over 200,000 people worldwide.

The average CEO lasts only seven years, but Bernard Arnault, the world's richest person, has been the leader of LVMH since close to its inception, creating key person risk. A Parisian adage, "all roads lead to Arnault," aptly captures his immense influence.

Unlike most luxury brands that are built on heritage, LVMH's story is of shrewd acquisitions and financial manoeuvring. Arnault's nickname "the wolf in cashmere", accurately represents his quite brilliant ruthless tactics, mastering the art of the leveraged buyout (LBO). His approach was not to strip the asset of its value, as made popular in 80s America, but to acquire undervalued companies with hidden potential, like Christian Dior, which he saw as a sleeping giant within the Boussac textile company, purchasing the whole company for $60m, in which $15m was his own money.

LVMH itself emerged from a shotgun wedding between Moët Hennessy, led by Alain Chevalier, and Louis Vuitton, under Henri Racamier. Ego clashes and fighting in the press quickly led the pair to seek outside support. While Chevalier found backing in Guinness, Racamier made a fateful decision turning to Arnault, opening the door for the wolf to enter the LVMH hen house. Arnault, with a keen eye for opportunity, seized the moment. Within months, he amassed a significant stake in LVMH, effectively taking control of the newly formed conglomerate.

Before Arnault's leadership, the industry was fragmented across individual brands, but he realised the potential for powerful economies of scale. The sector operates in a very unique way: needing scarcity to promote brand value, thus stunting growth. You can't lower your cost structure too much without devaluing your brand. Outsourcing non-core activities wasn't an option either, as maintaining quality control was paramount. What Arnault realises is that you need to create a small-scale production that is boutique and serves a small set of clients. But you can have a large-scale business by having a large portfolio of brands, creating scale through talent and materials, but importantly also through distribution (i.e. shops, experiences and customer relationships).

LVMH's story is of shrewd acquisitions and financial manoeuvring.

Equity market capitalisation (m)
€368,054

52 week high-low
€893 - €644

Net dividend yield
1.77%

Price/earnings ratio
24

Upon taking over, Arnault implemented a significant shift in strategy. He expanded LVMH's production capabilities, increasing the number of factories from 5 to 14. As Arnault states "If you control your factories, you control your quality. If you control your distribution, you control your image." This strategic change was followed by aggressive acquisitions. In the decade beginning 1996, LVMH acquired 19 brands including household names like Loewe, Celine, Sephora, DFS, Tag Heuer, and Fendi.

LVMH transcends mere products, instead selling a status symbol. As Coco Channel put it: "Luxury is a necessity that begins where necessity ends." This can be seen in the way fashion shows have morphed over time, from showing off what you could buy to now being a super high-production piece of art, where a model might be wearing only 1 or 2 items for the brand.

LVMH's importance has grown as women's fashion has evolved: accessories like hats, gloves, and wristlets have given way to more practical shoulder bags. The fashion and leather goods segment is the statement piece of LVMH, making up just under half of sales. It is thriving as these goods are easy to sell, and they don't require sizing, trying on, hemming or modifying. They are easy to create and produce, which all lead to enviable operating margins of 39.9% in fashion and leather goods, compared to the wider group operating margin of 26.4%.

LVMH's reach extends far beyond just handbags and luggage. The company encompasses a diverse portfolio of "Maisons" (independent houses) spanning fashion, wines and spirits (Dom Perignon), perfumes and cosmetics (Sephora), watches and jewellery (Bulgari and Tag Heuer), and selective retailing (including airport duty-free giant DFS, whose original logo was designed by Andy Warhol). Each Maison still retains its unique identity, while benefiting from LVMH's shared resources. LVMH continues to expand, acquiring Tiffany & Co. for $15.8bn in 2021, the largest acquisition in the luxury industry and reaching €86bn in sales with €15bn in net income in 2023. LVMH remains expensive like its products, being valued as the 2nd most expensive company in Europe.

Succession planning after Arnault becomes crucial and remains one of the key risks for the future. Arnault's five children are all executives working within LVMH and are poised to inherit this remarkable legacy.

Please read the important notice on page 1.

Collectives commentary

Mining for opportunities

Olivia Markham
Co-Portfolio Manager of BlackRock World Mining Trust

An update on mined commodities and the mining sector from Olivia Markham, Co-Portfolio Manager of BlackRock World Mining Trust.

