GBIM

Gore Browne Investment Management

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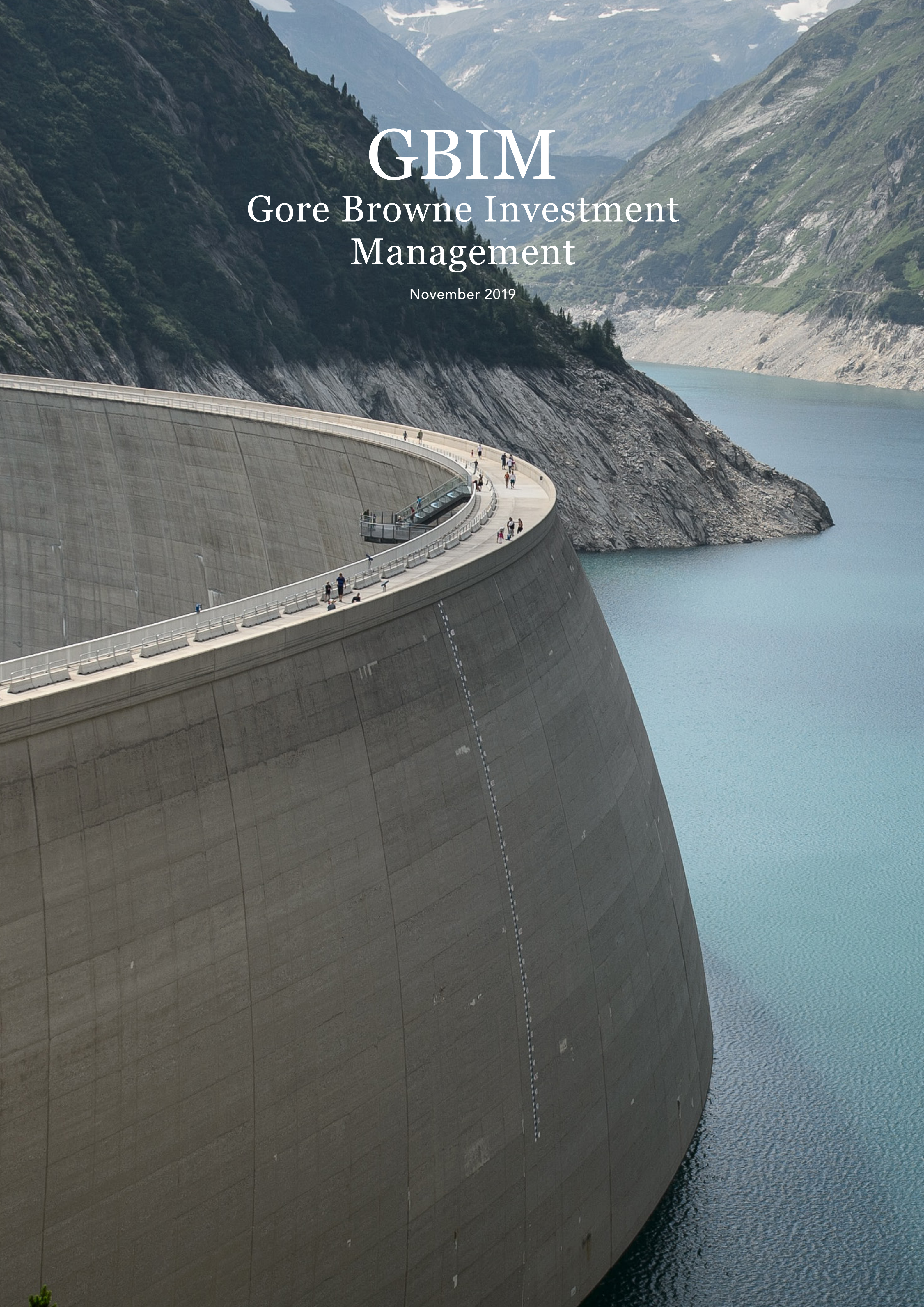


Hello & Welcome

The "season of mists and mellow fruitfulness"[1] has passed on, and heavy rains and a cold snap are now upon us. The apples have dropped from the trees, ladybirds and spiders are moving in, and political wrangling continues. 31st October seems long ago but 12th December is not far away. The political terms of reference have shifted a little and while Brexit is still not done and dusted, Boris is not in a ditch yet either. If only England had won the rugby.

