

## Charging Point

Towards the end of January, shares in GameStop, an old-school American video games retailer, were driven higher by a cohort of (largely) young day traders looking to make a killing, armed with laptops and furlough cheques.

Whilst the potential to make money was no doubt appealing, their more important mission was to expose a number of hedge fund managers who had borrowed GameStop shares to sell 'short', hoping to eventually buy back in at a lower price, possibly at the expense of GameStop's workforce.

To widespread surprise, the tactic worked, at least in part. As the GameStop share price was propelled higher, so the hedge fund managers were obliged to cover their losses, buying shares back not at a lower, but a more expensive price. At least one high profile hedge fund manager was forced into a humiliating bailout. Hedge funds can be accused of many things, but rarely have they been held to public account for their lack of social conscience.

Capital markets are driven by the need to produce a return relative to risk. There are myriad ways of achieving this, but the requirement to make money (or, at the very least, preserve it) is central. The industry has, more often than not, bypassed the social consequences of its business activities. That is now all changing.

Environmental, Social and Governance issues (ESG) have always affected investors, some more than others. As a junior investment manager, I was intrigued by the written instruction on several new investment management contracts to avoid Nestlé. Why? Because, of the company's promotion of an 'addictive' baby milk powder in developing markets, a tiny part of the company's empire even then. There are many other examples of reputation-trashing stories. Johnson & Johnson's baby talcum powder, for instance, with its alleged cancerous properties or, more recently, a subsidiary company of Compass Group overpricing food parcels for the needy at the height of the COVID-19 pandemic.

Aware of the shifting sands of public sentiment, businesses and lawmakers have started to address ESG issues more seriously. Invariably, there have been accusations of corporate 'greenwashing'; spinning ESG credentials to create the impression of environmental friendliness (think Emma Thompson jetting over to an Extinction Rebellion rally). But impending EU regulations are raising the bar. As a consequence, most companies already have personnel in place dedicated to ESG adoption. Many will have to change the way in which their businesses are run, way beyond installing a few solar panels on the roof.

For some companies, this process is easier than for others. Inevitably, those EU recommendations will be expensive to implement. Meeting ESG targets in a company whose core business is extracting oil from tar sands, or manufacturing military



hardware is going to be a lot harder than providing a pleasant working environment for trainee solicitors. Certain sectors such as energy and tobacco are already widely shunned by institutional investors fearful of reputational backlash. But should these sectors be denied access to capital in a free market, given the difficult conditions under which they already operate and their relevance to our way of life?

In fact, under the strictest interpretation of ESG rules, swathes of companies would be bundled out of portfolios in one stroke. Just a few days ago, Nike and fashion retailer Burberry were called out by the Beijing government (and boycotted by their all-important Chinese customers) for having the temerity to express concerns over the alleged use of Uighur forced labour in cotton production. The source of raw materials has long since been a concern for many manufacturers, especially those operating in frontier markets. Can we not, now, invest in China? Just how far can or should shareholders go to eliminate the risks, many of which they have no way of knowing?

Whilst many institutions will have already made up their minds, individual shareholders have no obligation to be dictated to by ESG policies. Some, like those concerned about Nestlé, may want their portfolios to be managed with a very serious ESG overlay. Others may not be bothered in the slightest. Most will, we think, fit somewhere between the two extremes, wanting to create wealth but in a way which demonstrates awareness of modern sustainability concerns. After all, some may one day transfer their wealth across to the GameStop generation, a group which, by many accounts, already holds a lot more influence over markets than is widely believed.

**Russell Collister**

CHIEF INVESTMENT OFFICER - APRIL 2021

# Retail Therapy

'In his blue gardens men and girls came and went like moths among the whisperings and the champagne and the stars.'

(*'The Great Gatsby', F. Scott Fitzgerald, 1925*)

With few exceptions, I absolutely hate window-shopping. Defending e-commerce, I have previously lamented on the wet, windy and disconsolate experience of buying goods in town, often accompanied by a relatively high failure rate, my spirit inevitably yielding to sipping a cortado and waiting (oft in vain) for the rain to pass and my clothes to dry out. There is, however, that rare experience when I find a perfect parking space, go into the first shop and find exactly what I want, returning home shortly thereafter. My husband knows that I like a nice dress and finding one which meets my discerning taste makes me feel good. In our current stop-start world of occasional lockdowns (alas, COVID has not shunned the Manx), retail sojourns are mercifully scarce. Some of my female friends even travel to the UK mainland for an activity I might readily trade for sticking needles in my eyes, a sentiment which is not widely appreciated.

