

Uncommon Sense

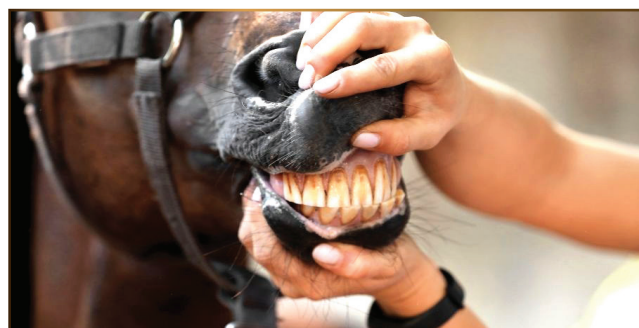
During those languid days of Christmas, subdued by mulled wine and mince pies, I gazed out at some pretty miserable weather. Instead of walking the dog, I made the mistake of scrolling through my Facebook account.

At present, Facebook is approximately 10% populated by the interesting activities of friends and family and 90% by utter rubbish, resulting in an aggregate 100% waste of my precious time left on this mortal coil (with apologies to my friends and family). One particular thread, on a group (which will remain nameless), started down a Grinch-like path of naming and shaming, to which I (mistakenly) tried adding some logical, unbiased and, so I thought, helpful comment. Just in case I was feeling left out, I too was subsequently labelled with insults, as was everyone else in the thread, the sorry sequence eventually descending into what my younger son (aged 20) described as 'lacking couth'. In Jewish culture, there is a saying that 'a debate for the sake of heaven will endure', concerning the art of respectfully disagreeing while remaining civil. So much for heaven, or civility, for that matter.

Blinked, and you might have missed it in the mainstream press, but the Vice President of Berkshire Hathaway, Charlie Munger (the Oracle of Omaha) died at the end of November, only a month or so shy of what would otherwise have been his centennial celebrations on New Year's Day 2024. Like another of my favourite market gurus (Peter Lynch), Mr Munger prized logic, patience (buying and holding stocks) and reading, often biographies, where he would discover that loss (and failure) formed the creative process, a common theme in the lives of the most successful. On his endangered species list, however, were individuals who had 'uncommon sense'. As clearly evidenced by the unchecked biases of Facebook users, he rightly suggested that 'most people are a mass of crazy prejudices', a characteristic which has not entirely passed me by. Recognising bias (the nemesis of logic and common sense) is a bit like discovering that your body is not symmetrical and that your left shoulder, which you injured twenty years ago, is less mobile than your right. We are all the product of nature and nurture and our opinions are formed by both, whether we like it or not.

As investment managers, it is our duty to override such biases and to question our tenets. While we had been promising our clients this moment for some time, we were still startled by the speed at which the 'higher for longer' mantra on interest rate expectations swung, in the final months of the year, to hopes of a 2024 rate-cutting fest. Gone are the comments about 'Table Mountain' interest rate trajectories and, like heated brandy set alight over a Christmas pudding, the 5% yield on a US 10-year Treasury bond evaporated in a flash, resting at 3.93% by the end of 2023. Sparking a welcome rally in equities, investors were finally able to put a floor on the valuation of future earnings growth, while the two-year long headwind faced by high quality real estate and infrastructure investments ebbed, emerging from the long shadow of a 5% return on (risk-free) cash.

In one respect, this was a wonderful affirmation of our consistent advice to clients, to remain patient and fully invested. That said, this rally also constituted a significant confirmation bias after a long bear market. It is also our duty to recognise why central banks generally take their foot off the gas; namely that they expect harder times ahead. Only 30% of UK mortgages have re-set within a higher interest rate environment and the mortgaged home-owner is the UK's most economically active demographic, suggesting that the delayed effects of interest rates rises do not necessarily bode well for credit quality or consumer strength, despite ongoing job market resilience. While inflation is moving in the right direction, there are still inflationary forces



Don't just stand there, check the teeth.

in play which threaten to confound the Bank of England's 2% target for some time to come. It is also worth recognising that we are only one factor away from a modestly stagflationary backdrop, at least in the UK and Europe, where economic growth remains sluggish and inflation above target. While pleased to see that high unemployment is the missing piece of this puzzle, hirings in both Europe and the US have cooled in recent months.