Commitments to climate change, the NHS, and general fiscal largesse abound, whichever party you listen to. You have read our views on the need for a shift to fiscal stimulus previously, and a link to "The Financial Health of the Nation" is here for online readers. Simon James continues this theme, making particular reference to Mario Draghi's retirement from the European Central Bank.

In this issue we have a number of articles on topics which, in industry parlance, fit into "ESG" themes. ESG stands for environmental, social and governance, and covers themes relating to climate change, the environment generally, social wellbeing and equality, and good corporate transparency and governance. Of interest is Fran Hamer's article which explores the benefits of linking saving habits to planting trees in China.

We also continue Joe Cornwall's series on AIM/IHT investments. On this occasion the subject is the importance of sustainably high returns on capital to create better outcomes for investors.

Oliver Findlay reports on our sponsorship of the Army Benevolent Fund and the summer reception at Sandhurst.

Finally if you would like to use our new investor portal "myGBIM", and have not yet signed up for it, then Toby Bazzard explains how to proceed.

Thank you for reading, and we hope that you get the election result you are hoping for.

Sources:

[1] John Keats "To Autumn"

Has Inflation Reached Retirement Age?

By Simon James

We have argued for a long time that monetary stimulus is not enough to create a stronger global economy. Recently, Mario Draghi, President of the European Central Bank, said much the same thing as he announced further monetary stimulus but added,

> "Almost all the things that you see in Europe, the creation of more than 11 million jobs in a short period of time, the recovery, the sustained growth for several quarters, were by and large produced by our monetary policy. There was very little else... Now it's high time for the fiscal policy to take charge." [1]

This may be his way of preparing the ground for Christine Lagarde, who will take over from Draghi at the ECB in November.

Prior to Draghi's statement a colleague had asked me whether a shift from dependence upon monetary policy towards a greater emphasis upon fiscal policy might increase inflation. It's a good question.

Since I started working in the City in 1980 Monetarism has been the dominant economic policy.

Simply put Monetarism is a school of economic thought that holds that the money supply is the main determinant of economic activity. In other words, if the money supply is growing, the economy will grow, and if money supply growth is accelerating, so will economic growth.

However, it also argues that if too much money has been put into circulation then inflation will rise too. Hard line monetarists have argued that the substantial volumes of Quantitative Easing or "QE" would cause rampant inflation, but it hasn't happened.

Why? Possibly because many such commentators seem to have forgotten that it is not just the availability of money which is important but also the degree to which it is used. Since the credit crisis in 2007-9 this measure has been relatively weak. There are many reasons why this may have been so, but it may have been related to constraints upon the growth of disposable income, and this is at the root of my colleague's question.

Would fiscal stimulus release pent-up demand? The answer depends upon how the money is spent. If it targeted those whose standard of living has been most under pressure, then it might.

But I also believe that Monetarism is too narrow a concept within the world we live in.

The constraints upon inflation relate to many other things: an abundance of the supply of goods and services in many sectors driving prices down; a new wave of workers entering the global market and keeping a lid on wage growth; baby boomers going into retirement with their appetites for disposable goods having been partially sated; technology providing efficiencies; and the growth of open borders and free trade between nations. These have broken the wage/price spiral.

The huge amount of debt that households already have is a further constraint upon demand growth, and probably the greatest constraint upon a rise in interest rates too.

