GBIM

Gore Browne Investment Management

July 2019

Hello & Welcome

England are cricket world champions, Wimbledon provided some amazing entertainment, and our netballers came so close. The strawberries may be over, but the raspberries are delicious. This all distracts us from a sinking pound, Brexit and Tory party myopia. John McDonnell offers aspirations to travel to sunny uplands, but the costs of the journey look high. He has "the top five percent" in his sights.

As usual we have some other ideas for you to think about, but with a nod to the above you might like to see the observation on land ownership and wealth taxes. Inequality has risen in recent years.

Mark Arkwright is continuing the theme of paying for the elderly and looks at the practical considerations involved. Have you got effective powers of attorney in place?

Joe Cornwall continues his depiction of how we invest in the AIM market, while the article on elevators and escalators, which may not seem uplifting, nevertheless exemplifies what we believe to be strong business models.

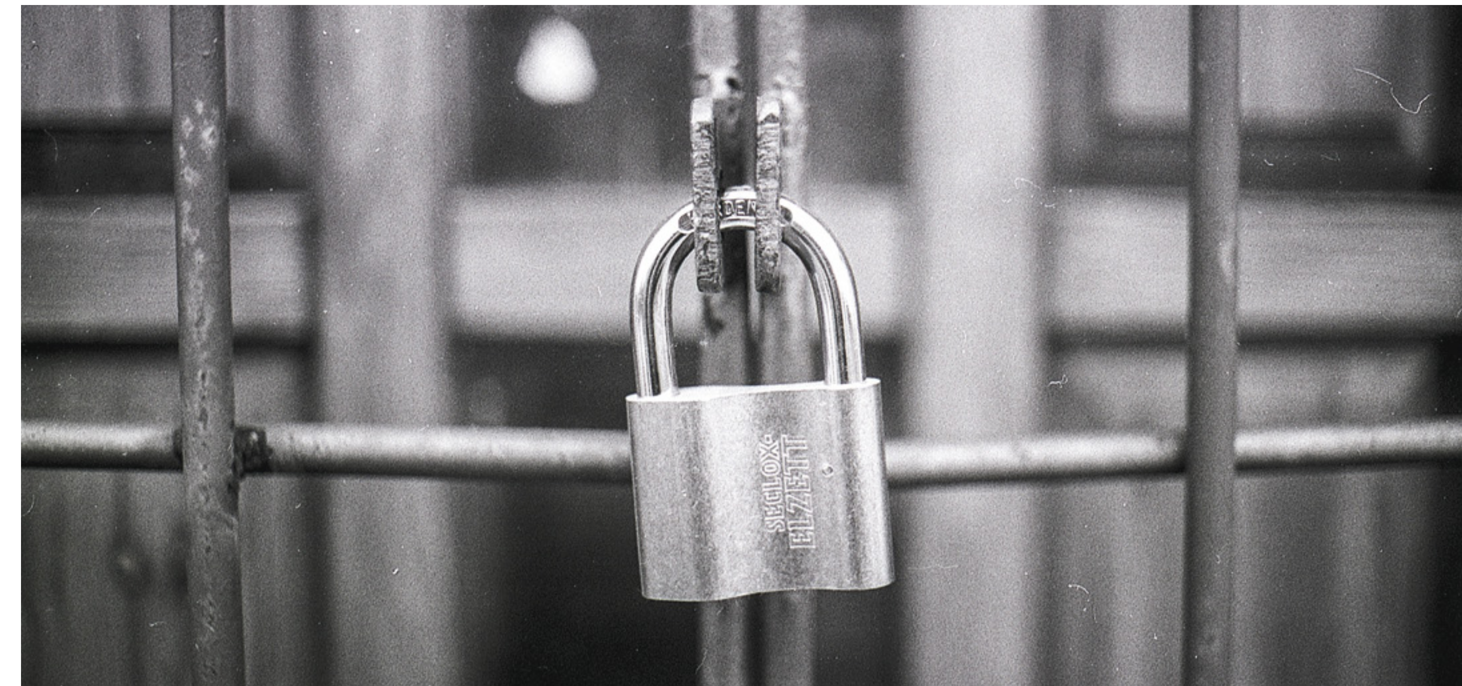
Simon James initiates a series on electricity, its changing generation and usage, and the attendant investment implications, and the update on autonomous vehicles may give a vision of the horizontal travel of the future.

