GBIM

Gore Browne Investment Management

Spring 2020

Hello & Welcome

In this edition we include a number of articles which explore or relate to investing in the future of the Earth and its occupants. To some this is ethical investing, to others it is ESG (environmental, social and governance), sustainable, responsible or impact.

Whatever you call it, we believe that these themes will resonate more loudly in the minds of investors as the human race emerges from the far-reaching distress caused by Covid 19.

From experienced institutions to novice individuals, investors are increasingly demanding that their investments show a sense of stewardship of their capital's potential impact on society and the environment, rather than being driven simply by the financial outcomes.

Mark Arkwright describes the positive impact of ethical and sustainable investing upon portfolio returns, and Joe Cornwall explains why being sensitive to the valuation of investments is essential. Olly Findlay sets out a history of how charities have developed in the UK.

We witness daily people evolving their habits for an array of reasons, many of which are to do with health and wellbeing. These often relate to diet, such as eating meat fewer times during the week. It does not have to be extreme, such as asking that "the lion shall eat straw like the ox" – Isaiah 65:25. Despite being a keen omnivore, I tried a vegan sausage roll recently and found it surprisingly tasty!

Other changes may involve reducing one's carbon footprint by buying an electric car or travelling to a holiday destination by train rather than airplane. All the changes create opportunities for investors.

Many causes of change or disruption have an underlying cause in population growth. This is especially true of the demand for resources, whether food or water or oil. We include a series of articles here on demographics to illustrate its complex impact.

But what impact will this have upon companies? A recent survey by the management consultants, McKinsey, showed a clear belief among corporate leaders that ESG strategies enhance their companies.

57% of surveyed executives and investment professionals agree that ESG programs create shareholder value, and among consumer-focused companies this is higher (66 percent). A small minority remains unconvinced. Just 3 percent of respondents believe such programs reduce shareholder value [1], and 14 percent say they are unsure. The remaining 25% say ESG programs have no effect on shareholder value.

We have written previously about how greater gender diversity has been shown to improve corporate returns. Increasingly this is measured globally, and we now receive research on this topic [2] and other specialist subjects such as protein sources.

Specialist funds are available to pursue particular interests. In addition to long standing growth stories such as technology, infrastructure and biotechnology, there are now opportunities to invest in energy transition, food and agriculture, water or companies which have made the most progress in improving employee diversity.

At GBIM we have always offered bespoke portfolios to our clients, and these provide further opportunities to tailor your interests to your investments.

Sources:

[1] https://www.mckinsey.com/business-functions/sustainability/our-insights/the-esg-premium-new-perspectives-on-value-and-performance

[2] https://equileap.org/2019-global-report

Quality Investing, Coronavirus and Flybe

By Simon James

The current environment is a real test of the durability of all business models. The nature of the shock from quarantining is not just found in the breaches in global supply chains, but also in the changing behaviour of consumers. We don't know how long this sharp downturn will persist, but it is an emphatic interruption to "business as usual".

It is at times like this when companies which have clear weaknesses can fail, and this is what happened to Flybe recently, to Thomas Cook last year, and to countless retailers and contractors. Many businesses in travel, leisure, the arts and hospitality face extinction as a result of Covid 19.

Policymakers are taking broad steps to mitigate the impact to businesses and households. There is a range of measures which can be taken: Central Banks ensuring that commercial banks have plenty of liquidity; deferrals of payments of taxes or business rates; sovereign guarantees of corporate debt; helicopter money ($1200 in Hong Kong); ensuring that healthcare and welfare systems have all the resources they need at their disposal (everywhere).

"Quality investments require strong finances, and strong cash flows in particular. They require a competitive advantage in their areas of expertise."

These are measures which can have an immediate effect and so, as George Osborne said recently, "vaccinate the economy".

Governments everywhere are looking at how to protect their citizens and their economies, but the unusual nature of the recession into which we are falling means that they are responding to circumstances as they develop or change.

This is the environment when "the strong get stronger". Strong companies will benefit from the fall-out of this episode. This is one reason why we maintain a focus on so-called "quality" investing.

Quality investments require strong finances, and strong cash flows in particular. They require a competitive advantage in their areas of expertise.

This is true of commercial companies, property companies and infrastructure investments.

Sources of income from secure cash flows sourced from well financed property and government-backed social infrastructure or renewable energy projects, or from global leaders across growing business sectors are essential components of portfolios.

We do our best to have limited exposure in portfolios to the corporate victims of disruption or to "price-takers", those companies which have no or little control over the pricing of the goods they sell, such as commodity companies or banks.

This does not mean that the share prices of the investments we prefer will not fall at a time of generally falling stock prices, but they will invariably survive, and quite likely benefit from, episodes such as this.

What are the Performance Implications of Investing Sustainably?

By Mark Arkwright

Many investors, wishing to focus their portfolios on sustainable investments for ethical reasons, have an understandable concern that they may have to forgo (or dilute) long term returns. Happily, there is plenty of evidence to suggest that an Environmental Social and Governance (ESG) emphasis can in fact enhance financial returns.

Perhaps the most comprehensive research into the relationship between ESG and financial performance found that in around 90% of the 2000 studies that they reviewed the results showed that there was no negative relationship [1]. More encouragingly still, the majority of studies reported positive findings, supporting the belief that incorporating broadly ethical investments actually improves performance in the long run.

In a broadest sense, companies that practice good governance are probably well managed and therefore likely to be relatively successful.

Another explanation for these satisfactory returns is that the companies invested in for a positive impact on society or the environment are often small or medium-sized and at the forefront of innovation and new technologies; if successful this sort of business can perform exceptionally well.

A third, and more recent, explanation relates to the divesting by increasing numbers of investors of companies whose products might directly or indirectly increase carbon emissions or otherwise be seen to have detrimental effects on society or the planet.

Do investors have to accept higher risk (volatility) to achieve their ethical objectives? On the face of it you would think so – smaller companies, new technologies, and so on. Recent research illustrates that ESG does not impact all stocks equally [2]; perhaps not surprisingly the effect is most pronounced (positively or negatively) in the best or worst-in-class quartiles.

Further research shows that risk is reduced when ESG factors are taken into consideration, despite the reduction of diversification in portfolios [3].