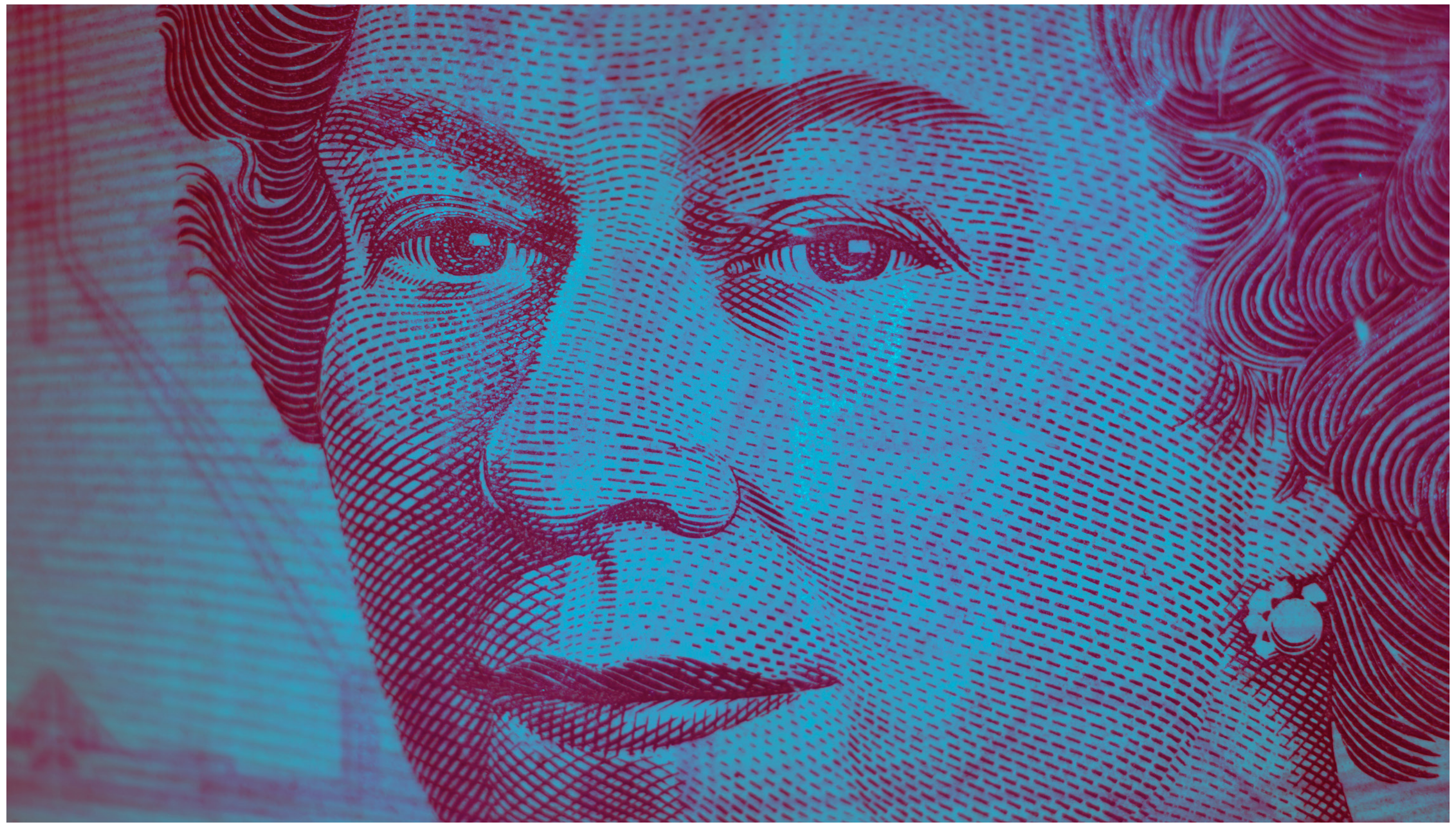
To me the greatest risk of inflation would be from the breakdown of free markets, which would then reawaken the wage/price spiral. Something like a price shock in the UK if the Pound is devalued would be a one-off impact.