After a challenging start to the year, the past few weeks have seen strength in mined commodity prices and mining equity performance. Industrial metals prices have been supported by improvements in economic data from China and evidence that the underinvestment from producers in recent years is significantly constraining supply. Gold and the precious metals have slightly separate drivers but have also performed strongly, appearing to be supported by central bank demand and 'safe-haven' buying amidst heightened geopolitical risk.

We have also seen mining equities outperform broader equity markets in recent weeks. This follows a 12-month period of underperformance as equity markets appeared to primarily focus on artificial intelligence (AI)-related technology stocks. On top of rising commodity prices, stickier than expected inflation also appears to have been supportive for the mining sector more recently. Despite the recent uptick, mining companies continue to trade well below long-run averages compared to their historic figures and relative to broader equity markets. So, value opportunity or value trap?

The main driver for mining equities tends to be the performance of the underlying commodities, which are in turn dependent on market supply and demand. It is our view that the supply side of the equation is likely to remain constrained over the coming years, supporting commodity prices, while demand is evolving to support long-term demand growth.

Mining companies have largely focused on capital discipline in recent years opting to pay down debt, reduce costs and return capital to shareholders rather than investing in production growth. Capital expenditure for the European miners over the past eight years, for example, has averaged -35% lower than in the preceding eight years. This is limiting new supply, and there is unlikely to be a quick fix given the time lags involved in investing in new mining projects, especially at a time when inflation has pushed up build costs. At the same time, existing mines are ageing, and it is becoming more difficult to get products out of the ground.

The cost of new projects has also risen significantly. Recent M&A activity in the sector suggests that strategic buyers see an opportunity in existing assets in the listed market, currently trading well below the amount it would cost to build anew. Other issues restricting supply include cases of governments closing mines, permitting issues and a general lack of shovel-ready projects.

On the demand side, the commodity supercycle (2002 – 2011) was all about China's extraordinary growth, and while China remains the most important individual economy for mining, we expect this importance to gradually decline through the end of the decade.

We expect global infrastructure spending to drive the next wave of demand, with low carbon transition-related infrastructure particularly meaningful, as mined commodities are essential for technologies like wind turbines, solar panels, and electric vehicles. For example, offshore wind requires 5.4x more steel and 2.9x more copper per megawatt of power capacity when compared with gas.

This is one reason that some investors who previously excluded the sector, are now reassessing their stances. Another reason is that some investors are considering investing in companies with plans to improve their emissions intensity as a new way to incorporate sustainability. We believe companies that are able to navigate the 'brown to green' transition (i.e., moving from fossil fuels to sustainable energy) effectively will be re-rated over time and perhaps see an additional premium on the materials they produce.

The other area gaining attention on the demand side is the implications for materials from the build out of AI-related data centres, both for the centres themselves but also for the increased power infrastructure required. There seems to be a relatively high degree of uncertainty around the exact impact on demand. However, this may be an additional oncoming tailwind for materials with already tight supply and demand fundamentals.

The main driver for mining equities tends to be the performance of the underlying commodities.

The BlackRock World Mining Trust aims to provide diversified exposure to mining assets such as: public equities (the majority of our portfolio), corporate debt and unquoted investments such as royalties. We have a bias to the copper subsector, the commodity for which we have the highest conviction in long-term prices exceeding current market estimates.

The supply and demand dynamics of mined commodities is such that there is the potential for higher-than-expected commodity prices and better-than-expected earnings for the companies producing them. The constraints caused by an extended period of underinvestment in production coupled with the structural demand growth that's necessary for the energy transition present an attractive outlook for mined commodities – and subsequently mining equities. With the sector trading below long-run averages relative to history and relative to broader equity markets, we think it's worth a look for investors without exposure.