Apologies, if I've just popped a few party balloons. The caveat to this, however, is our stock selection discipline. As always, this focuses on high-quality investments, including companies with diverse, sticky revenues, strong cash flows and low debt, leaving us less concerned about a weaker growth environment than we might have been, had we honed our investment skills during the era of 'free money', where the cost of capital was nearly zero. A climb-down from high inflation and interest rates is welcome but neither do we expect to return to the lost decade of ZIRP for depositors and bond holders. Quality equities will stay the course and will likely outperform in the long run, but equally we herald the return of bond securities to the investment manager's arsenal. We may see 10-year yields settle at around 3-4% while inflation remains at 3% (a nonexistent real return) but bonds are unlikely to revisit the 'return free risk' which drove us away from this asset class for over a decade. There is also the renewed possibility of investing in index-linked securities with the prospect of an actual, real, return (gasp).

We are always taught to be mindful of 'what if' scenarios. With at least two major conflicts still in progress, the regionalisation of supply chains ongoing, protectionism to the fore and a major economy continuing to stagger back from lockdowns (China), the path to recovery will not be smooth. Key to portfolio performance will be the removal of our own biases through diversification and careful portfolio construction. In a world where large chunks of investment are determined by cheap algorithmic triggers on 'soundbites', our increasingly unfashionable discipline of company due diligence is likely to be our differentiator. As my other guru, Peter Lynch, once suggested, *'the early Greeks used to sit around for days and debate how many teeth a horse has. They thought they could figure it out just by sitting there, instead of checking the horse. A lot of investors sit around and debate whether a stock is going up, as if the financial muse will give them the answer, instead of checking the company'*. Uncommon sense, indeed.

Mary Tait

CHIEF INVESTMENT OFFICER - JANUARY 2024

Echo Beach

Readers old enough to remember the 1980s hit single Echo Beach, by Martha and the Muffins, will also be old enough to remember something called 'customer service'. In the financial industry (mainly the banks) the concept of 'service' has been hacked down branch by branch (literally), as part of a transition to shift everything online (and, by definition, increase profits). This is fine (sort of), until something inevitably goes wrong, triggering the need to call the dreaded 'help desk'.

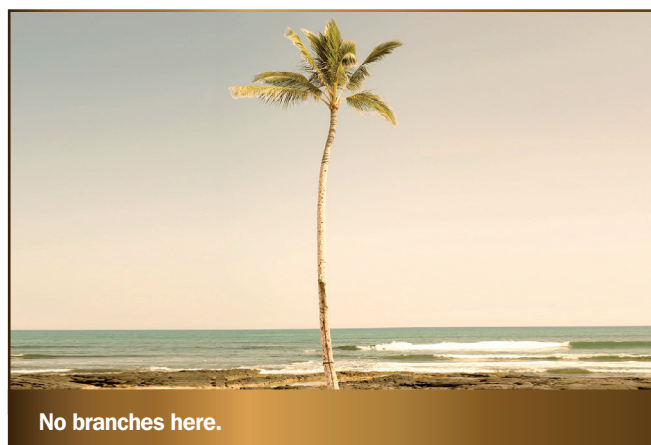
The use of help desks is rarely an uplifting experience. They are often staffed by isolated workers in a call centre, or (worse) 'working from home', or (worse still) by a robot. The Sisyphean challenge of getting to the end of a call is a familiar one, especially for those used to 'levelling up' in computer games as players advance from stage to stage. It seems to be a common human trait to follow instructions once committed, despite absolutely knowing that the result will be inconclusive. More often than not, the caller (and/or computer) gives up and drives 50 miles to the nearest branch to speak to a person (who will inevitably recommend their online banking service).

For this privilege, the banks (and others) charge a fee, sometime hidden, sometimes not. With fully disclosed fees, we rarely take issue. These firms are not charities. What we do take issue with is the disconnect between the level of service and the level of fees, disclosed or otherwise. In financial services, this gap has been growing for far too long.

Enter, stage left, the brand-new **FCA Consumer Duty**. Introduced by the UK regulator in 2023, this harmless sounding set of regulatory rules requires firms to 'act to deliver good outcomes for retail customers'.

This hardly sounds like a game-changer. From the perspective of a CISI* qualified investment professional (e.g., all of the FIM investment team), this new duty merely restates and simplifies a meaningful 8-point code of conduct to which those qualified are already individually bound in letter and in spirit (see below).

The key difference is that the requirement to treat customers fairly, is now a regulatory obligation for companies, not just chartered individuals of a professional body. For readers who



assume that financial services businesses have always acted in their best interests, think again.