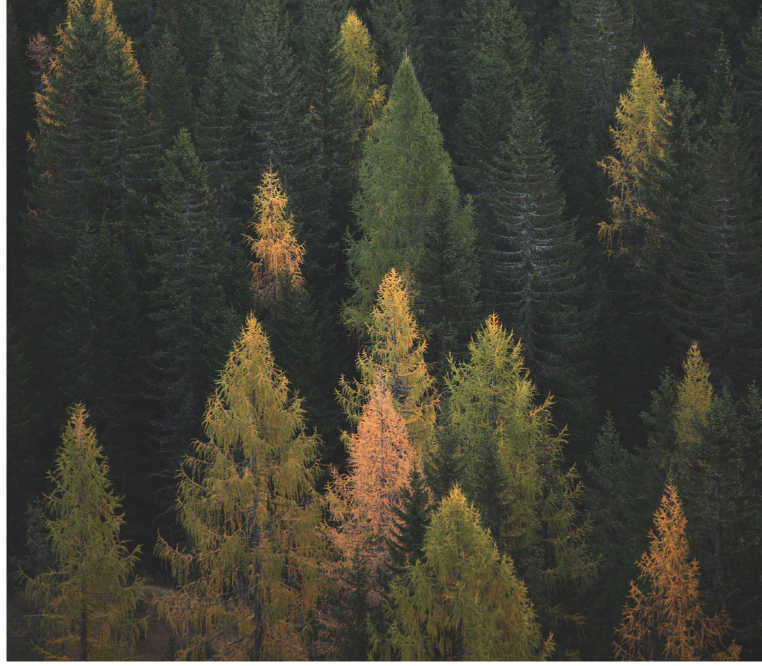
Some types of fiscal policy might cause an inflationary impact, but I suspect that they would be overwhelmed by the continuing waves of disruption in products and services across free markets.

I believe that inflation and interest rates will remain "lower for longer". Vivat the free market.

Sources:

[1] https://www.ecb.europa.eu/press/pressconf/2019/html/ecb.is190912~658eb51d68.en.html





Ant Forest

By Fran Hamer

Making an impact and having fun at the same time is a winning combination that has led to the planting of 100 million trees.

Ant Forest, a personal carbon account launched in 2016 by the mobile and online payments platform Ant Financial, a subsidiary of Alipay [1], itself part of the Chinese giant Alibaba, is changing consumer behaviour in China through gamification. Gamification applies typical elements of game-playing to other areas of activity, to stimulate engagement with a product or service.

Users are prompted to consider their carbon footprint in different ways including paying their bills online; cutting paper; walking and using public transport.[2] All the activities are tracked through Alipay and users accumulate carbon points which are deposited in a carbon account and then converted to virtual 'green energy.'[2] After accumulating enough green energy customers are awarded a real tree which is then planted. Planting is monitored via satellite so users can track their own progress as well as the collective efforts of their fellow customers. And a bit of competition between friends is encouraged![3]

Individuals want to know how they can make a difference and this initiative is a route for the public to do just that. The scale of Alipay with its millions of users means it can have a serious impact and is one way in which harnessing digital energy is helping to meet an environmental challenge.

Governments and institutions around the world will be taking note[3] of this positive impact, but there is a more difficult issue to overcome.

Data privacy, which is a sensitive issue, comes into view. Last year Ant Financial was reprimanded for having a default setting whereby users were opted into sharing personal information with the company.[4] It is worth remembering that Apps like Ant Forest are dependent upon capturing data, but the company needs to show that initiatives like Ant Forest are not just another way to capture more data and risk compromising privacy. Consumers in developed markets tend to be the most concerned with this, but questions about big data and how it is being manipulated or used will remain under scrutiny as corporate governance becomes increasingly important to investors.

The impact on privacy will become clearer over time but in the meantime the trees are bound to help!