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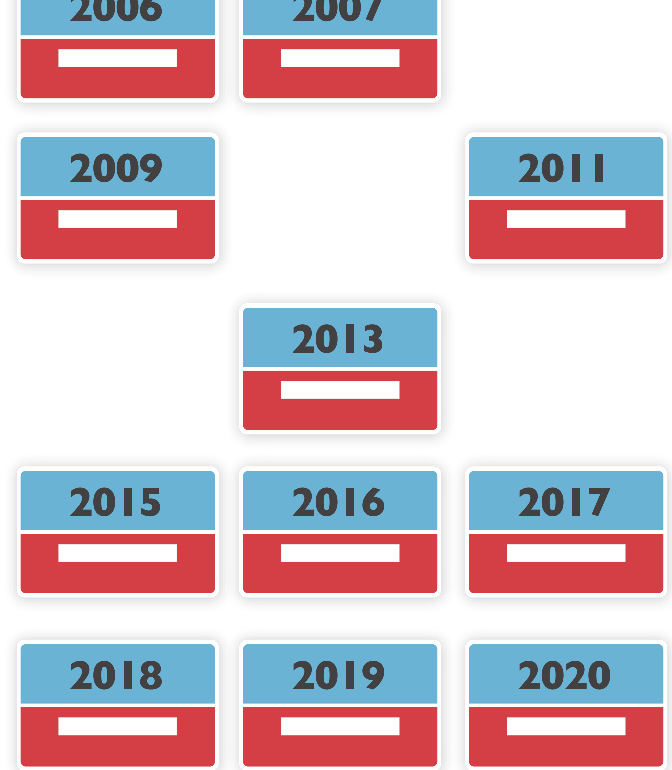
Wealth Planning in Focus



Filling in the gaps

Ryan Gordon
Paraplanner

As the UK government has recently launched its new online state pension checker tool, Ryan Gordon reminds us of the April 2025 deadline to 'top up' missing National Insurance years dating back to 2006.

While the state pension should not be relied upon solely in retirement, it does provide a guaranteed income that can form part of a retirement income. The sum you may receive from it varies based on your age and the amount of National Insurance (NI) contributions paid. Usually, the government has a strict ruling that you may only 'plug' gaps within your contribution history for the previous six tax years. However, due to transitional arrangements, this six-year window has been extended back to 2006, for those who are of the correct qualifying age. This transitional opportunity is only available until April 2025, meaning those who may stand to benefit need to act now.

The new state pension guarantees that, providing, in general, that you have at least 35 years of National Insurance contributions (NIC), you shall receive the full state pension which currently equates to approx. £11,502.40 pa (£221.20 pw) at the national state pension age (currently age 65). Note that it is important that you check your state pension age as this can vary. The minimum amount of qualifying years to benefit from any state pension is 10.

What if there are gaps in NI contributions?

For most, the qualifying number of years of state pension contributions is achieved long before we reach our state pension age. However, it is not uncommon for gaps to occur within our NI contribution history. For those aged between 40 and 73 (men born after 5 April 1951 and women born after 1953), you have an opportunity to buy back any lost NI contribution years between 2006 and 2016. In doing so, you are able to potentially increase your final state pension, which, depending on the number of the years you live past state pension age, may provide you with a significantly greater sum than had you elected not to pay the price of the voluntary contribution. The cost varies depending on the year purchased, but ranges from £795.60 pa to £907.40 pa (£15.30/week to £17.45/week).

This transitional opportunity is only available until April 2025, meaning those who may stand to benefit need to act now.

We recommend checking the government website to see your contribution record from age 16. It is important to mention that, in some cases, you may find that a year is not 'full' due to a period of the year where NI contributions were not recorded. In these instances, the missing voluntary contribution may be simply for a few weeks and can easily be made full for a minimal cost.

Secondly, it is worth checking whether gaps in your record may be filled with NI credits. There are a number of scenarios where individuals qualify for credits, such as childcare benefits, statutory sick pay credits, job seekers' allowance credits or jury service. In utilising any credits available to you there is a potential to fill partial years of contribution for free.

Checking your entitlement and topping up your state pension online is relatively straightforward; however our Wealth Planning team can help you to assess your own personal circumstances to determine whether doing so is likely to be the right option for you.

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

JM Finn *News*

National Treasures Exhibition

Following the opening of our York office in 2023, JM Finn is now proud to partner with the York Art Gallery through sponsorship of the National Treasures exhibition.

National Treasures is a key strand of the National Gallery's programme celebrating its bicentenary. A year-long festival of art, creativity and imagination marks two centuries of bringing people and paintings together.

York Art Gallery is one of twelve partners participating in National Treasures, and will host a masterpiece from the National Gallery's outstanding collection to celebrate this occasion. Claude Monet's 'The Water-Lily Pond' (1899) will be the central feature of the major new exhibition at York Art Gallery which will bring together key loans from regional and national institutions alongside collection works, and a large-scale commission by contemporary artist Michaela Yearwood-Dan.

Lucy Coutts, Head of JM Finn's York office has outlined why sponsorship of the exhibition resonates with the firm: "The National Treasures initiative is incredibly exciting and very much chimes with us; where the National Gallery are looking to make these paintings accessible, so we aim to make wealth management more accessible to help individuals meet their financial challenges. We are proud to be a part of this wonderful exhibition which gives us a unique opportunity to cement our presence in York."