In the US a recent Morningstar Landscape Report [4] showed that in 2018 63% of the U.S. sustainable funds sit in the top half of their respective Morningstar sectors, including 35% in the top quartile. Only 37% of the sustainable funds ended in the bottom half, with just 18% in the bottom quartile.

Another report by Morgan Stanley Capital International (MSCI) [5], using a different methodology, came to three broad conclusions:

1. High ESG rated companies are more competitive and can generate abnormal returns, leading to higher profitability and dividend payments.
2. High ESG rated companies are better at managing company-specific business and operational risks and therefore have a lower probability of suffering incidents that can impact their share price. Consequently, their stock prices display lower idiosyncratic tail risks.
3. High ESG rated companies tend to have lower exposure to systematic risk factors. Therefore, their expected cost of capital is lower, leading to higher valuations.

It is reasonable to conclude that, provided stock selection is judicious and there is a prudent spread of risk, it is perfectly possible to make 'profits with purpose' and clients investing in a sustainable portfolio can expect at least to match the performance of broader markets.

Sources:

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610

[2] https://www.unpri.org/academic-research/how-esg-investing-affects-financial-performance/548.article

[3] https://granito.center/insights_details.php?id=19

[4] https://www.morningstar.com/insights/2019/02/19/esg-landscape

[5] https://www.msci.com/documents/10199/9aec76d8-376f-91ef-a575-b2b0ea65061a

Demography is Destiny

By Simon James

1. The Big Picture

"Demography is destiny" [1]. But what is it? People think of the size of the total population, of its changing size, of its changing shape. They think of the balance between young and old, male and female, and the proportions of Europeans, Asians and Africans.

They also contemplate the effect of a growing population upon the use of the world's resources and its effect upon our environment.

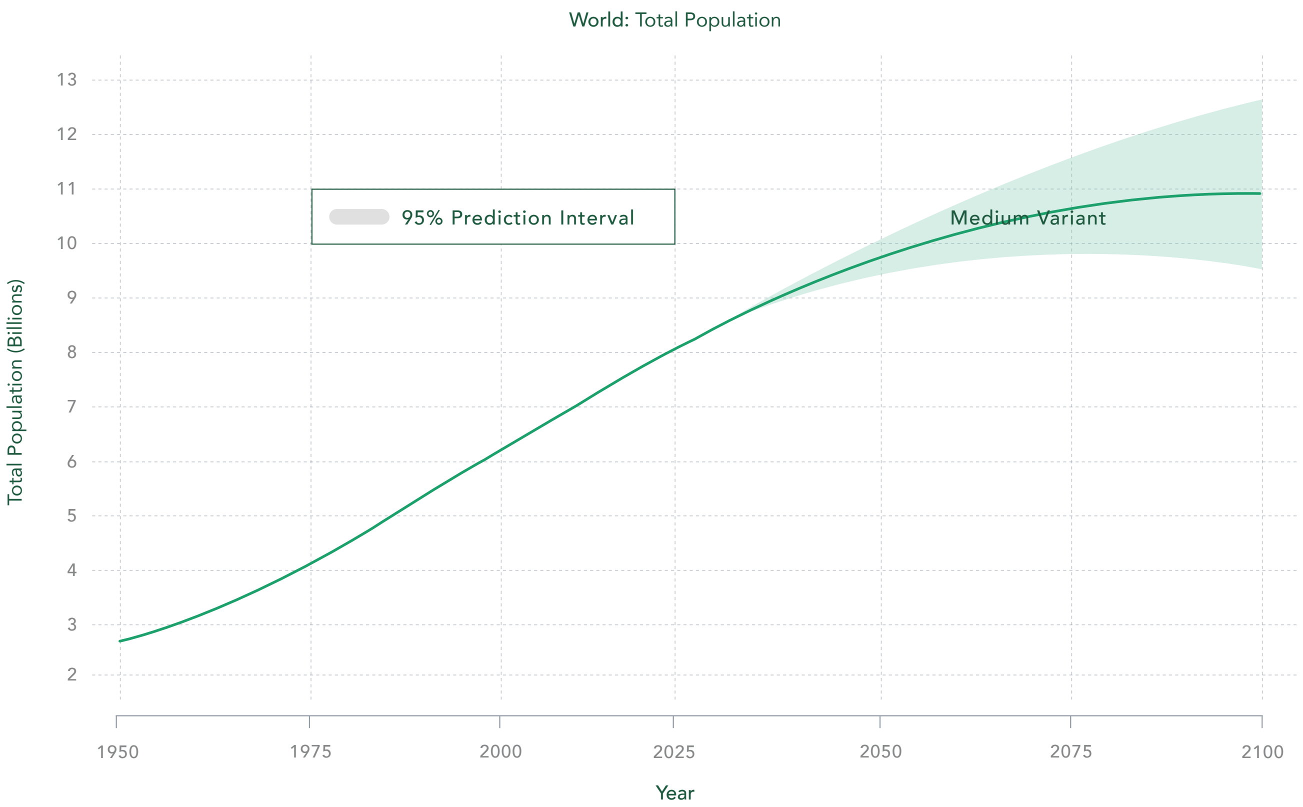
These are all different things which, from an investor's point of view, need dissecting.

There is no doubt that two major demographic trends - an ageing population in developed and emerging economies, and high population growth in parts of the developing world - will have an enormous impact on our future.

I'll separate the issues into three broad segments, starting with economic (GDP) growth, moving on to migration, and then to resource scarcity.

But before we start let's see the big picture: the total global population has been growing, and will continue to grow, very rapidly.

Central predictions of the UN statisticians and the range of error to their forecasts

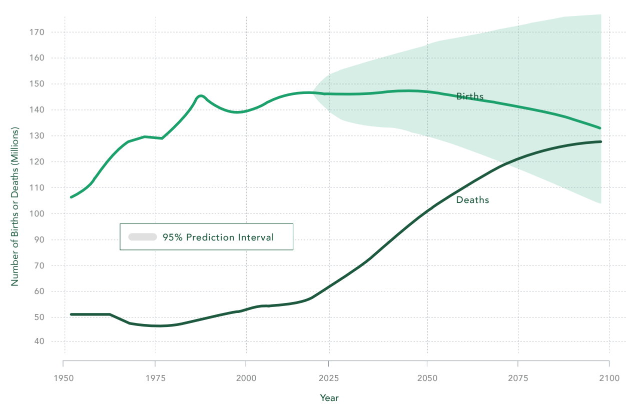


The chart to the left shows the central predictions of the UN statisticians and the range of error to their forecasts (a 95% certainty that the next observation falls within their range) which they consider reasonable. Under all scenarios the total global population will grow substantially from about 7.8 billion today.