Jamie Crarer however posts a cautionary note on the unintended consequences of innovation. At a time when income inequality particularly affects people in rural and coastal communities this is a sensitive and important issue.

Perhaps there are lessons for all to learn from the troubles being experienced by Neil Woodford, and we should all learn from them.

Finally, if you are worried about forgetting about everything we have written about, then please look at "Sans Forgetica".

Thank you for reading, and we hope that you enjoy the summer.



Woodford's Woes

By Simon James

The dramatic fall from grace suffered by Neil Woodford recently holds cautionary lessons for all investors, professional and amateur alike.

First, illiquid assets, such as property, infrastructure and unlisted companies should be bought by retail investors only through closed-ended vehicles, such as investment trusts or real estate investment trusts (REITs). Open-ended vehicles, such as unit trusts, suffer redemptions when markets or managers come under stress, and thus may have to raise substantial amounts of cash quickly. To achieve this they should own only liquid assets.

Second, only support managers who "stick to their knitting". Managers earn their reputations by investing in specific niches. Those who use the strength of their reputations to invest in other ways should be considered with scepticism. We should always ask whether they have lost their sense of humility. The best managers invariably never lose that understanding.

Third, when a manager leaves an established firm to set up their own boutique there can be good and bad reasons for doing so. Large firms often pressurise their top managers to manage more money than the manager believes is appropriate. Leaving to escape that pressure can be a good call, but one needs to understand whether they will become less effective when they give up the support on which they may have previously relied.

If however they are leaving to escape some of the controls of the large firm, or to earn more money than the large amounts they already earn, then beware!

Finally, be wary of managers whose funds invest in each other, or in the same underlying holdings as each other. Such situations can, but don't always, cause conflicts of interest, which may then risk compromising the manager.

GBIM has for a long time held exposure to infrastructure and property, and a small amount of unquoted companies. It is all held through specialist investment trusts or funds which invest in such assets through the stock market. We set great store by knowing the managers well and so have regular meetings with them.

Energy – From Hydrocarbons to A New Economic Paradigm?

By Simon James

Some people would argue that significant shifts in the availability and cost of energy cause great economic and social leaps forward. Without trying to defend that proposition, in this and subsequent editions we shall explore the changes in the provision and use of electricity and the impact it may have upon social and economic value chains.

Many of the ideas we explore will be reflected in the investment choices we make. Already funds we invest in have exposure to renewable energy generation and storage, electric vehicles and their components, data analysis, robotics and artificial intelligence. Stalwarts of the past, such as electricity utility or oil and gas companies, will increasingly have their relevance questioned.

Progress will be gradual in nature and take many years to reach fruition, but it is already happening.

Throughout the twentieth century energy generation was dependent upon hydrocarbons, whether for heating our homes or powering our cars. The cost has often been held captive to the competing political and economic interests of the providers. This may now be changing. The pricing of renewable energy generation is continuing to fall to such a degree that the installed base of wind and solar installations is increasingly meaningfully. It is hard to believe that this would not continue.

The majority of power generated is lost in the processes of generation, transmission and distribution. This drives interest in having a decentralised network of generation, such as solar panels and tiles on factories or houses, or combined heat and power facilities, such as that at St Bartholomew's Hospital in London.