The exhibition will run at the York Art Gallery until 8th September 2024.

Bond Focus

UNDERSTANDING BOND CONVEXITY

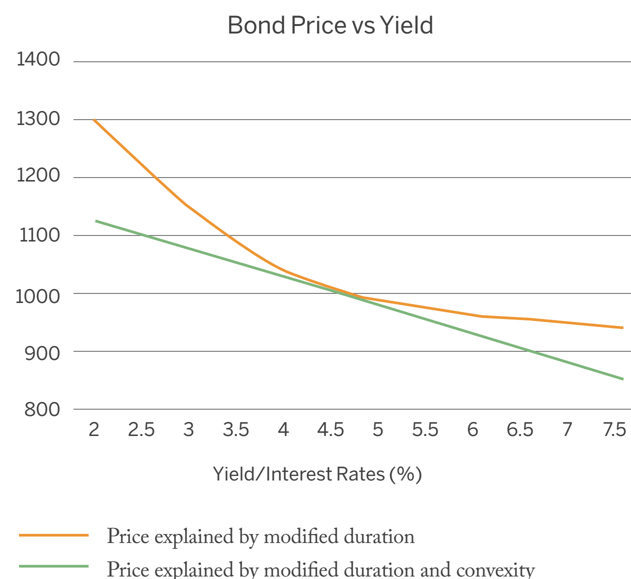
Jack Summers
Research Assistant

The modified duration ("MD") of a bond is a measure which describes the relationship between a bond's price and interest rates.

It tells us the expected percentage change in the bond price for a 1% change in interest rates. Bond prices move inversely with interest rates; higher interest rates push bond prices down and vice versa. For example, if a bond had an MD of 2.5 then its price would be expected to rise by 2.5% if interest rates fell by 1%, and fall by 2.5% if interest rates rose by 1%.

The issue with MD as a standalone measure is that it assumes a constant linear relationship between bond prices and interest rates. This linear relationship is assumed to be constant for both upward and downward interest rate moves of all magnitudes and is demonstrated by the green line in the chart below. In reality, what we observe is that the relationship is non-linear.

When plotting the actual non-linear relationship on a chart for an ordinary simple bond, we can observe that the orange line looks something like a curve. This curvature is referred to as 'convexity' and there are two key drivers of convexity in the relationship between bond prices and interest rates.



"The level of convexity differs bond to bond depending on a range of factors including time to maturity and coupon size.

Firstly, MD changes with interest rates. MD or sensitivity to interest rates is larger when interest rates have fallen compared to when they have risen. As a result, we expect a larger move (increase) in bond prices when interest rates fall versus the move (decrease) in prices when interest rates rise.

Secondly, a modified duration of 2.5 would predict a bond's price to increase 2.5% for a 1% fall in rates and increase 12.5% for a 5% fall in interest rates. In reality, we would likely see a bond's price rise by more than 12.5% when interest rates fall because of convexity or the propensity of bond prices to become increasingly sensitive to larger changes in interest rates as rates fall. The opposite is true for large increases in interest rates, where we would likely see smaller price reactions to large interest rate increases than is implied by modified duration. These two aspects combine to form the orange line in the chart above.

The level of convexity differs bond to bond depending on a range of factors including time to maturity and coupon size, but we can adjust a bond's expected price evolution for convexity fairly easily. And, whilst MD reigns as the most commonly used metric in measuring bond price sensitivity to interest rates, it is important to be cognizant of the convexity effect.

Independent View

The art of charitable giving

Chris Thurlow
Managing Director, Ludlow Trust

Have you thought about gifting to charities – and what might be the best way to go about it? Chris Thurlow explains why charitable trusts can offer a rewarding and tax-efficient way to maximise the money a charity receives from you. Ludlow Trust Company specialises in setting up and running charitable trusts, and also offers a matching service, bringing together over 5000 charities with philanthropists seeking charitable funding opportunities.

What is a charitable trust?

A grant-making charitable trust is a charity registered with the Charity Commission (or equivalent). The funds of the trust are used to make grants to charities and other organisations for charitable purposes and public benefit.

Why set up a charitable trust?