More recently, Manx household 'non-essential' shopping has been restricted to an entirely Amazon-based experience (no change for me, then). My online basket has been finely balanced between paint, caulking and gin, a consequence of being largely confined to one's house. Cocktails anyone? DIY? Well, at least I have the choice. There is, however, one retail experience which has (until now) almost completely passed me by. This phenomenon, also a product of 'stay at home' orders during the coronavirus pandemic, was recently coined by the press as 'identity investing', where a growing army of retail investors have benefited from the democratisation of share investing via trading platforms such as Robinhood and eToro. So instead of spending their relief checks (spelt deliberately in the American form) on 'experiences' (banned by COVID decree), bored participants are splurging spare spondooliks on either the FOMO\* 'gamification' of bitcoin, or 'impact' investing which makes them feel good. This, despite the fact that, at ludicrous valuations, some prospective investments make no money and are constantly tapping their investors for more cash (e.g. ITM Power, the UK-listed hydrogen specialist currently hitching a ride on the alternative energy-powered bandwagon).

This is a rather uncomfortable revelation for an 'econ' like me. When I do buy a nice dress, I work out its 'utility value' (cost divided by estimated number of wears), this process applying more intensely to investments. Once I have decided what sectors are likely to do well, I hunt for high quality investments with strong balance sheets at a justifiable price. No Jimmy Choos in my wardrobe, ladies. I am subsequently slightly horrified that anyone in their right mind would use as their rationale for buying a stock: 'it makes me feel good'. Yet, this is exactly what is happening in the market today and why some stocks, already hair-raisingly expensive, are continuing to make ground. This 20s zeitgeist has not been lost on one of its key advocates, Elon Musk, the 'Technoking of Tesla' (according to a recent Form 8-K filed with the SEC). As Harvey Specter, the irascible attorney of the US drama series 'Suits' might say of him, Mr Musk plays the man, not the odds, pandering more to public sentiment rather than to the economic fundamentals of his business.

In an opposite revelation to that of the drunken, bespectacled man in Gatsby's 1920s 'Merton College Library' who is



Bright young things....or vile bodies?

astounded to discover that his host's books are 'a bona-fide piece of printed matter' and not cardboard, once again in the 2020s, it appears to be more about image, feelings and sentiment rather than tangible foundations. This is a worrying precedent but is hardly new. John Maynard Keynes used the term 'animal spirits' in his 1936 book, 'The General Theory of Employment, Interest and Money', to describe the instincts and emotions which influence human behaviour, explaining why, for example, consumer confidence indicators are so fickle. As a proponent of share ownership, I welcome the democratisation of investment markets however as much as a third of all US trading is now executed by retail investors, the majority of whom have limited long-term investment experience (if one bears in mind that our last proper bear market was 13 years ago, when many of them had barely bid farewell to their teens).

I had hoped that increased access to capital markets by the general public would be a positive move towards slow and steady wealth participation, reducing the rich-poor divide, demanding greater accountability at board level by investors and providing a much needed boost to under-funded pensions. Unfortunately, this new level of 'ownership' by subsequent generations has seemingly taken one of two conduits, either via increased passive fund exposure (it was very lonely at company AGMs even before the pandemic and the 'C-suite' has an increasingly easy ride) or via these sometimes-overpriced, social-media-driven investments, bought for FOMO and YOLO\*. While the latter still encourages a sense of ownership, it is the kind of retail therapy one might equate to the purchase of a nice dress; thrilling on day one but consigned to the charity shop after a few years of wear and tear, having fallen out of fashion. It would serve us well to remember that the 'roaring twenties', so well illustrated by the shallow behaviour of F Scott Fitzgerald's fictional characters (a phenomenon he witnessed first hand, dying prematurely after a long struggle with alcoholism), was followed by the Great Depression, the grand parties at 'West Egg' and the champagne which fuelled them suddenly going flat. Buying shares on the basis of sentiment alone, like snapping up a nice pair of Jimmy Choos, is unlikely to fund your pension, old sport.

## Mary Tait

INVESTMENT DIRECTOR

\*The fact that I have to add a footnote to FOMO and YOLO betrays my age. My sons would just 'Google it'.

# The Future Perfect?

‘On what principle is it, that when we see nothing but improvement behind us, we are to expect nothing but deterioration before us.’

(Thomas Babington Macaulay)

In 1968, Professor Paul R. Ehrlich published ‘The Population Bomb’ in which he alarmingly predicted a global famine in the 70s, noting that ‘hundreds of millions of people will starve to death in spite of any crash programs embarked upon now.’ This essentially reiterates the pessimistic idea purported by Thomas Malthus, more than a century earlier, that population growth would always outpace food supply and in doing so must always result in disease, famine, war and calamity. In the face of such struggle, the argument for limiting population growth seemed to be the only viable solution and is one of which Ehrlich himself is a proponent. It will come as no surprise to anyone that those predictions were anything but accurate, although the author has continued to move the goal posts and revise his predictions to this day.