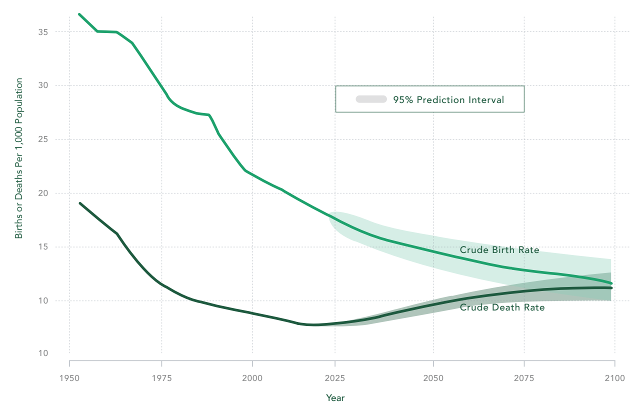
An interesting calculator of the total population at any given moment can be found at: https://www.worldometers.info/world-population. It is rather shocking.

The population is growing so fast because medical discovery has enabled people to live longer, not only into old age, but also by reducing infant mortality. Changes in the birth rate have lagged the changes in the death rate.

World: Average Annual Number of Births & Deaths



World: Crude Birth Rate & Crude Death Rate



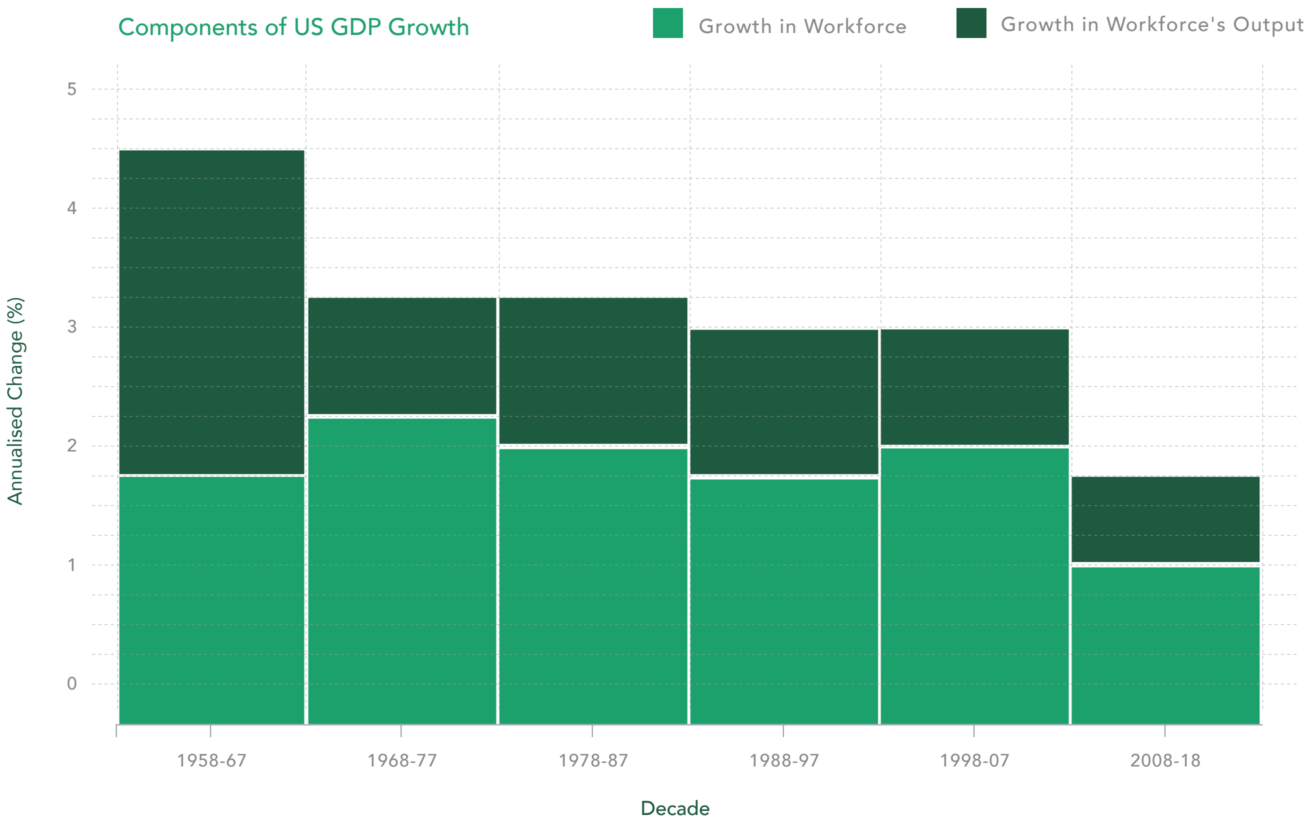
As we can see in the second chart the number of children born is predicted to be flat but might vary considerably, while all scenarios assume a sharp drop in the birth rate, as can be seen in the third chart, because a constant number of births is expected to occur while the total population continues to grow.

The actual number of deaths is expected to rise sharply, but to remain below the number of births, although the birth and death rates should converge towards the end of the century.

The crude birth and death rates, referred to above, are proportions of the whole economy, without taking either gender or migration into account.

2. Its Impact on Economic Growth

Some people argue that the growth rate of an economy is closely linked to population growth. There is a link, but there are other factors at play too.



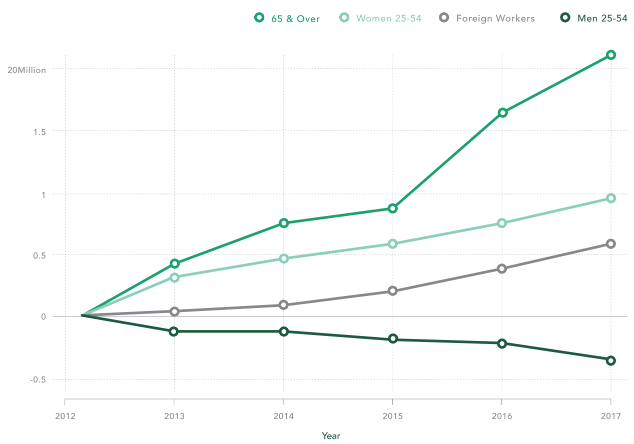
Sources: BEA, BLS, JPMorgan AM, GBIM

Productivity growth is the other key component and, as we can see above, both varied from period to period in recent US history.