Grant-making charitable trusts are a great way to make a social impact and engage the next generation, in a tax efficient way. From funding your favourite theatre to safeguarding your local schools or supporting global climate change initiatives – and everything in between. However niche or broad the cause, well-invested wealth can help make a difference.

Leaving a legacy

Charitable trusts can help you to leave a lasting legacy, allowing you to support causes close to your heart. They can be created at any time and forming a trust now allows you to decide how it runs and to build and scale it as you wish.

Engaging the next generation

Starting a charitable trust can help involve and engage future generations with the world of charitable giving as well as assets and investments. Older children can learn important lessons about investing through observing how a charitable trust is run and helping manage it, while young children can start to understand how family wealth can be used to help others. Consider the long-term value of engaging with your family in deciding which charitable causes to benefit.

Very compelling tax reliefs

Charitable trusts benefit from exceptionally compelling tax reliefs. For an additional rate taxpayer, the cost of setting up a new charitable trust may be about half of the total value of the trust – in practice this means a £500,000 trust only costs £275,000 if using Gift Aid – an example is over the page. Even greater benefits are available where you gift investments which would normally be subject to capital gains tax, which can be effectively written off by gifting the investments to charity. This could involve transferring assets currently in a JM Finn Portfolio into a charitable trust, with the trust assets continuing to be managed at JM Finn. There is also an opportunity to transfer single line holdings, which can then be sold tax free and invested in a diversified portfolio, or indeed other external portfolio assets. These benefits also extend to giving via your will, where a gift of 10% of your estate to charity could end up only costing your family around 2.5%.

Example tax position on a gift of £500,000 to charity

	Cash gifts	Gifts of shares
Gift to charity Income tax saving (additional rate taxpayer)	£ 400,000 £ (125,000)	£ 500,000 £ (225,000)
Current year net cost to client Notional future capital gains tax saving (no annual exemption)	**£ 275,000** £ –	**£ 275,000** £ (40,000)
Net cost to client including notional tax saving	£ 275,000	£ 235,000
Gift by client	£ 400,000	£ 500,000
Gift Aid recovered	£ 100,000	£ –
Total receipt by charity	**£ 500,000**	**£ 500,000**

In addition, once funds are held in a charitable trust, they are generally not subject to tax. This means that income and capital gains from investments can be received gross, maximising the value for your chosen beneficiaries.

Making the most of your giving

It is important to ensure that you find the right advisors and partners in your charitable giving. This could be by bringing added value in the world of philanthropy, offering help to find the right charity to support and guidance on how to assess the impact that your giving has made. A key advantage of using a partner like Ludlow Trust for charitable trusts is the ability to manage the administration, such as dealing with unsolicited applications or arranging annual accounts – allowing you to focus on the enjoyment of being able to choose who should benefit, when and how.

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Ludlow Trust Company is a Trust Corporation, which allows us as a corporate body to act as your professional trustee. This means that when Ludlow Trust Company is appointed, our team – led by your dedicated Trust Manager – will be on hand to seamlessly deliver informed, personalised guidance at every step. We also have years of experience in advising on trusts for family members, wills and estate planning.

www.ludlowtrust.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

Cashflow matching

Sir John Royden
Head of Research

Cashflow matching is when (a) a client wants a regular series of predictable and secure payments and (b) a bond portfolio is built that achieves this result.

We tend to use government bonds (gilts) because they are available in smaller denominations, unlike most corporate bonds which trade in minimum denominations of £100,000 – which means you would need a fairly large client portfolio before achieving any level of diversification.

Take for example, a client who wants an inflation-linked post-tax income of £3,000 per month starting in 2025 and running out to 2038. The first issue is to ask whether we want to predict inflation or use pure index-linked bonds to provide the link to inflation. If we predict inflation at 3% per annum, then we can use conventional gilts (i.e. that are not linked to inflation) as well as inflation-linked gilts to generate cashflows. That has the benefit of giving us a large number of maturing bonds to match monthly payments with capital redemptions and, to a much lesser extent, interest payments.

Using index- (inflation) linked gilts on their own is likely to cost more in capital terms if the inflation priced into the gilts is greater than our estimates of inflation rates. It is a strategy which also relies on estimated inflation-linked coupons to plug the gaps between redemptions.

Index-linked gilts are driven by the Retail Price Index (RPI). The methodology for calculating RPI is going to change in 2030 with the result that RPI is likely to be 0.7% less than would have been the case under the current methodology. This change is priced into the gilt market already, but it still introduces another layer of uncertainty into our estimates.