Sources:

[1] https://en.wikipedia.org/wiki/Ant_Forest

[2] https://medium.com/@AntFinancial

[3] https://unepinquiry.org/news/ant-financial-app-reduces-carbon-footprint-of-200-million-chinese-consumers

[4] https://www.chinamoneynetwork.com/2018/04/09/china-central-bank-fines-ant-financials-alipay-for-misleading-ads-poor-data-protection

Aiming For Growth

Joseph Cornwall

So far in this four-part series we have discussed the characteristics of high-quality businesses and the methods available for them to grow.

In this penultimate article we look at the importance of how sustainably high returns on capital lead to better outcomes for investors.

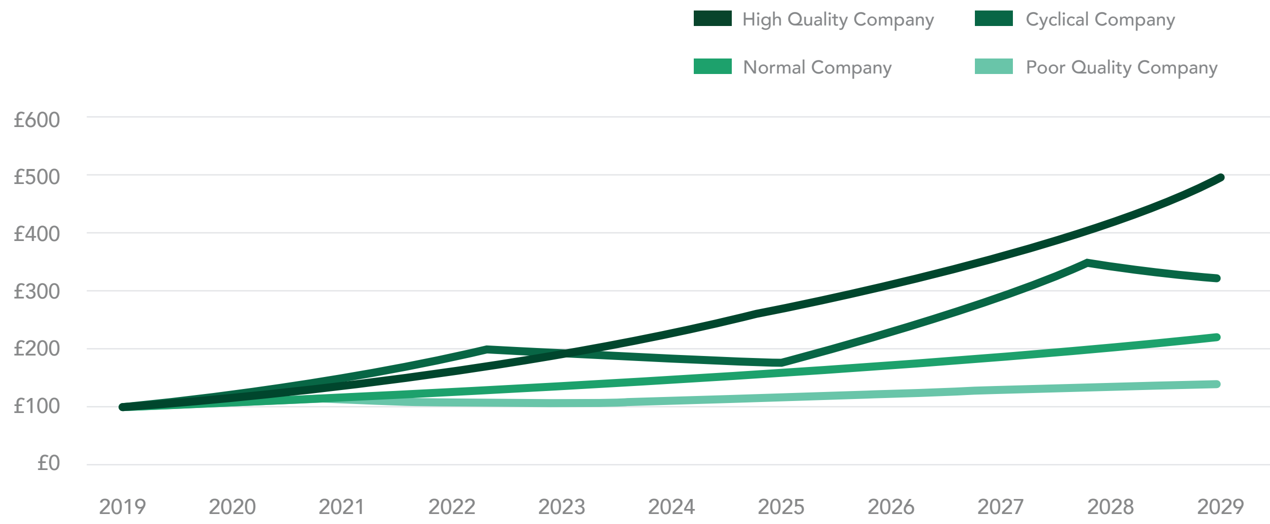
There are many different types of business, and of varying qualities. A key signal of business quality is return on capital. Return on capital is the percentage figure a company earns each year in profits for each pound invested in the business.

A poor-quality business will have a persistently low return on capital, perhaps below its cost of capital. The cost of capital is the required return at which the market is prepared to invest, allowing for the risk of the company. A current example of poor-quality businesses would be many UK and European banks.

A cyclical business at buoyant points in their cycle may have a return on capital that is high, followed by periods when the return on capital is low, or even negative, during cyclical troughs. An example would be UK housebuilders. These are not necessarily bad businesses, but management need to be aware of where they are in the cycle so that their business battens down the hatches at the right time. This is difficult. Management need to be exceptional.

Good quality businesses are likely to have high returns on capital – of 15% or more - and be able to earn that return year after year. This means that at 15%, £1 invested at the start of the year is worth £1.15 by the end of that year, and £1.32 by the end of the following year. Many branded consumer goods businesses are historic examples of companies that have consistently compounded returns at high rates.

Below is a chart depicting the returns available to companies, on the assumption that all profits are re-invested into their business, as opposed to a portion being paid out in dividends to shareholders.



The difficulty in evaluating a business's quality is in determining how sustainable their return on capital is. How susceptible is the business to the economic climate and competitive forces? Does the market in which they operate have many years of growth ahead? Could they become victim to regulatory or technological disruption? Will management continue to run the business and its finances effectively?