Evidence of this shift is starkly shown by the performance of several major UK financial service businesses since the rules came into effect last year. The largest of these, **St James' Place**, which is listed on the London Stock Exchange, suffered a share price fall of over 30% over the full year, compounding a similar fall in 2022, a bad year for equity markets. The share price reaction was, in part, thanks to the company's welcome (albeit inevitable) adoption of the Consumer Duty instigated by a new CEO who set about ensuring that its fee structure was fair (the inference from the share price being that previously, it was not).

The fallout from the new rules does not leave us feeling especially warm towards our industry. We have long argued that, whilst institutional business inevitably attracts a keener fee structure than non-institutional (or retail) business, this does not give the financial services sector carte blanche to charge through their teeth, unchallenged. Nor, for high quality service do we expect a race to the bottom. Pricing should be fair, commensurate with performance and proportionate. It is disappointing that failure to ensure this outcome has necessitated regulatory intervention. The more so when, as individual investment professionals, we have adhered to a voluntary code of conduct for many years.

Russell Collister

DIRECTOR OF GROUP INVESTMENT STRATEGY

CISI Code of Conduct - Principles

<p>Principle - Personal Accountability</p> <p>Stakeholder(s): Self, Clients, Regulators, Colleagues, Market Participants, Firm, Profession, Society</p> <p>To strive to uphold the highest levels of personal and professional standards at all times, acting with integrity, honesty, due skill, care and diligence to avoid any acts, either in person, in a remote working environment or digitally which may damage the reputation of your organisation, your professional body or the financial services profession.</p>	<p>Principle - Client Focus</p> <p>Stakeholder(s): Clients</p> <p>To put the interests of clients and customers first by treating them fairly, being a good steward of their interests, never seeking personal advantage from confidential information received and utilising client data only for a defined purpose.</p>	<p>Principle - Conflict of Interest</p> <p>Stakeholder(s): Clients, Market Participants, Regulators</p> <p>Being alert to and actively manage fairly and effectively any personal or other conflicts of interest, obeying legislation and complying with regulations to the best of your ability, ensuring you are open and cooperative with all your regulators, challenging and reporting unlawful or unethical behaviour.</p>	<p>Principle - Respect for Market Participants</p> <p>Stakeholder(s): Clients, Market Participants</p> <p>To treat all counterparties and business partners with respect, to observe proper standards of market integrity, good practice, conduct and confidentiality required to maintain the highest level of mutual trust.</p>
<p>Principle - Professional Development</p> <p>Stakeholder(s): Profession, Clients, Colleagues</p> <p>To strive continually for professional excellence, committing to Continuous Professional Development (CPD) and promoting and supporting the development of others.</p>	<p>Principle - Aware of Capabilities</p> <p>Stakeholder(s): Clients, Profession, Market Participants</p> <p>To decline to act on any matter about which you are not competent or qualified unless you have access to such advice or assistance to carry out the work in a professional manner, taking into account the nature of the individual mandates given by your customers and counterparties.</p>	<p>Principle - Respect Others and the Environment</p> <p>Stakeholder(s): Society, Colleagues, Clients, Regulators, Market Participants, Profession, Professional Body</p> <p>To treat everyone fairly and with respect, supporting opportunity for all, embracing diversity and inclusion and ensuring that the environmental impact of your work is considered.</p>	<p>Principle - Speak Up & Listen Up</p> <p>Stakeholder(s): Society, Colleagues</p> <p>To be active in speaking up and encouraging others to do so by listening up, promoting a safe environment for all and recognising the responsibilities you have to the communities in which you operate.</p>

Time Flies

I'm not sure about you but I hate to admit when people are right. For me, this is particularly true when it relates to things my parents have said. Growing up, as we approached each year end, I remember having conversations with them about how quickly they felt the year had gone but for me it felt like a drag, probably because I was looking forward to the years when I would learn to drive or go to the pub for my first legal drink. These conversations always ended with the same statement: 'enjoy these years now, as they only go quicker as you get older'. I hate to admit it, but my parents were right.

Four years ago, it's hard to believe that we were looking forward to entering the new decade. As we headed into 2020, many would have anticipated the biggest change for the United Kingdom would be its official exit from the European Union and few could have predicted the mayhem which subsequently unfolded. Back in late 2019, hardly anyone noticed when news emerged that China was monitoring the outbreak of a flu-like virus. How that small outbreak changed the world we knew. Much of 2020 and 2021 were dominated by the Covid-19 pandemic with people's lives coming to a standstill, as countries across the globe implemented months of lockdowns to slow the spread of the virus. Society gradually adjusted to a new 'normal' during much of 2022, the roll-out of vaccines cancelling the need for further lockdowns and allowing people to begin travelling again. While daily lives gained some normality, it was in the greater economy where repercussions were subsequently being felt. Inflation figures climbed sharply, the UK's rate peaking in October 2022 at 11.1%; levels not seen in over 40 years. To combat these record high figures, interest rates were increased at every opportunity, the UK's central bank hiking the base rate by 14 times since December 2021, settling at 5.25%, the same level interest rates reached prior to the Global Financial Crisis. Despite the immense struggles over these three years, the period from 2020 to 2022 seemed to pass in the blink of an eye.