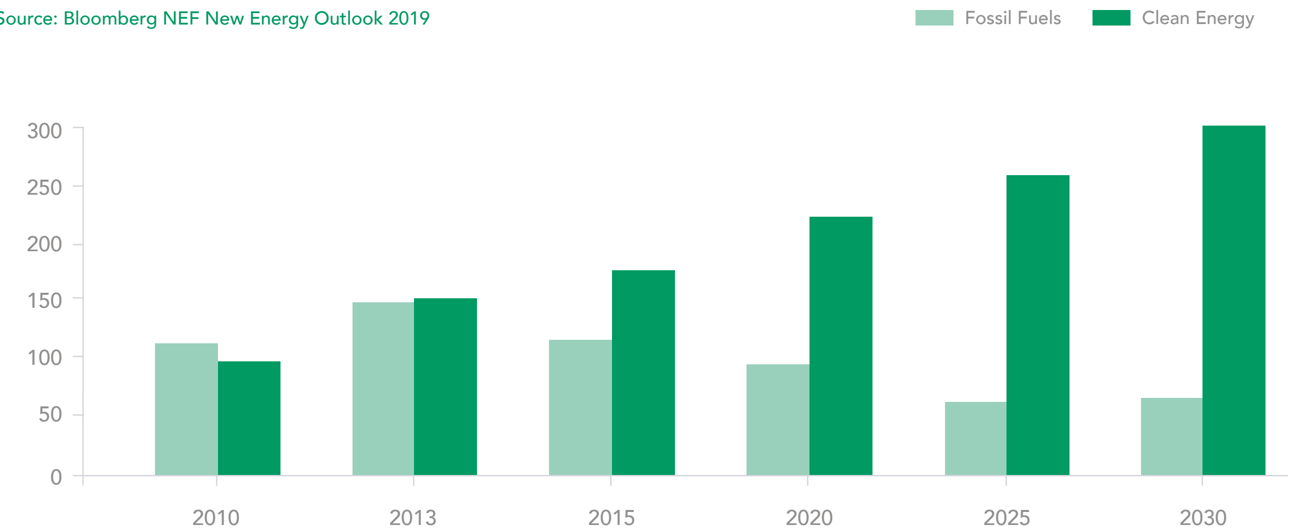
When a meaningful breakthrough has been made in the storage of electricity, both the advantages of hydrocarbons, availability at a reasonable price and transportability, will have been superseded. Already the need for large centralised generators has been removed.

Bloomberg New Energy Finance predicts that global electricity demand is set to increase 62%, resulting in global generating capacity almost tripling between 2018 and 2050. This will attract $13.3 trillion in new investment, of which wind will take $5.3 trillion and solar $4.2 trillion. In addition to the spending on new generating plants, $840 billion will go to batteries and $11.4 trillion to grid expansion.

Throughout the world, but especially in lesser developed economies, demand for clean and locally generated electricity is growing dramatically. Whether you are a climate change believer or denier there will be opportunities to invest profitably.

Global additional power generation capacity by energy type 2010 - 2030

Source: Bloomberg NEF New Energy Outlook 2019



Self-Driving Vehicles Are A Reality

By Simon James

Many people continue to believe that the introduction of autonomous vehicles, or self-driving cars, is a long way off. Perhaps this is true for common everyday driving, but it is not wholly correct.

There are already autonomous buses on the streets of Shenzhen, the region of mainland China immediately adjacent to Hong Kong. They drive on designated lanes, initially five kilometres long, and are permitted to go 15kph. They can detect obstacles, avoid them, and have their own traffic light system.

The bus can seat up to 14 people and has been developed by a well-known Chinese tech giant with a local vehicle manufacturer.

It has no driver's seat, steering wheel or pedals, it runs on electric power, and can travel up to 100km (62 miles) after a two-hour charge, at up to 70 kph.

Already 100 buses have been built. They have also been trialled in a park in Beijing, and a deal has been done with a major Japanese investor for them to be used very soon in Tokyo.

Paying for Care for the Elderly

By Mark Arkwright

One of the most stressful concerns for the elderly and their families is how to fund the cost of care in later life. Weekly fees for a nursing home in England vary substantially according to location but are typically between £600 and £800 per week (yes, weekly!) (Source: https://www.ageuk.org.uk/information-advice/care/paying-for-care/paying-for-a-care-home/), and if specialist care is required the annual costs can easily be in excess of £100,000.

Many people prefer to remain at home for as long as they can. One of our clients pays nearly £70,000 a year to stay in her home, with a full-time carer, and that is before the usual day-to-day costs of running a household.

Either way it is an expensive episode in life, and it makes no allowance for the unpaid contributions of family and friends.

There are a number of ways that care costs can be mitigated by the State, such as NHS Continuing Care or Local Authority funding, but eligibility for these can be complicated and confusing. The NHS itself says "The process involved in NHS continuing healthcare assessments can be complex." To emphasise the point they then mention "An organisation called Beacon gives free independent advice on NHS continuing healthcare." (Source: https://www.nhs.uk/conditions/social-care-and-support-guide/money-work-and-benefits/nhs-continuing-healthcare/)

Local authority schemes rely on individuals having limited capital - less than £23,250 in England. (Source: https://www.nhs.uk/conditions/social-care-and-support-guide/money-work-and-benefits/when-the-council-might-pay-for-your-care/).

In practice a large majority of us will have to rely on self-funding for care and will have to draw upon the income or capital from our savings and investments.