Diversifying the Labour Pool

Women, foreigners and the elderly have contributed the bulk of Japan's employment growth.

Sources of Employment Growth



Source: Statistics Bureau, Japan Ministry of Internal Affairs & Communications, Ministry of Health, Labour & Welfare

Additional Source: Greg Ip on Twitter

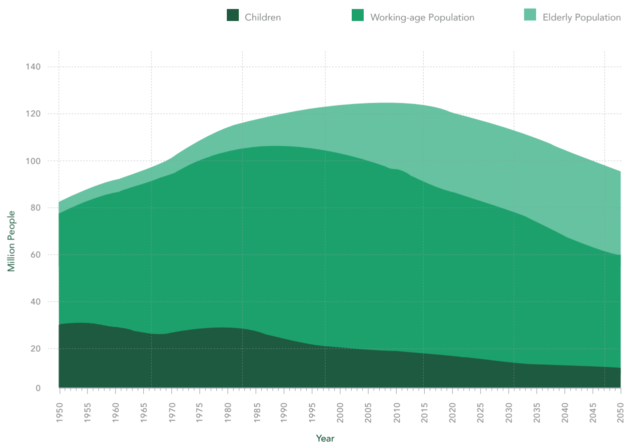
The ageing of Japan's population also helps to explain in part why the Japanese are global leaders in robotics (both industrial robots to enhance productivity and the volume of production, and household robots to help an increasingly elderly populace) and consumer disposables (e.g. nappies) for the elderly.

But arguably the most difficult years for Japan lie ahead. As many as 12 million Japanese people may disappear from the country's workforce by 2040, according to official estimates. That's a fall of around 20% [2].

The best-known illustration of the impact of an ageing population upon economic growth is Japan. People have spoken about Japan's "lost decade" as its economy has appeared to stagnate while the working age population has declined.

However, although the numbers of people of working age (15-65) have declined by 4.7 million since 2012, the workforce has increased in size by 4.4 million. Since 2012 the proportion of the population in the workforce has increased by more than in any other country because they have recruited from the elderly, women and foreigners.

Behavioural changes may occur quietly and slowly, but they are powerful when evoked.

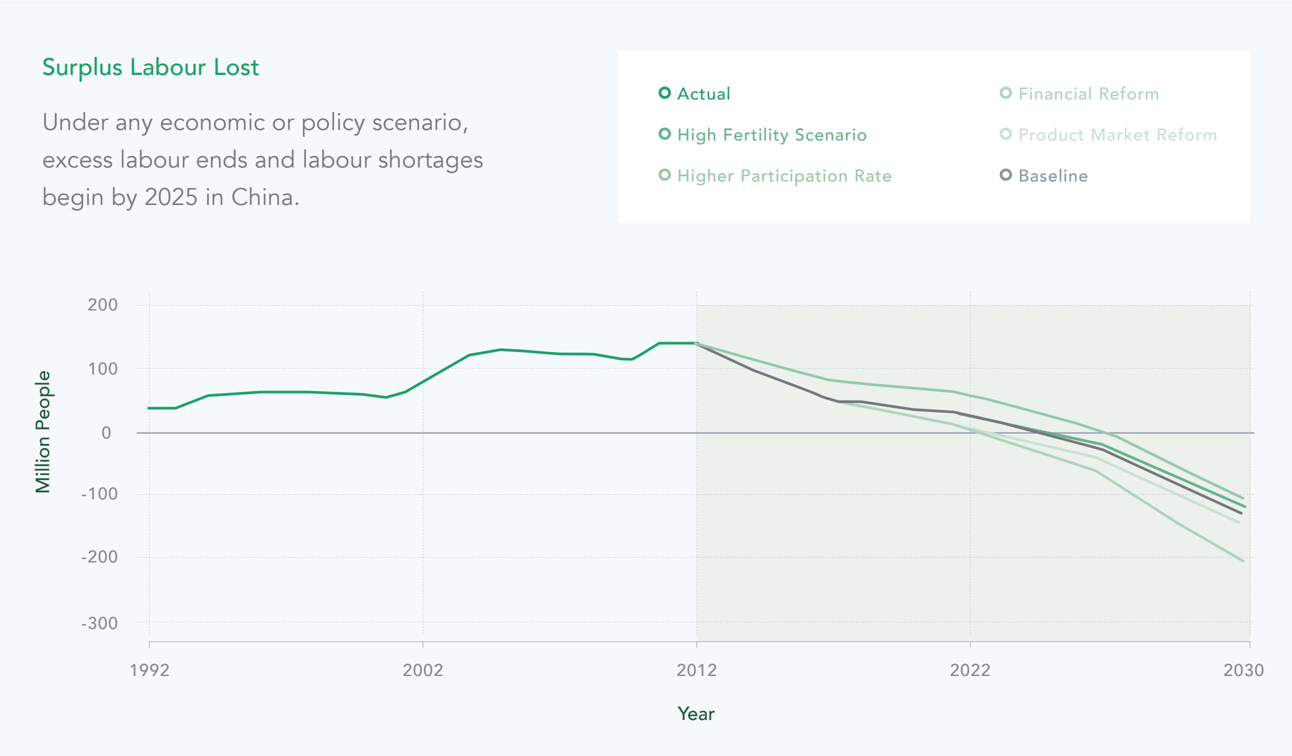


Source:

OECD Historical Population Data & projections (1950 - 2050)

It is therefore understandable why many investors may prefer to buy shares in individual, global-leading, Japanese companies rather than the Japanese market as a whole.

China's "one-child" policy is well-known. Although it has now been changed to allow families to have two children, demographics is destiny as the following chart shows.