While challenges were still present, there was a sense of optimism as we entered 2023. While not through the worst of the economic turmoil, it did appear that the end of it was slowly approaching. Inflation figures, though still relatively high, were slowly decreasing month-on-month, as the effects of higher interest rates were being felt. Unfortunately, this optimism was short-lived. We witnessed a banking crisis in the US, with Silicon Valley Bank and First Republic Bank collapsing, while UBS rescued Credit Suisse in Switzerland. More recently, we witnessed the devastating effects of the Hamas/Israel conflict, which saw over 1,000 Israelis killed at Hamas' first strike. In retaliation, Israel launched multiple airstrikes against Gaza and invaded northern Gaza. The soaring death toll of innocent Palestinian civilians, mostly women and children, fuelled questions over whether Israel was committing war crimes, sparking fears that the conflict might lead to a broader Middle East War, a concern which only started to ease as we approached the year-end. Unfortunately, this was not the only conflict raging during 2023. The war between Ukraine and Russia has continued, nearly two years after the initial conflict broke out, with Russia gaining territory and no sign of a ceasefire in sight. Despite such atrocities, we have also seen several positive developments, particularly concerning significant technological advancement. Technology has progressed rapidly over recent years but 2023 saw the continued



rise of generative artificial intelligence (AI) models, most notably ChatGPT, with these models advancing in machine learning and natural language processing and becoming capable of creating realistic and coherent text, images, and music. With all this, it felt that the days, weeks, and months of this year flew past at an ever-increasing speed.

With so much changing over the last four years, it does raise questions about what could potentially happen over the next 12 months. While interest rate cuts can't be fully guaranteed, the effects of tighter lending conditions and receding energy and food prices have helped to halve inflation in the UK, with the latest CPI figure being 3.9% in November. Also in recent weeks, the Fed Chair, Jerome Powell stated that this historic tightening of monetary policy is likely to be over, officials believing they will see around 0.75% of cuts in 2024. Markets reacted well to this announcement, with the FTSE100 and S&P500 increasing by around 3% and 4% respectively during December alone. 2024 will also see the most voters in history take to the polls, with around 50% of the populations of 70 countries likely to take part. These votes could prove consequential for years to come, two of the most notable elections being in the UK and US. In the UK, it appears more likely that the power of the Conservative Party will come to an end after a 14-year run, while in the US, the debate continues over whether Donald Trump will run against current President, Joe Biden, who has already announced his intentions to stand for a second term.

We all know that it's impossible to accurately predict what will happen over the next 12 months, but on one thing I remain confident: Just like the last four years, we will get to the end of 2024 and the question many people will be asking is: Where has this year gone?

Charlotte Cunningham
INVESTMENT MANAGER



Doing Your Homework

After a difficult period, we have almost forgotten that markets can experience tailwinds as a rising interest rate era draws to a close.

Subsequently, it would not be unreasonable to expect 2024 to be above average, providing that there are no black swan events. Indeed, a bumper year for the UK market could be classed as a black swan event, given its rarity. Regrettably, not all positions have weathered the cycle in good shape and a bad call means letting someone down. To achieve respectable returns, one must adopt and manage risk, but we don't have a crystal ball. Another element of private client portfolio management which is equally upsetting is when a long-standing client dies. I recently had to liquidate a deceased friend's portfolio, established over fifty years ago, but it is worth sharing some observations here because in today's environment, the portfolio's strategy was both successful and unusual, despite being quite normal when my career started.