There is a range of financial products which can help manage the situation, such as care annuities, long term insurance, or a deferred payment scheme. Some of these options can be expensive and are often complicated. Access to them may also depend upon how much capital you have. Advice from a specialist adviser is very important. Here are a few other alternatives that could be considered:

1. Rental Income can be a viable option if you are fortunate enough not to have to sell your home and can rent it out – ideal if you have a flat in London!
2. Equity Release, where you access part of the value of your home to fund care, is popular; but there are risks attached and it is expensive.
3. Using Savings has the advantage of being readily accessible and fee free; but utilising a long-term savings pot risks eroding (the real value) of your income over time as modest inflation outstrips meagre current interest rates.
4. Paying for care using a Pension income, such as flexible access, annuity purchase or income drawdown is an option, provided you have other assets to fund your retirement.
5. If you are able to use the Income from your Investments this can also be a great way to pay for care. Within reason an investment portfolio's income can be adjusted to meet varying requirements, and potentially capital can be used as a top up when necessary. Of course, the investment pot needs to be of sufficient size, and the funds may come from or need to be supplemented by the sale of a house or pension drawdown. The risk is that, while long term income can be relatively predictable, capital values can fluctuate if markets are unstable. Volatility can be reduced to some extent by investing in low to medium risk investments. For example, GBIM's Capital Preservation Portfolio strategy, which aims to provide a solid total return (income and capital) is designed to do just this.

Care in later life can be funded from one or a combination of any of the above, and more. Good planning is advisable and seeking sound investment advice essential.

Aiming for Growth

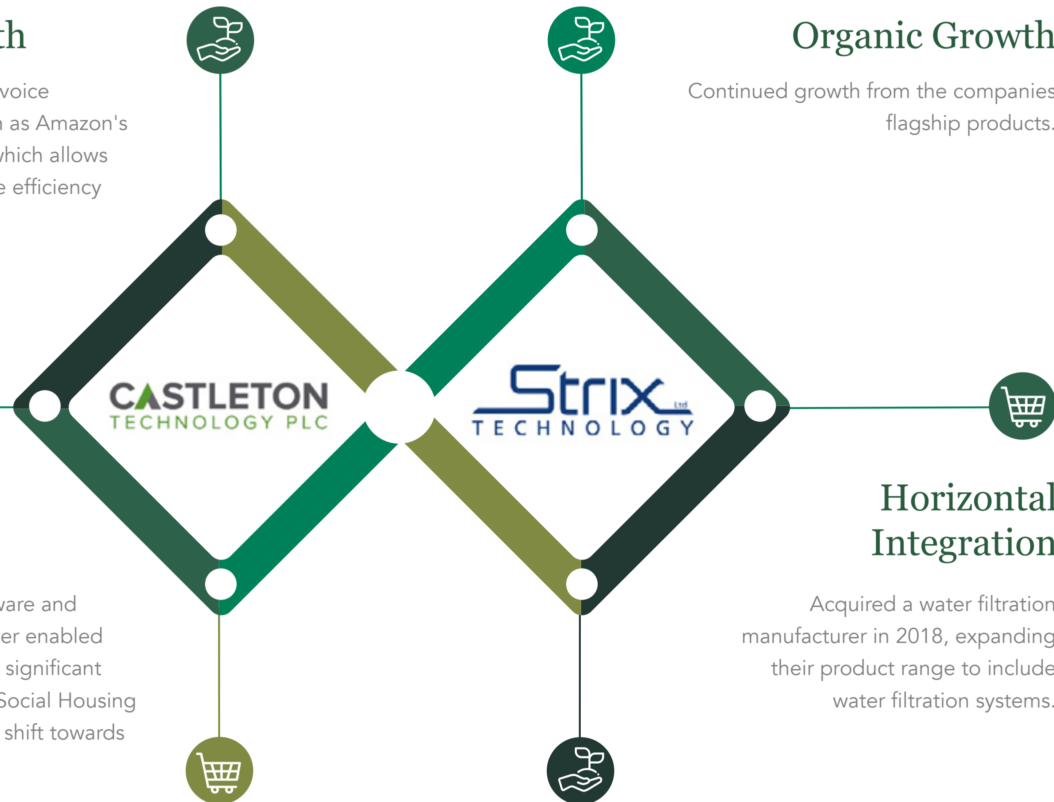
By Joseph Cornwall

In the first part of this four-part series, we discussed the characteristics that we look for in businesses in our AIM Inheritance Tax Portfolio Service. We now look at the options available to companies to enable them to accelerate their growth.