Sources: CEIC; World Bank, World Development Indicators Database; United Nations; and IMF Staff Calculations

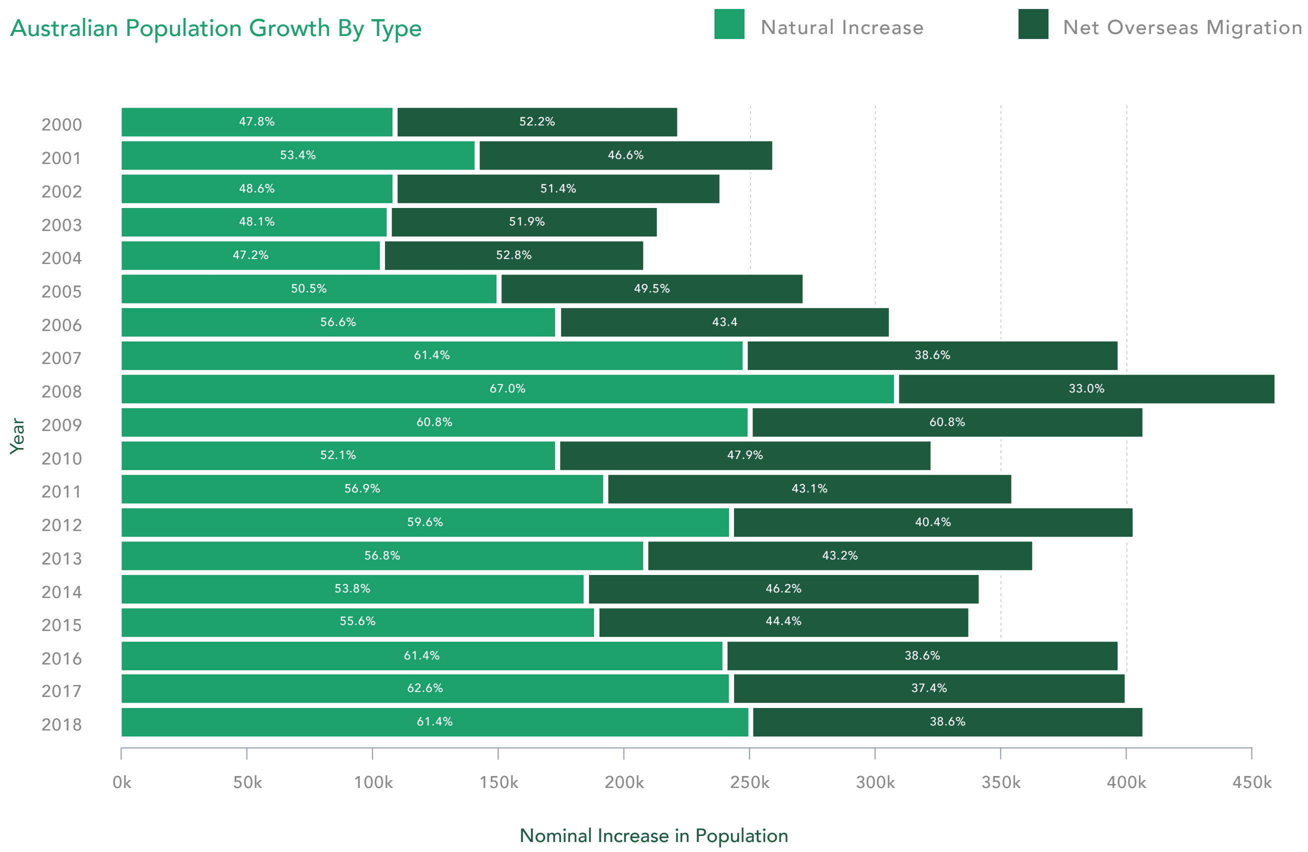
Inevitably the "one-child" policy is having a lagged impact upon the size of the workforce. This lies behind some of the concerns about future growth in China and is an important premise for the "One Belt, One Road" strategy, which aims inter alia to export low-skilled jobs to neighbours in the ASEAN (Association of South-East Asian Nations) countries.

It also underlies the "Made in China 2025" project which propels the Chinese economy towards higher skilled industries driven by information and environmental technologies. It is interesting that both Tesla and VW have opted to build electric cars in China.

The emerging expertise which the Chinese have in robotics, artificial intelligence, 5G telephony and the "internet of things" appears an industrial and security threat to those who have become accustomed to that leadership advantage. It is this initiative, and America's loss of geopolitical hegemony, which lie behind the trade war with the USA. This problem is unlikely to be solved soon.

3. Migration

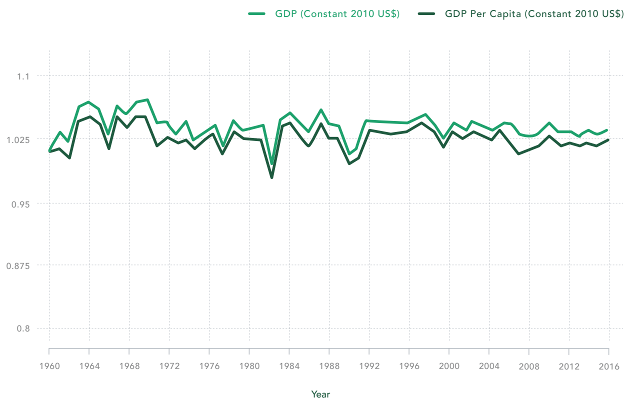
The opposite demographic effect can be seen in Australia, where the population has grown significantly. Partly because of the birth rate, but substantially because of their migration policy, the total population has doubled from 12,793,034 in 1970 to 25,359,162 today, 10th January 2020. This has led to Australia being described as "The World's First Immigration Economy".



Sources: ABS
Credit: RMIT ABC Fact Check

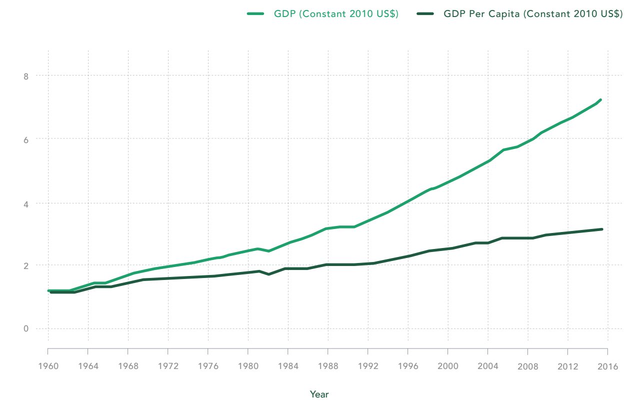
Theoretically this should have been very positive for economic growth in Australia. It has been for every year bar two in the last 60 years, but only at the overall level. From an individual Australian's perspective, the economy has not only had several recessions, but also growth at a personal level (for which read wages) has always been lower than for the economy as a whole.