Only by thorough and continuous analysis can answers to these questions, and others, be given with a degree of confidence.

In the final article in the series we will discuss how much we are prepared to pay to buy shares when we have discovered a high-quality business.

Concrete Issues

By Simon James

We allocate substantial proportions of our clients' money to infrastructure investments. On the one hand they have provided consistent and inflation protected income, and on the other hand these investments can improve the lives of many millions of people.

These are investments in schools and hospitals, in green energy sources such as wind or hydro-electric power, in water quality such as sewers, and in transport such as bridges and railways. But there is a cost which is less obvious than the simple monetary expense.

It is a cost which causes environmentalists concern. Carbon emissions.

Cement, which is used to create concrete, is the glue which binds all these social constructs together, but it is made by being separated out from limestone.

Most limestones form in shallow, calm, warm marine waters. That type of environment is where organisms capable of forming calcium carbonate shells and skeletons can easily extract the needed ingredients from ocean water. When these animals die, their shell and skeletal debris accumulate as a sediment which forms limestone. Limestones formed from this type of sediment are biological sedimentary rocks. Their biological origin is often revealed in the rock by the presence of fossils. [1]

Concrete has a problem. The material is used so widely that world cement production now contributes 5 or more per cent of annual global CO2 production. And the problem looks set to get worse: by 2050 concrete use is predicted to reach four times the 1990 level.

The reason concrete has a big carbon footprint is that huge quantities are used because it is a remarkably good building material.

But scientists argue that it is also a carbon-efficient material. "The reason there's so much concrete is because it is in fact a very low impact material," says Karen Scrivener, head of the construction laboratory at the Swiss Federal Institute of Technology, Lausanne. "If you replace concrete with any other material, it would have a bigger carbon footprint. Many people have the idea that if you built in steel, you'd make things better – but in fact you'd make things worse."[2]

The cement industry is actively seeking solutions, and the largest global cement-producing companies are attempting to mitigate the carbon footprint of cement, but they cannot eliminate it.

They are attempting to separate limestone at lower temperatures. Cement is separated out by intense heating in kilns, and the design of these kilns is being reviewed so that lower temperatures (1200C, rather than 1500C) can be used.

Lower temperatures require less energy; if the CO2 emissions could be kept separate from other flue gases then the CO2 could be captured without requiring a separation process which requires further energy; recent

advances in steel technology allow more heat to be conveyed by radiation, and more tubes to be used, which allows the CO2 to be kept isolated from the other gases.

Others are looking at the possibilities of re-using the concrete found in the rubble of old buildings, which could also re-capture some of the original CO2.

If the CO2 is captured the storage of it in empty oil and gas fields under the sea is already well established and accepted as a solution.

Another solution is to change the recipe for concrete so that, rather than needing water to solidify, it uses CO2 to create a type of stone rather than concrete. This would only work in the pre-cast market because it requires moulds and is less than 25% of the concrete market. But it all helps.

Human ingenuity is actively seeking solutions, but the process requires time, and is unlikely to enable zero emissions. But would society be better without concrete? [3]

Sources:

[1] https://geology.com/rocks/limestone.shtml

[2] https://www.rsc.org/images/Construction tcm18-114530.pdf

[3] https://www.bbc.co.uk/programmes/p07l12s5

Understanding ESG

By Simon James

Talking to clients and to peers around the market about ESG (environmental, social and governance), it is quite clear that people either have different understandings as to what it includes and excludes, or simply don't know what to think, so I am very grateful to JP Morgan who have addressed the issue head-on, and given some helpful insights.[1]

They suggested that there are effectively five different strategies, which I summarise (with a little of my bias/ interpretation) as follows:

1. Exclusions - does what it says. Likely to exclude arms, gambling, alcohol and tobacco (traditional ethical mandate), but might also exclude for example oil & gas companies or miners because they have a significant carbon footprint.
2. Positive Tilt - overweight companies which do good and underweight those which are not so clear. Companies in transition, such as Equinor, might be included. [2] (
3. Best in Class – companies which are clearly trying to make a positive difference in all that they do.
4. Thematic – selecting one or more themes from the Sustainable Development Goals and focusing expressly upon them.
5. Impact – specific goals defined by a client seeking particular measurable outcomes.