The opportunities for companies to grow are set mainly by two factors. First, whether their market is in structural growth or is primarily a cyclical market, and second by how well-financed the company is.

Organic growth is the most potent engine for investors. Structurally growing markets present stronger investment cases as businesses can grow due to expanding opportunities and weaker competitive forces. This can give time for management to establish a niche, and to erect barriers to entry. It may require little incremental investment.

Management are likely to know their market well, often making organic growth less risky than acquisitive growth. Organic growth includes developing new products or taking on new customers in a new or under-penetrated market. Geographical expansion may also offer potential. Further examples are highlighted below:



Organic Growth

The company has linked voice recognition devices, such as Amazon's Alexa, to their systems, which allows customers to increase the efficiency of their operations.

Horizontal Integration

The acquisition of a software and managed services provider enabled them to capitalise on the significant opportunities within the Social Housing market's ongoing market shift towards digitalisation.

Vertical Integration

A growing presence in India has provided additional development capability to the company.

Organic Growth

Continued growth from the companies flagship products.

Horizontal Integration

Acquired a water filtration manufacturer in 2018, expanding their product range to include water filtration systems.

Organic Growth

Entered into a collaboration with a leading global consumer product company, based in the USA, to develop a new range of coffee machines.

Cyclical companies can grow organically but management must be careful not to expand at the wrong point of the business cycle. For example, a brick manufacturer would not want to install a new kiln just prior to the housing market stagnating or lending conditions tightening. In cyclical companies, investors must rely on management to be prudent over the long-term and to time their investments well.

The other determining factor in accelerating the growth of a business is a company's financial resources. Highly indebted companies have their options restricted unless they can convince equity investors to provide them with more cash, however companies with cash on their balance sheet and the ability to borrow will have more flexibility in funding growth projects. We find that some analysts overlook the use of cash or debt-financing for growth, meaning that market forecasts can be exceeded.

If a company has the balance sheet flexibility to be acquisitive, the two main options are:

- Horizontal Integration - The acquisition of a business operating at the same level of the value chain in similar or different industries. This tends to be most powerful when there is an ability to cross-sell – either existing products to new customers or new products to existing customers.
- Vertical Integration - The purchase of a supplier or customer. This can be for growth purposes such as moving up the value chain. This might allow higher profit margins, and so develop a more robust business. This might future-proof its business by buying an essential supplier.

Acquisitions can be significant growth-drivers if they meet some of the criteria laid out above. Nevertheless, execution is important as working practices and cultures are aligned. The acquisition rationale and integration roadmap must be clear. A poor acquisition can distract management and set the overall business back, and research shows that the majority of acquisitions fail to create value for buyers.

In the next article in the series we will look at the importance of achieving sustainable returns on capital as businesses continue to invest for their future.

Going Up?

By Simon James

We have often written about Industry 4.0 and other exciting developments in technology, but there are two regular stalwarts, one from Finland the other from Switzerland, in global equity funds we like which are prosaic by comparison.

This duopoly makes lifts and escalators, which are distinctly old world, so why do they appear in many fund portfolios?

The first reason is demographics and the movement of people from the countryside into cities. The proportion of the world's population living in towns and cities today is around 55 percent. That figure is set to rise to 68 percent by 2050 according to the UN's 2018 "Population Division" report.

Urban populations grew rapidly from 751 million in 1950 to 4.2 billion in 2018. Together, India, China and Nigeria will account for 35% of expected growth between 2018 and 2050. The UN projects that by 2050 India will have added 416 million urban dwellers, China 225 million and Nigeria 189 million.

The density of urban populations has risen and continues to rise so buildings must reach higher and their occupants need to be transported vertically.

Forecasts suggest that the global elevator and escalator markets will grow at rates substantially in excess of the global economy.

The second reason is that they are not simple providers of machinery. Over time they have modified their businesses so that a growing portion of their income is from the services they provide rather than the hardware they install. Although repairs and replacements form a large part of this, providing digital access and oversight is an increasing requirement, while safety and environmental concerns are increasingly important. These provide regular, recurring fees, rather than one-off lump sums, and thus a more predictable and higher quality source of income.

Finally between the two companies they have such a substantial market share that there is little competition, and so limited threats to their position or pricing.

When do Wealth Taxes Become Politically Acceptable?