Australian Annual Economic Growth Rate



Source: https://data.worldbank.org

Australian Economic Growth



Source: https://data.worldbank.org

The cumulative difference of this over 60 years is immense. The economy has grown by over 7 times, while GDP per capita has risen less than 3 times.

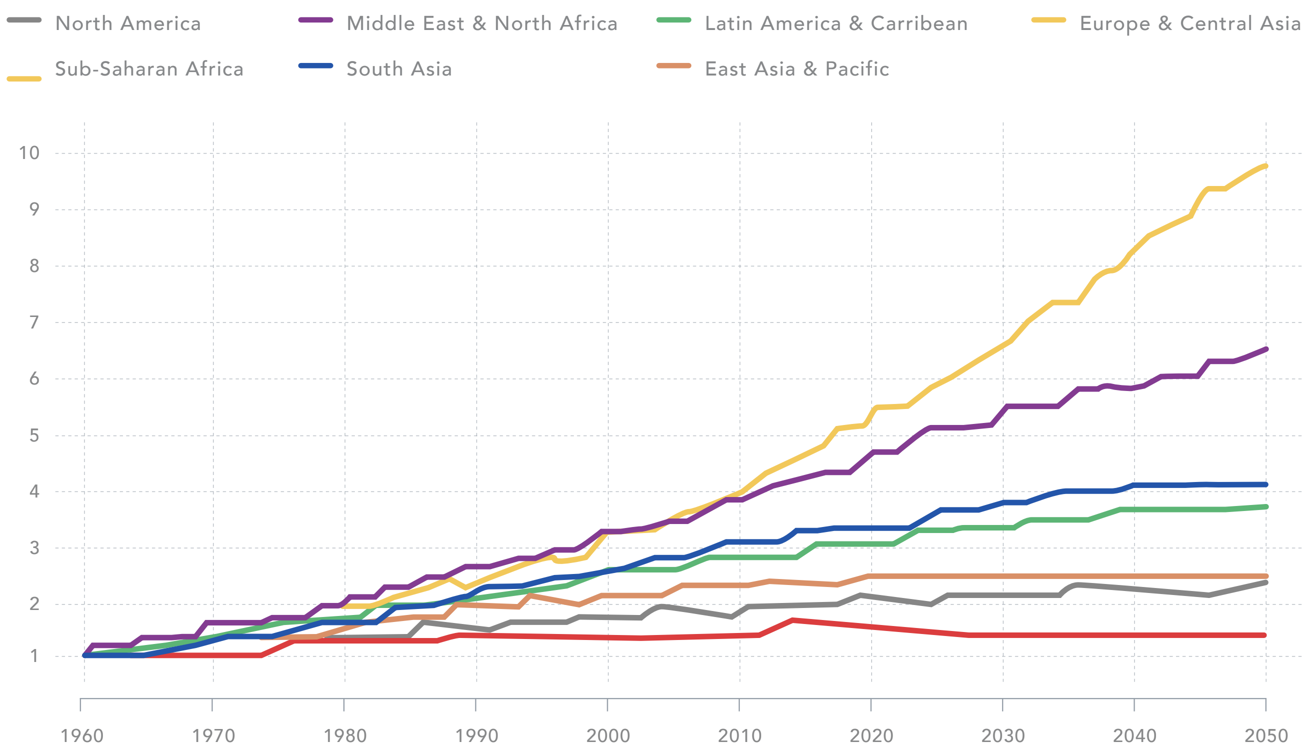
When we consider the issues which have emerged during the Brexit period, many have related to the availability of good jobs, the failure of wages to maintain their purchasing power for many years after the Credit Crisis in 2008, and pressures upon the supply of good homes and healthcare. Like Australia, Britain has undergone a period of substantial net inward migration.

Across Europe migration from the Middle East and Africa has caused policy stress in all countries.

The largest prospective regional growth in population during this century will be found in sub-Saharan Africa. The Middle East and North Africa region will also experience rapid increases.

The Population in Sub-Saharan Africa is Projected to Grow 10-Fold Between 1960 & 2050

Trends in population size relative to 1960



Source: http://blogs.worldbank.org/opendata/worlds-population-will-continue-grow-and-will-reach-nearly-10-billion-2050

More than half of global population growth between now and 2050 is expected to occur in Africa. The population of sub-Saharan Africa, with its high birth rates and declining death rates, is projected to double by 2050. Rapid population increase there is anticipated even in the unlikely scenario that fertility levels fall sharply in the near future. Regardless of future trends in fertility in Africa, the large number of young people currently on the continent, who will reach adulthood in the coming years and have children of their own, ensures that the region will play a central role in shaping the size and distribution of the world's population over the coming decades [3].

Europeans have already experienced the impact of migration from Africa and the Middle East in the last decade, and this is unlikely to stop without significant inward investment into those countries so that young people have a reason to stay at home.

Ageing European and Russian populations suggest these countries could provide a natural home for a minority of educated migrants, but the need for infrastructure and jobs throughout Africa and the Middle East should be clear.

4. Resource Scarcity

In 1798 Thomas Malthus published his theory on the "Principle of Population". He posited that populations grow faster than the supply of food and thus lead to a shortage of food.

Malthus then argued that this would lead to the Malthusian catastrophe, which would bring the population level back to a "sustainable level."

"Famine seems to be the last, the most dreadful resource of nature. The power of population is so superior to the power of the earth to produce subsistence for man, that premature death must in some shape or other visit the human race. The vices of mankind are active and able ministers of depopulation. They are the precursors in the great army of destruction, and often finish the dreadful work themselves. But should they fail in this war of extermination, sickly seasons, epidemics, pestilence, and plague advance in terrific array, and sweep off their thousands and tens of thousands. Should success be still incomplete, gigantic inevitable famine stalks in the rear, and with one mighty blow levels the population with the food of the world [4]."