Glossary of key terms

Gearing – The extent a company uses debt relative to equity in its capital structure. The greater the reliance on debt, the greater the gearing. Gearing can contribute to increased return on equity but also increases the financial risk to the business.

Hard/soft landing – A 'hard' landing refers to a period of economic slowdown caused by central bank tightening that triggers a recession. In a 'soft landing' despite tightening, recession is either mild or avoided.

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

Index-linked bonds – both coupon payments and principal for these bonds are linked to a measure of inflation, typically the Consumer Price Index except in the UK when it is the Retail Price Index. This is in contrast to conventional bonds, which have no built in link to inflation.

Leveraged buyout – a corporate acquisition of another company that is funded predominantly by debt.

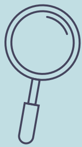
Maturity of a bond/gilt – the date at which a debt instrument ends, at which point the borrower must pay back the principal value of the debt in full to the bondholder.

Price/earnings ratio – a ratio derived by dividing a company's share price by its earnings per share. It is a relative valuation measure to determine if a company's share price could be over or undervalued relative to its earnings.

Retail Price Index – one of several indexes that can be used to gauge changes in consumer inflation. It tracks prices of a theoretical basket of goods over time.

The Purchasing Managers' Index – A survey-based measure of sentiment around current and future business conditions in the service and manufacturing sectors. A number greater than 50 indicates expansion whilst below 50 represents contraction.

'Sticky' inflation – Persistently elevated levels of inflation within an economy, typically associated with core measures where prices do not adjust as quickly to supply and demand changes.



Asset allocation and sector focus

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

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

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

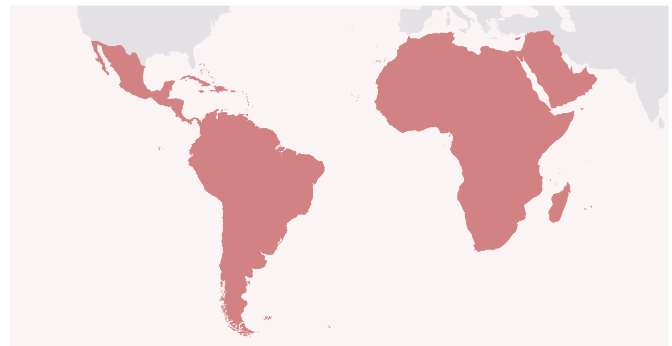
Here we present a snapshot of the current views.

Asset Allocation

Overweight Neutral Underweight

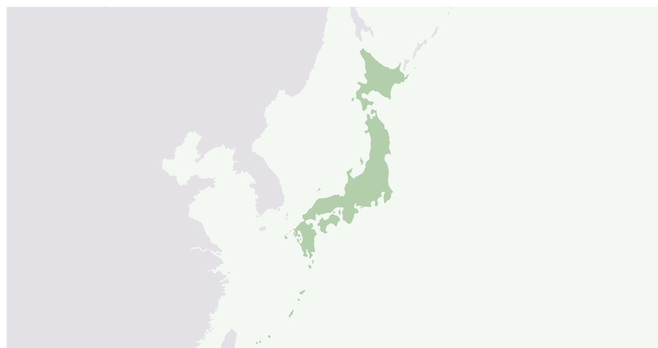
North America

Recent US inflation prints have exceeded consensus expectations, pointing to inflation being stickier than previously anticipated. Traders have scaled back bets on the pace of rate cuts, suggesting rates may have to be higher for longer to bring inflation back to the target level. In conjunction with this, US equity valuations are at a premium, with the S&P500 trading on a 22x forward price-earnings multiple. These considerations lead us to a neutral view on North America.



Emerging Markets

Higher-for-longer interest rates in the US should support continued dollar strength. A strong dollar is a headwind to dollar-exposed emerging market economies. We are still waiting to see how Javier Milei's economic experiment in Argentina evolves. Equity valuations in emerging markets look reasonable on a relative basis, however dollar strength and geopolitical risk mean we retain our cautious view.