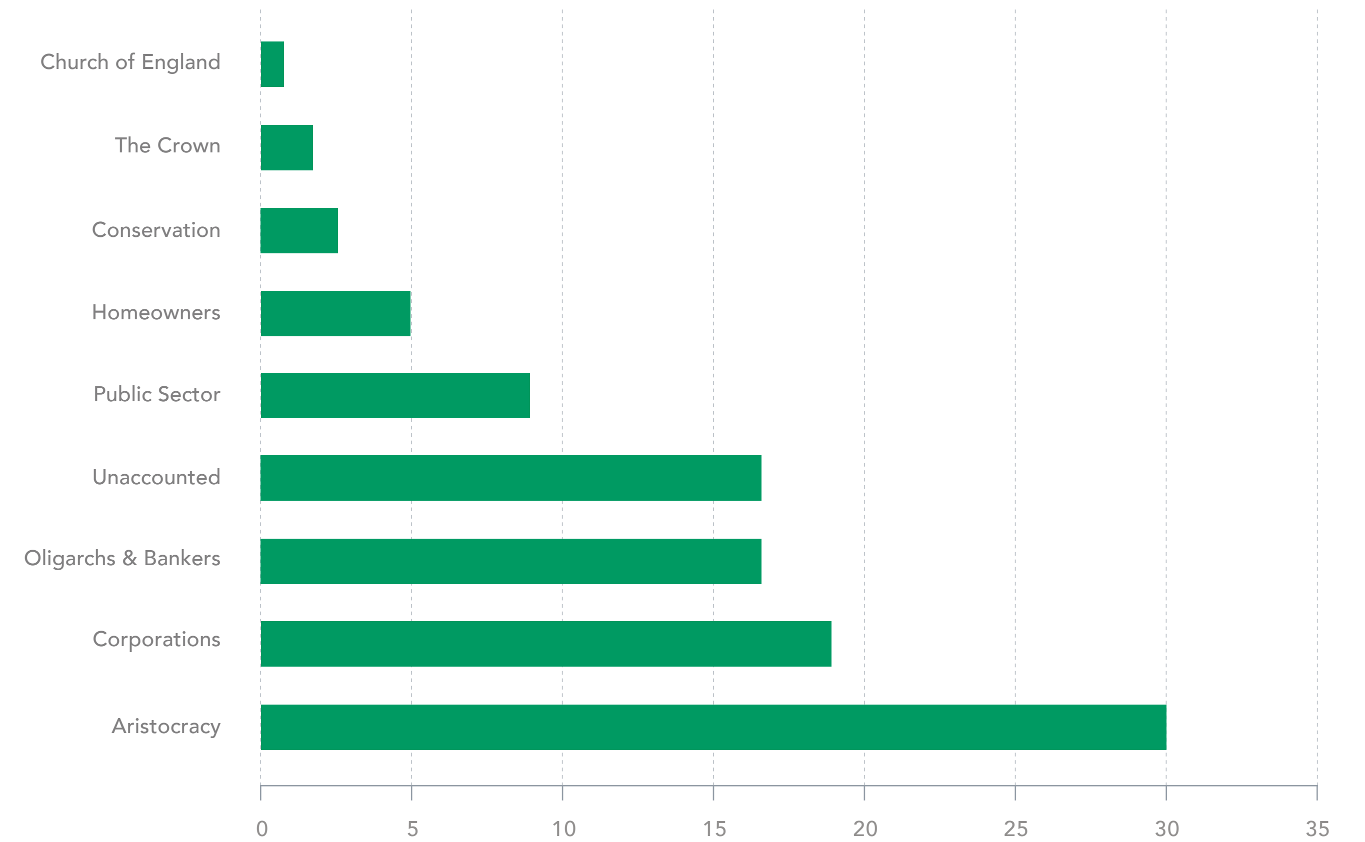
By Simon James

I have written recently about the potential for wealth taxes to be a part of the funding of the NHS, long term care for the elderly and State pensions.

A recently published book by Guy Shrubsole, called "Who Owns England?", shows that half of England is owned by 25,000 people, or less than 1% of the population.

These findings, sourced from the Land Registry and other sources accessed through The Freedom of Information Act, are unlikely to deter those who believe that wealth should be taxed.