To correct the imbalance, Malthus also suggested using "preventative checks" to control the growth of the population. These measures include family planning, late marriages, and celibacy [5].

Fortunately Malthus's grim forecasts have not played out. In Western Europe populations have grown but food production has also risen because of technological advances.

Thanks to many technological advances, food production has dramatically increased over the past century often exceeding the population growth rate. For example, during the 1930s in the US, 25% of the population worked in the agricultural sector while total GDP was less than $100 billion [6]. Today, less than 2% of the population works in the agricultural sector, while total GDP is over $14 trillion [7].

The limited availability of land at the time was the basis for Malthus' theory on food production constraints. However, thanks to productivity improvements, the use of agricultural chemicals and machinery, storage, packaging and globalisation, we can trade food across borders, time zones and seasons, which increases the amount of food available for consumption.

Today however Malthusian-style concerns about the future availability of resources is becoming an increasing concern everywhere. "Demography is destiny" in terms of demand for the planet's resources.

One does not need to embrace the fears of "Extinction Rebellion" to recognise the growth of demand for resources, the need to replace or supplement many of them, and the benefits of changes in lifestyle or consumption.

Nor does one have to believe that "Carbon Zero" is achievable by 2050 or any other chosen date to recognise that long term growth opportunities exist for investors in associated areas. Food, agriculture, water, electrification, de-carbonisation, smart cities, the internet

of things, medical discovery, robotics, data storage and security, all these and more will provide interest and opportunity for years to come.

Demographics and technological discovery are driving the need for more investment in infrastructure, whether it is for communications or healthcare, the needs of the elderly or lifelong education.

The more crowded and the more connected the world becomes, the more we need to care about good governance and ensuring decent social outcomes for more and more people, wherever they are from and whatever their beliefs.

The world's economies may be slowing down, but growth segments remain, and opportunities will persist. The disruption of existing economic and business models will continue, but changes create opportunities.

These are all good reasons not to invest passively, for example predominantly in indices, which by their very nature are dependent upon the businesses which succeeded in the past. Many will continue to succeed, but many will not. We remain committed to seeking out new opportunities while also seeking to avoid the pitfalls of simply assuming that present incumbents will succeed.

Sources:

[1] Auguste Comte 1798-1857

[2] https://www.weforum.org/agenda/2019/02/japan-s-workforce-will-shrink-20-by-2040/

[3] https://www.un.org/en/sections/issues-depth/population/index.html

[4] Thomas Malthus, 1798. An Essay on the Principle of Population. Chapter VII, p. 61

[5] https://www.intelligenteconomist.com/malthusian-theory/

[6] https://www2.census.gov/library/publications/decennial/1940/population-occupation/00312147ch2.pdf

[7] https://fred.stlouisfed.org/series/USAPEMANA

Monitoring Gender Equality in the Workplace

By Simon James

Gender equality is becoming a key issue for investors, alongside environmental and governance themes.

In 2017, the UK Government passed legislation (Equality Act 2017) which made it obligatory for companies with more than 250 employees to disclose their gender pay gap. A year earlier, in 2016, the Hampton-Alexander Review committed to achieving the 33% target for women on boards as well as in leadership teams of FTSE 350 companies by 2020.

It has become clear that improvements are most likely to happen when relevant criteria are monitored, and when legislation has been approved.

But research shows that the UK still lags behind Australia, France and the Scandinavian countries. Five of the top ten companies and eleven of the top twenty are in Australia [1].

This is likely to have been driven by legislation being in place since 2012, requiring companies to publish comprehensive public reports on their gender equality performance on a yearly basis. Facilitated by the Workplace Gender Equality Agency (WGEA), these reports cover six indicators, including gender composition of the workplace and governing bodies, remuneration, provision of parental leave, and flexible work arrangements. Australia is an example of how enforced transparency can motivate improved performance over time.

Equileap is the leading organisation for providing data and insights on gender equality in the corporate sector.

They research and rank over 3,500 public companies around the world using a comprehensive Gender Equality Scorecard™ with 19 criteria, including the gender balance of the workforce, senior management and board of directors, as well as the pay gap, parental leave and sexual harassment.

The top ranked company is Diageo, a British company, but it and Glaxo are the only UK members of the top twenty, compared to Australia's 11 entries.

Diageo has achieved gender balance on the executive level (40%), and women represent 37.5% of the board, 34% of senior management and 32% of the workforce. They have no pay gap (i.e. published an overall mean pay gap of less than 3%) and have a strategy to close any gender pay gaps which appear. Diageo offers a living wage to its employees, 26 weeks of parental leave to both primary and secondary carers and flexible work arrangements, in terms of varying the schedule and location of work. Diageo is also a signatory of the United Nations' Women's Empowerment Principles.

Despite this strong showing in gender diversity issues, there remain complications for Diageo when it comes to ethical investors. They are one of the world's largest manufacturers of alcoholic drinks.

Complicated, isn't it?

Sources:

[1] https://equileap.org/2019-global-report

Aiming For Growth

Joseph Cornwall

In the previous three parts of this four-part series we have discussed the qualities we like our AIM Portfolio Service's companies to possess. This article discusses the importance of valuation when investing for the long-term.

Different types of investor value businesses in different ways based upon their investment process. For instance, a value investor may be looking at the asset-backing of the business and may use Price-to-Book to value a business. This is the price you are paying for the value of the assets, which may be land, buildings, equipment, loans or intellectual property which the company owns.

Many other investors value businesses based on the Price-to-Earnings ratio, otherwise known as the PE ratio. This is a simple measure, but one which can be easily manipulated by management teams.

We therefore use a modified approach for interpreting reported earnings, known as "cash flow conversion". Cash flow conversion measures the proportion of profit that is converted into cash. In a high-quality business, it should approximate to 100%. If it lies above 100%, management are likely to be accounting very prudently. If it sits significantly below this figure they could be accounting aggressively. We like companies with cash flow conversion of close to 100% or above.

This resonates comfortably with our philosophy of being so-called "quality investors". We believe we are in a world where industries are undergoing widespread disruption, and thus companies we favour need strong finances and good management. We are looking for businesses with the potential to compound relatively high returns over the long term.