Twenty years prior to the book’s release, an innovative solution started forming when an agricultural scientist named Cecil Salmon discovered a variety of wheat (Norin 10) which grew half as tall as the typical variety, owing to a growth-limiting mutation in the Rht1 gene. Before this, attempts to boost the yield of wheat were proving fruitless, as fertiliser was causing crops to grow so tall that they eventually fell over. Norman Borlaug set to work on cross-breeding this growth-resistant gene into a new variety of wheat that yielded three times as much as before. By 1963, this dwarf wheat variety accounted for 95% of Mexico’s wheat production and was eventually introduced to Pakistan and India. In the same year that Ehrlich published his book, in which he said ‘I have yet to meet anyone familiar with the situation who thinks that India will be self-sufficient in food by 1971.’ India issued a postage stamp (pictured) celebrating the wheat revolution and became a net exporter of wheat just a few years later. Borlaug’s wheat and rice varieties earned him a Nobel Peace Prize, heralding the start of the Green Revolution.

The predictions purported by Ehrlich in this instance have a habit of assuming that technology will never improve enough to find a solution. Nor does anyone consider that a solution may already be available but is simply disconnected from the problem it’s able to solve. In the eyes of Ehrlich, limiting population growth was the only way to avoid a famine, despite the fact that his prediction was proven wrong, even as his book was hitting the shelves. However, from a marketing perspective it’s not surprising that the pessimistic outlook gains more traction. After all, it’s hardly sunshine and rainbows which decorate the front page of the national press! The optimistic view that things will continue to get better is naturally a harder argument to make, and it would be easy to proselytise about having faith in humankind rather than following facts, but let’s not forget that the world has continued to improve, despite the adversity encountered so far.

Of course, such a statement can only be made with the benefit of hindsight and, to echo a phrase often seen in the investment world, past performance is not indicative of future results. In his 2010 book, ‘The Rational Optimist’, Matt Ridley highlighted that nobody at the 1893 Chicago World Fair predicted the automobile or the mobile phone when asked which invention would most likely have a big impact on the Twentieth Century. In



that regard, we’re clearly awful at anticipating the long term positive changes we can make to the world, so it would be a strange turn of events if we could predict, with utmost accuracy, the amount of harm likely to be caused instead. Communications technology has now transformed almost immeasurably, to the point where people the world over are connected in more ways than they ever were previously. This provides an environment for idea sharing and innovation in a way that can only be a source for optimism. This leads me to believe that, whilst the biggest proponents of climate change paint a grim picture for the years ahead, we’ve never been better placed to find a workable solution than we are now.

However, for my optimism to have any grounding, the lines of communication and innovation must be kept free so that ideas can flourish. After all, whilst the largest institutions may have the biggest platforms to advertise ideas, they can’t compare to the accumulated knowledge shared across an immeasurable number of industries. I’d sooner argue that an established body would more likely be a hurdle to overcome rather than the problem’s solution. For example, Borlaug’s introduction of dwarf wheat into other countries would have proceeded far more smoothly, had it not been for the lobbying from state grain monopolies in India, determined to protect the status quo, or red tape from customs officials in Mexico and America. Today, whilst it’s clearly a good habit to be mindful of one’s impact, we risk emphasising restraint to avoid catastrophe, rather than innovation to overcome it.

**Michael Craine**  
INVESTMENT MANAGER

# Fasten Seat Belts

In my January letter to clients, I signed off by saying: *'Whilst there are always clouds on the horizon, particularly in the US, they do not appear unduly problematic at the moment'*. Three months later, the environment is evolving quickly as bond yields surge and the economic recovery gains traction, all thanks to the vaccine roll-out, but should we worry?

We cannot always control our fears. They are an impulsive reaction similar to when the 'fasten seat belt' sign illuminates mid-flight, just as the toilet light finally turns green. No airline guarantees a comfortable passage. I am also sure that most of us will have received the equivalent of a shaken Martini delivered to our seat when we ordered it stirred, thanks to a bit of turbulence, but why do we fly? Because it is the only option for reaching a desired destination within a reasonable time frame.

Investing is much the same; if we want to accumulate wealth, we can do it slowly via cash deposits with only the inflationary risk to bear but then we may neither have the time nor the sums to achieve our goals, if returns are modest. Alternatively, we can speed things up by investing in bond and equity markets, but this exposes us to volatility often created by rising bond yields and inflationary fears; the natural consequence of an economic recovery. When this happens, bond holders face capital losses along with equity investors holding expensive stocks, but the latter can rotate. When the technology sector comes under pressure, financials and other cyclicals can pick up the baton as investors move from growth to value, but for bond investors the choice is not so easy. Selling longer-dated stocks and buying at the short end of the yield curve to protect capital results in a cut to income and little prospect of capital gain. This has been a modest sacrifice, year to-date, given that the worst double-digit losses in decades have been recorded at the longer end of the yield curve. Perhaps heading to cash would have been more prudent? Recent events also demonstrate that the tight correlation between bond and equity markets is breaking down again, a testing but necessary process to normalise capital markets which has been lacking since 2008.