Proportion of Land Ownership



Payments and Cash - The Unintended Consequences of Innovation

By James Crarer

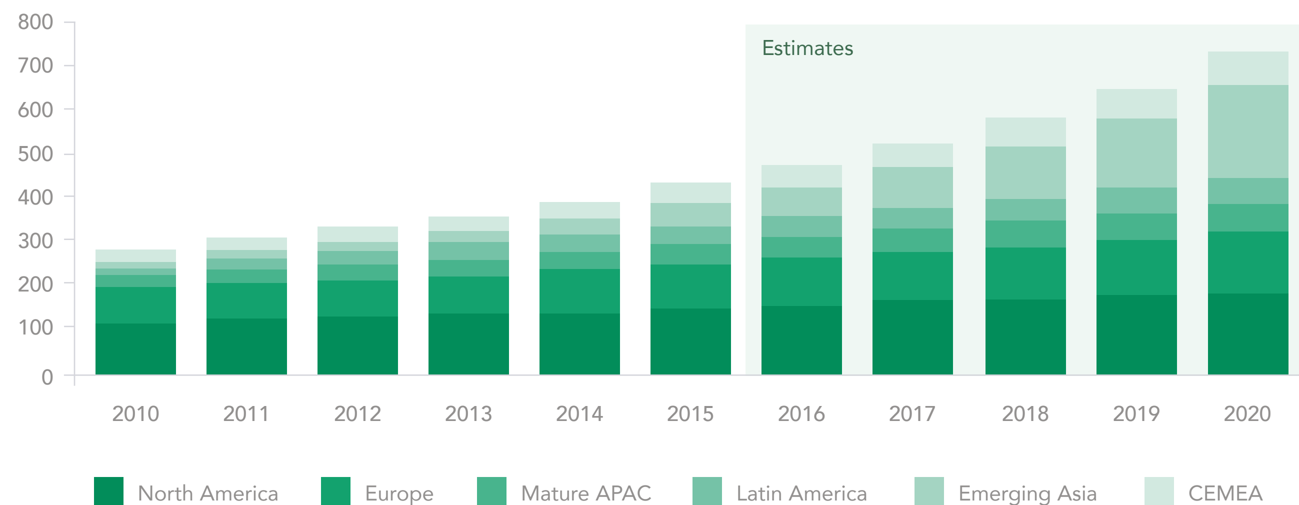
I mentioned in a previous article that Amazon, through Amazon Go, was closing the gap between consumers' online and offline shopping experiences. Many of our previous articles have focussed on disruption and how our everyday behaviour is being influenced by innovation. There are undoubtedly great benefits to be had from embracing new technology and the abundance of these enables us to have more frictionless consumption, making our busy day to day lives easier to manage. But for all the benefits there have been suggestions recently we are sleepwalking into unforeseen problems.

Growth in e-commerce is gathering considerable momentum, with the impact of the likes of Amazon on the high street well documented. Facebook recently announced enhancements to its Instagram platform which will enable users to buy tagged products which are being advertised on the platform. This cuts out the need for customers to go onto the retailer's website.

This new functionality, coupled with most retailers' free returns policies, improves the convenience for the end user and arguably reduces the need for them to head into their nearest store to have a browse, or to contemplate withdrawing cash from the nearest ATM.

Number of worldwide non-cash transactions (in bn)

Source: Capgemini & BNP Paribas



As the chart shows, the West is not as far down the road as other countries around the world. In Asia, a cashless transition is already approaching an inflection point. Central governments are shaping their policies in favour of a cashless society while technological innovation, high smart phone penetration and structural factors like demographics and urbanization are driving adoption.

The South Korean Central Bank has been promoting the concept of a cashless society and plans to cease minting coins by 2020, while the Indian government decided to press ahead with demonetization and withdrew the INR 500 and INR 1000 bank notes. At the consumer level, during last year's Chinese New Year, 688 million people used WeChat to send and receive virtual hongbao (traditional red packets used to gift cash). (Source: UBS, Shifting Asia: The road to cashless societies April 2018)

For many people these innovations will be useful new tools, which they then take for granted. But the suggestion in the report is that there are 25 million people in the UK for whom living in a cashless society would present real challenges.

The lack of high-speed internet infrastructure in remote and rural areas means that many merchants and retailers are still unable to use electronic payments. The Financial Conduct Authority states that there are 4.1 million adults in the UK who are in financial difficulty, and debt charities advise people to cut up cards and use only cash to assist them with budgeting.

According to the Access to Cash report, to keep the cash infrastructure of the UK operational in its current form costs £5 billion per year, much of which is fixed and paid for by high street banks. As cash use declines, the economics of this model is becoming seriously challenged, forcing banks and ATM service providers either to reduce the number of free ATMs or to get rid of them completely.