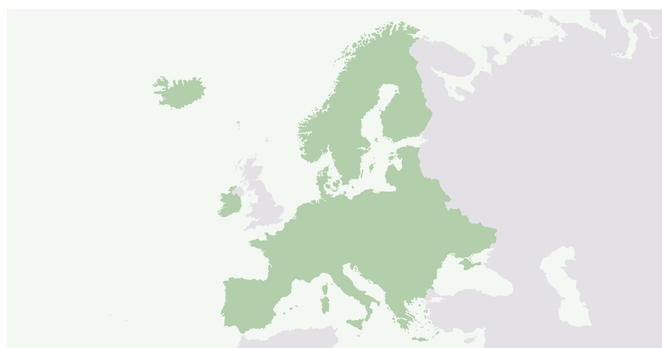


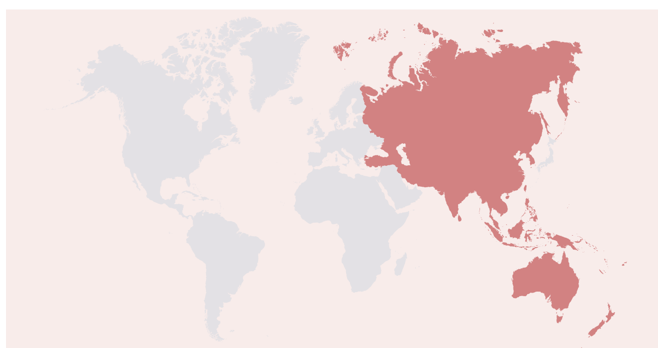
UK

The UK market continues to look cheap, with several FTSE companies the subject of takeover bids of late. First quarter GDP growth of 0.6% surprised to the upside, lifting the UK out of a technical recession. Furthermore, UK inflation continues to converge with the target of 2%. The suggestion now is that the Bank of England will cut interest rates before the Federal Reserve, with traders pricing in the first cut at either of the next two Monetary Policy Committee meetings.

Japan

The Yen slid to a 34-year low against the dollar as the Bank of Japan voted to maintain interest rates in the 0.0-0.1% range. This reportedly led authorities to intervene in order to shore up the currency. The Nikkei 225 has pulled back from its all-time high, but improving corporate governance should continue to benefit Japanese equities.





Europe

The expectation remains that the European Central Bank will commence rate cutting when it meets in June, though there is concern that the last leg down to 2% inflation may prove stickier than previously anticipated. After a period of stagnation, Eurozone GDP grew by 0.3% in Q1 with Germany recovering to 0.2% growth having contracted in the prior quarter. In addition, indicators such as the European Purchasing Managers' Index point towards easing conditions for companies in the region.

Asia Pacific

Asia Pacific mostly revolves around China. The Chinese government appears confident that the economy is on course to achieve its 5% GDP growth target without a further stimulus package. However, underlying data releases, including retail sales and home prices, give some cause for alarm. Electric vehicle (EV) equities have been a bright spot in Chinese markets, though unsurprisingly the US has responded with significant import tariffs on Chinese-made EVs, further heightening tensions between the world's two largest economies.

Please read the important notice on page 1.

Sector Focus

Overweight Neutral Underweight

Communications

The telecoms sector has benefitted from above-inflation price rises as many contracts are structured with Consumer Price Index + % increases, yet this will abate now as global inflation rates are falling. Rising debt costs remain a headwind (albeit a reducing headwind) as companies are forced to refinance at higher levels. The portions of the sector more exposed to consumer discretionary spending would struggle in a recessionary environment, although streaming companies may be more resilient.

Consumer Discretionary

Inflation has been falling, but the performance of the sector is likely to continue to be driven by macro considerations, as the sector remains pinned to the economic cycle. The non-essential element of their products/services makes them less resilient to a downswing. From the pandemic, businesses have been supported by excess consumer savings. With savings depleted, the risk of higher rates for longer looms over the sector and underpins our underweight stance.

Consumer Staples

Input costs have been a headwind for the sector, however, given abating inflation this should start to reduce. Non-discretionary demand provides defensiveness. Pricing power has been resilient, while volumes are flat to negative. As consumers are more wary of budgets, growth will likely be suppressed as firms will be not able to rely on price as much, turning to a more balanced relationship between price and volume. 2025 could provide a rebound in growth and it would remain wise to focus on the longer term.

Energy

Last quarter saw the oil majors moving in line with oil prices, except that when oil fell back down in price, the oil majors did not come off as well as expected. Brent started the quarter at $81 and ended at $83. In mid-April it peaked at $92. Sadly for the UK oil majors, they suffered more than the US majors (Chevron and Exxon) on the way down. We are neutral on energy at these levels because we are close to an oil price which drives demand destruction.