This is all part of the natural cycle for seasoned investors, but for new traders it is different and their ranks have swollen due to commission-free trading, stimulus cheques and easily available credit. As Mary suggests in her article, they have never seen a market correction and are typically exposed to high-growth stocks. An old rule of thumb which applied during an era of US inflation was that if a prospective price-to-earnings multiple and the potential inflation rate exceeded 20, a stock was expensive. If one were to apply this now, many successful stocks of the past 12 months would see an attack of vertigo. If one were to assume a 5% inflation rate, we could then appreciate the potentially sharp setback in some sectors, should economies start to run hot. New investors can only draw comparisons with sports betting, where they might cut and run as the tide turns against them, but this tide is rising bond yields, something fans of GameStop or Tesla may not yet appreciate. As the beating heart of



Belt, braces and a Martini...

capital markets, US Treasuries set the pace for the global cost of money. In August last year, the 10-year yield touched a record low of 0.52% but has since surged to 1.76%, thanks to the Biden administration's \$3.9bn stimulus. The authorities appear reluctant to acknowledge that interest rate hikes may be required before 2023 should inflation need taming, but perhaps this is part of a masterplan to erode debt because inflation mauls bond investors. The experience of many investment managers who are long in the tooth (such as myself) is that once the inflation genie escapes, it is difficult to capture and often requires significantly higher interest rates. Compounding the situation today is a flood of bond issuance, as indebted companies and governments fear that if they fail to raise capital now, it will cost them more later.

It is important not to underestimate the impact of rising bond yields, which extends to bank deposits, loans, mortgages, house prices, the cost of doing business and retirement annuities. Unlike the credit crisis, where stimulus money went to the banks to ensure they remained solvent, this time it's in people's pockets. The outcome is therefore likely to be different; some will save, others will invest and even dentistry looks set to benefit, according to the US diversified industrial giant, 3M Co. Travel, leisure and entertainment are sure to benefit but if everyone wants to do something at once, prices will rise. We may be worrying unnecessarily and the pressure may quickly recede but alternatively, prices could spiral, with higher wage demands emerging as unions recover their mojo. Individually, we may start to bring forward purchases, fearing that delays will cost us more. Therefore, the direction of inflation is as much in our hands as with the central banks. It is also worth remembering that, during 121 years of UK record-keeping, inflation has averaged 3.6%, peaking at 24% in 1975 and rallying again to 18% in 1980. It is just 0.9% today, a long way offside, relative to historical averages. Certainly, the ingredients for change are starting to fall into place and it is time to do the investment equivalent of fastening our seat belts, so we can arrive comfortably at our destination. Now, where is that Martini?

**Paul Crocker**  
INVESTMENT DIRECTOR

**Investment Management Briefing Editor:** Mary Tait, Investment Director

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 Viv Hounslea at [vhounslea@fim.co.im](mailto:vhounslea@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.

Russell Collister - Chief Investment Officer  
☎ +44 (0) 1624 604700 ✉ [rcollister@fim.co.im](mailto:rcollister@fim.co.im)

Paul Crocker - Investment Director  
☎ +44 (0) 1624 604701 ✉ [pcrocker@fim.co.im](mailto:pcrocker@fim.co.im)

Mary Tait - Investment Director  
☎ +44 (0) 1624 604702 ✉ [mtait@fim.co.im](mailto:mtait@fim.co.im)

Tony Edmonds - Director  
☎ +44 (0) 1624 604703 ✉ [tedmonds@fim.co.im](mailto:tedmonds@fim.co.im)

Michael Craine - Investment Manager  
☎ +44 (0) 1624 604704 ✉ [mcraine@fim.co.im](mailto:mcraine@fim.co.im)

Pieter Cloete - Investment Manager  
☎ +44 (0) 1624 604705 ✉ [pcloete@fim.co.im](mailto:pcloete@fim.co.im)

Charlotte Cunningham - Trainee Investment Manager  
☎ +44 (0) 1624 604713 ✉ [ccunningham@fim.co.im](mailto:ccunningham@fim.co.im)

Barbara Rhodes - Head of Settlements  
☎ +44 (0) 1624 604712 ✉ [brhodes@fim.co.im](mailto:brhodes@fim.co.im)

Ralph Haslett - Chief Operating Officer  
☎ +44 (0) 1624 604710 ✉ [rhaslett@fim.co.im](mailto:rhaslett@fim.co.im)