Innovation is creating a self-fulfilling cycle. Banks' profits are under pressure and so they funnel their customers towards their cheaper, more efficient, digital offerings; branches and ATMs are then used less, and so justify cost cutting measures, as it is reflects what their customers are doing. Coupled with the threat posed by the global technology giants' own fintech offerings, the response from banks is to invest more in their digital offerings and to continue to move away from traditional branch and ATM services.

This may be good for banks' profits, but it does little to enhance their reputations among the public, especially those who are financially vulnerable.

(Source: Access to Cash Report - https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf)

Did You Know? - Sans Forgetica

By Toby Bazzard

The 'desirable difficulty' principle was developed by R. A. Bjork in 1994. He proposed that the harder our brains work in absorbing information, the greater the long-term retention will be. It was with this in my mind that Melbourne-based RMIT University recently developed memory-boosting font Sans Forgetica. The diagram below shows how it is constructed.

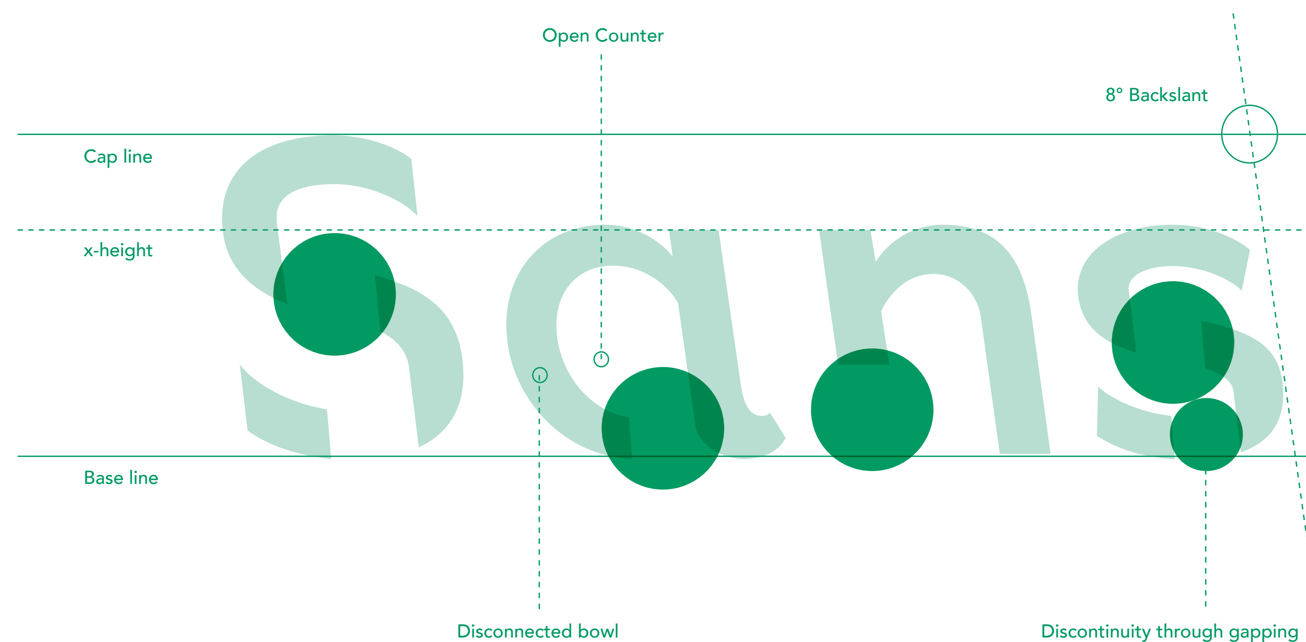
The design incorporates random gaps and a left slant which slows down the reader and results in deeper cognitive processing. While it's not designed for large bodies of text the potential uses include: exam studies; advertising campaigns; and combatting memory loss.

Let's put it to the test with a few facts:

"There are over 5 billion searches on Google every day."

"There are approximately 300,000 fonts in the world."

"Alexander the Great was able to remember all of the names of his soldiers—there were approximately 30,000 people in his army."



Salisbury Office:
Tel. : 01722 424 444
Email. : salisbury@gbim.co.uk

Harrogate Office:
Tel. : 01423 508 040
Email. : harrogate@gbim.co.uk

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