Today, there is no one strategy which works consistently. Tracking benchmarks with modest tolerance margins has become increasingly popular. Continually adapting to a changing environment leaves investors chasing momentum. On a relative return basis, one can never be too disappointed, but a portfolio ultimately needs good absolute returns to pay bills or fund retirement. Risks surface when the macro backdrop changes or when there is a geopolitical event, resulting in a market leadership change, such as that experienced by Japan in the 1980s, when it lost its position as the world's largest equity market. At that time, holding a global tracker (not that this existed) would have been a painful experience, particularly for a lump sum investor. A drip-feeder, on the other hand, could have averaged out of the predicament rather than cutting losses. Perhaps we are experiencing a similar situation today with 'The Magnificent Seven', representing 26% of global equities. These stocks are highly correlated and have performed well, so it is unlikely that any new investor at this point will be buying cheaply. The portfolio to which I referred earlier could not have been more different. There was nothing modern or new therein, although many companies had adapted over decades: far easier to do with a strong balance sheet. The portfolio was established to minimise dealing activity (dealing commissions at the time were 1.65%), to generate income and it was also subject to UK Capital Gains Tax (CGT). This meant that winners were allowed to run and losers were sold to offset gains, a similar philosophy which continues to support our equity-focused '**Pound a Day**' model portfolio service. The portfolio had a pure UK focus, holding quality large cap stocks with a cluster of old-name investment trusts for overseas exposure.

Records don't go back to day one, pre-decimalisation, so we have no idea how it performed since inception, but in recent years its net annualised return hovered between 6% and 8%. A position in **Royal Dutch Shell** generated around £2,500 per annum of income, yet the holding only cost £4,000, while the **Mercantile Investment Trust** was generating more income each year than the holding originally cost and the capital had appreciated by 3,300%. This was not an isolated sample. A holding in shares of **Experian** originated from Great Universal Stores, the UK

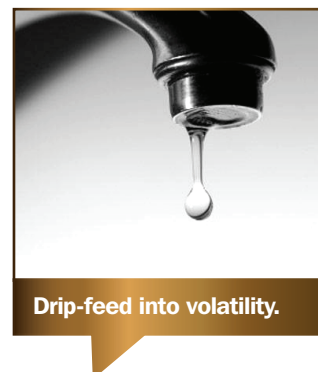
conglomerate nicknamed 'Gussies'. This never quite lived up to expectations, but transformed into a star performer. There was nothing exciting here (perhaps summing up the UK market) but consequently, there were also few disappointments. The mindset of generations makes a country what it is, but few feel comfortable with the past and often seek change.

On reflection, there are times when one wonders if anyone really understands the UK economy. We know that it is dominated by services, yet politicians continually seek to attract technology and science-based industries, forgetting that food and drink is the largest single manufacturing sector in the country, contributing just short of £35bn to the economy and employing 466,000 people. It is bigger than the auto and aerospace sectors combined with exports amounting to over £25bn across 220 countries. The UK keeps kicking itself over Brexit yet, even exports to Europe are growing at 22%. Digging deeper, at a retail level, who would have thought that 85% of Fortnum & Mason's food and drink offering is UK-produced with only wine and cheese holding back the numbers. That said, if **Chapel Down Group** continues to grow, perhaps overseas wines will also be displaced. Food is not tech, but we all need to eat. A bit boring perhaps, but the adjectives, 'boring', 'reliable', 'necessary' and 'familiar' should be considered more often in portfolio construction.

Sticking with the same theme, a recent article in The Times on market winners may have raised a few eyebrows considering both ten-year returns and how dull the winners were. The period ran up to April 2023 with **JD Sports** leading the pack with a 22.3 times return. **Games Workshop** followed at 14.3 times and **YouGov** at 12.2 times. Even one of our AIM stocks, **Judges Scientific** made it into the top ten. Averaging into and out of positions always makes sense and there is no better example of its success than with Judges. We first bought the shares for selected portfolios in June 2014, paying £20.80 but by July, they had fallen to £14.45, so we averaged down and continued to build positions for clients who sought IHT protection. We picked up 22p in dividend payments during the first year. This year, the equivalent amount was 76p per share and the shares now trade at £95.

Investing does not have to be complicated but it does require some homework, common sense and an ongoing interest in economics and politics, while trying to use volatility as a friend. If you don't fancy the effort but still want to give this strategy a chance, then let us do the management for you with our **Pound a Day Portfolio**, which runs winners and cuts losers, all for one pound a day.

Paul Crocker
INVESTMENT DIRECTOR



Investment Management Briefing Editor: Mary Tait, Chief Investment Officer

The investment team at FIM Capital Limited hopes that you have enjoyed reading our articles this quarter. If you are not currently receiving our Investment Briefing on a regular basis but would like to do so in future, or you wish to inform us of a change in your contact details, please contact us at enquiries@fim.co.im. Equally, please contact us if you no longer wish to receive our Briefing and we will remove you from our mailing list.

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