They said that (2) and (3) are the fastest growing styles.

They also pointed out that the different agencies which assess corporate performance on the various metrics sometimes have different recommendations. Tesla, which always seems to be a "marmite" example, was cited as a company which had caused such a headache. Presumably this is because while it may be an environmental star it is also considered a governance black hole.[3]

Governance has long been considered a fundamental part of how "quality" style fund managers assess companies. Environmental has become a focus in recent times, but many of the social benchmarks remain difficult to appraise and evaluate. Metrics across the board are difficult to identify and then measure. This is probably not a field within which regulators should play.

At GBIM we are trying to be pragmatic by sticking to our philosophy of offering bespoke portfolios to our clients.

We offer a tailored "ethical & responsible portfolio service" based on clients' preferences. This means that while we can apply a negative screen to provide a "no tobacco" or "no oil" direct stocks portfolio we can also include investments which aim to have a positive impact. The transition to profit with purpose is already underway in areas such as Agriculture, Diversity and Health to name a few.

It is therefore important to establish at the outset which areas are of most importance to a client by helping them classify their own priorities. GBIM separates ethical portfolio goals into six main themes, derived from the UN sustainable goals: Basic Human Needs; Climate; Decent Work; Healthy Ecosystems; Inclusiveness & Wellbeing; and Resource Security.

We agree with JP Morgan that there are different ways of interpreting clients' requirements, and we hope that we have found a way to address those requirements in a flexible and responsive way.

Sources:

[1] https://am.jpmorgan.com/gb/en/asset-management/gim/adv/webcasts/6347/369399?utm

[2] https://www.gbim.co.uk/news-insight/saints-and-sinners-in-change-investing

[3] https://corpgov.law.harvard.edu/2019/08/04/teslas-governance-record-and-esg-monitoring

GBIM and the Army Benevolent Fund at RMA, Sandhurst

By Oliver Findlay

Our wish to give wider support to the community encouraged us to be lead sponsor for the Summer Reception and Beating Retreat at the home of the British Army Officer, the Royal Military Academy Sandhurst.

Historically, a Beating Retreat signals the end of the working day on the battlefield and summons soldiers to return to their castle, mount the night's guard and tend to the dead and injured. Sandhurst's Old College, protected by its brass cannons from the Battle of Waterloo, was a suitable backdrop for this dramatic and solemn parade. The sun was falling behind James Wyatt's magnificent building as the band of the Parachute Regiment played music including the theme from Superman, The Ride of the Valkyries, and the Last Post.

This glorious event was in support of the Soldiers' Charity, which is more formally known as the Army Benevolent Fund (ABF). This charity aims to help serving and retired soldiers and their families. The scope of its work is extensive from mobility assistance, through finding employment, and on to managing care home fees.

Developing this type of wide and personalised service to individuals and families also lies at the core of our business at Gore Browne Investment Management. In a corporate world where big is becoming enormous and personal contact is reducing, we believe that meeting our clients and building a bond of trust with them is becoming more vital. The investment managers at Gore Browne look to understand clients and invest for them to achieve their needs and ambitions.

We enjoyed supporting and attending this entertaining and worthwhile event, and we wish the ABF all the very best in their important work.

Find out more here: www.soldierscharity.org

We're pleased to announce the launch of myGBIM

By Toby Bazzard

On your desktop, or as an app on your tablet or smart phone, your investments are brought together under a single login, accessible to you at any time, wherever you are.

GBIM Quarterly Investment Reports, tax packs and other documents can be electronically delivered to you, and as an alternative to email you can contact your Investment Manager directly through myGBIM.

For more information please visit our website or contact your Investment Manager to request early access.

www.gbim.co.uk/mygbim

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