Financials - Banks

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

Health Care

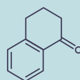
Biopharma has performed better recently as the sector has proved resilient, in addition to the ongoing tailwind being provided by obesity drug makers. Med tech performance has been more mixed but medical procedures growth remains resilient as the sector continues to recover from the effects of Covid. Valuations have increased recently but we still see long-term value in the sector. Longer-term demand remains resilient and the structural drivers associated with an ageing population are unchanged.

Industrials

Industrial indicators started to showed signs of recovery in the first quarter of 2024. The results of industrial equities were generally as expected. While areas of demand weakness and destocking make conditions challenging, there are signs of improvement as we head into the second half of 2024. With interest rate cuts being anticipated and better than expected UK and Eurozone GDP growth, the soft-landing scenario looks increasingly likely. This should support earnings growth later in 2024 and so we remain patiently overweight.

Information Technology

Performance in the sector continues to be driven by generative AI. Valuations look rich compared to historical multiples, and the sector is increasingly driven by a handful of very large companies. The sector is interest rate sensitive and so we would expect any rate cuts to be a tailwind, albeit less so following recent outperformance. The lack of margin for error provided by valuations and the increasing capital intensity of AI players drives our rating, yet we remain attracted to the sector longer term.



Materials

China is still the largest medium-term influence, although the press would have us believe that speculators are the strongest influence in the very short term. China appears to be heading towards its official government 5% GDP growth target and so additional stimulus is not required. We don't think that China will be supporting prices going forward. Longer term, the dynamics of the copper market and a possible bull move in the commodity super cycle remain supportive.

Real Estate

High rates saw volumes of commercial real estate transactions plummet in 2023, as valuations fell with heightened borrowing costs. Imminent rate reductions should help stimulate activity, helping investors to reduce their ‘risk off’ position. The market is at risk of inflation reacceleration and delayed rate cuts, but on balance we believe an uptick in the real estate sector is due on the back of easy comparatives and an improving economic landscape.

Utilities

The quarter saw Thames Water's financial condition deteriorate, with its parent Kemble Water Finance defaulting on a bond payment. The situation highlights the challenges faced by water companies as the next regulatory cycle 'AMP 8' approaches in April 2025. A key component of the UK’s energy transition will be reform of energy infrastructure, which should be supportive of asset base and earnings growth for UK power names. For this reason, we prefer power utilities which have a more attractive regulatory and operating environment than water.

Please read the important notice on page 1.

Meet the manager

Harkesh Kaul

Senior Investment Manager, London

Lives Chigwell

Started at JM Finn 2008

Hobby/pastime Gym enthusiast and Liverpool FC supporter

Favourite holiday Maldives

Hero Father

If you weren't an investment manager Commercial Lawyer

Fondest memory Birth of my son

Prefered music R n' B

Favourite book Pride and Prejudice

What does your role at JM Finn entail?

I look after portfolios on behalf of private clients that in some instances involves three generations of a family at one time. My role involves building and managing high-quality portfolios – the journey for which begins from a clean slate every time! I attend stock selection committee meetings – offering an opportunity to look under the bonnet of invested and potential companies. As well as looking after clients, I try to give back to the industry and as such am a member of the Chartered Institute for Securities and Investment Essex Regional Branch.

Has there been a standout highlight of your career so far?

The best investment decision of my career to date has been to invest in the tech revolution that is Artificial Intelligence. It is clearly a transformative piece of the technology world that many companies in multiple sectors will benefit from. As James Cameron, director of The Terminator, has said: "I warned you guys in 1984, and you didn't listen!"

What do you think the key to successful client relationships is?

To always put clients first and make sure one consistently delivers excellent client outcomes. Such results build trust and clients take great comfort in knowing their Investment Manager has his/her 'finger on the pulse' in so far as their invested stocks and global stock markets are concerned. Communication is paramount in keeping clients in the loop as and when changes are made, with succinct rationales each time.

What do you think the rest of 2024 could have in store for investors?

Inflation and interest rates will continue to steal the headlines for the foreseeable future, although as ever there will be compelling investment opportunities to capitalise on. The best companies in the world (in the mega and large capitalisation sphere) will undoubtedly continue to weather the storm. If one couples the best companies globally with a sound investment process, the outcome will produce a world- class portfolio of stocks which have potential to add long-term value to client portfolios. Whilst macro and geopolitical events are imperative to understand, stock picking highlights the uniqueness of JM Finn's offering. Such attributes conclude me to add what a privilege it is to look after clients each day in the driving seat of the best job in the world!

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