Therefore we take our and the market's estimates of growth rates for that company, apply those to our cash flow converted earnings estimates, and assess the structural, cyclical or company-specific factors to estimate a level of normalised growth in earnings per share over the medium-to-long term.

Taking our preferred measures of the company's earnings and growth rate, we now have a valid PE ratio but still need to value it appropriately. Given that our companies should have long-term structural growth opportunities, we use the "PEG ratio" to do this. The PEG ratio is the company's PE ratio divided by its growth rate.

PEG Ratio = PE / Earnings Growth Rate

We consider a PEG ratio close to 1 as attractive. However, these opportunities are not commonplace in good markets and many excellent growth companies can trade at PEG ratios in excess of 2. If a company we like has a High PEG ratio, we are likely to wait for a better entry point, even if we very much like the business in question.

What is the impact of paying too much for a company?

The best investment returns derive from first, profit growth, second, the company's ability to retain its strong finances and its competitive position and third, avoiding paying too much for the company's shares.

If we were to pay too much then, even if profits grow according to plan and the company remains strong, we would be at risk of reducing our potential returns.

To illustrate this point, there is an example below of a hypothetical excellent business. It has grown its earnings per share at 15% per year for 10 years, and we believe it will continue to do so over the next 10 years.

Starting with earnings per share at £1.00 its final earnings in Year 10 would be £4.05 per share, a 305% increase. If the PE ratios at entry and exit were the same, then the return would have been 15% p.a., the same as the earnings growth, delivering a 305% return.

However, it is rare for entry and exit valuations to be identical. You may have identified an excellent business but if its PE ratio weakens from your entry point, this will dilute your return. Equally a company which attains a higher rating will have delivered greater investment returns.

Starting PE Ratio Paid	Return on Investment after 10 Years on an Exit PE of 25	Return on Investment after 10 Years on an Exit PE of 15
35	189%	73%
30	237%	102%
25	305%	143%
20	406%	203%
15	574%	305%
10	912%	507%

Self-evidently buying at a reasonable initial valuation improves the probability of delivering good returns. This also reduces the risk of the investment if our growth estimates prove to have been too optimistic.

Nevertheless, a rigorous sell discipline is important. If we believe a company is losing its competitive advantage, then we sell its shares quickly to avoid a fall in its relative value in the stock market.

In the long run investment returns derive predominantly from the quality and growth of the business. However, the perception of quality may change over time and thus long-term investors need to be sensitive to the valuation of shares when they buy them.

Charities - An Introduction

By Oliver Findlay

"Charities are the eyes, ears and conscience of society. They mobilise, they provide, they inspire, they advocate and they unite [1]."

The practice of charity means the voluntary giving of help to those in need, and it has historically often been associated with religion. A common understanding of charity is what many people of faith would call 'almsgiving' - a strong tradition not only in Christianity, Judaism and Islam, but also in Hinduism, Buddhism and other faiths.

Outside religion it is also often seen today as "effective altruism", a philosophy and social movement that uses evidence and reasoning to determine the most effective ways to benefit others.[2] Such gifts might follow the occurrence of a disaster, whether man-made as in "9/11" or natural like the earthquake in Haiti or floods in Pakistan.

In the UK, about 50% of adults donate to charity which means we have one of the highest giving levels of any country in the world [3].

At the time of the origins of charitable giving within Christendom, it was believed that almsgiving was a 'Christian duty', and the donor probably hoped that the virtuous nature of a gift would help secure favour with God.

The relief of the poor was also believed to help avoid social disorder, which was a more practical, and possibly pragmatic, view of the concept.

The Middle Ages saw the establishment of structured charitable giving, with the church being the main beneficiary. Many schools and universities were established in or after the 13th Century by generous benefactors, although they were not the first schools. King's School, Canterbury was established in 597, and many other schools too before 1200. These were often associated with churches, but after the Reformation the wealthy reduced their donations to monasteries and so recipients became more diverse.

Sadly, by the late Middle Ages the misapplication and mismanagement of monies had become a serious issue. The 1601 "Statute of Elizabeth" (The Charitable Uses Act) was introduced with the intention of ensuring that charitable donations reached the intended recipients. The Statute's primary purpose however was to make trustees accountable for the appropriate administration of charitable assets, which in turn would encourage increased private charity for the relief of poverty, lessening the tax burden of providing relief for the poor [4].

The Act became the foundation of the modern definition of charitable purposes and in the nineteenth century "The Courts and the Charitable Trusts Act 1853" defined four purposes: the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community [5].

The fourth catch-all purpose has now been re-defined to include: the advancement of health or the saving of lives; the advancement of citizenship or community development; the advancement of the arts, culture, heritage or science; the advancement of amateur sport; the advancement of human rights, conflict resolution

or reconciliation or the promotion of religious or racial harmony or equality and diversity; the advancement of environmental protection or improvement; the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage; the advancement of animal welfare; and the promotion of the efficiency of the armed forces of the Crown or of the efficiency of the police, fire and rescue services or ambulance services.

In Britain today health charities like Cancer Research remain the most popular causes to donate to [6].

The 1853 Act established the Charity Commission for England and Wales. It is the non-ministerial government department that regulates registered charities in England and Wales, maintains the Central Register of Charities, and it answers directly to the UK Parliament rather than to Government ministers.

In late 2018 there were about 168,000 charities registered in the UK. The number fell sharply at the time of the "Credit Crisis" and has only recovered more recently [7].

The Charity Commissioners' role is to protect the charities, their beneficiaries and the trustees.

A recent example of their intervention was the removal of Alternative Housing from the register. The charity's objects were to provide accommodation, support and care to those in need within Bristol, but it was reported in news articles as providing housing with no heating, no water, broken cookers and overflowing raw sewage [8].

According to the UK Civil Society Almanac 2019 the voluntary sector employs roughly 870,000 paid workers, but the majority of charities rely entirely upon the work of volunteers and do not employ any staff at all: it is estimated that only 9% of charities employ paid staff, while 91% are solely reliant on volunteers. Volunteering is popular with 21 million people volunteering at least once a year [9].

The sector generates additional value to employees, which is only partly reflected in their salary. At least some are willing to earn less in favour of a working environment where a sense of fulfilment trumps salary expectations. These individuals benefit from a rewarding career path focused on driving change and helping to improve the life of others.

The Trustees are often the unsung heroes. They are charged to use their skills, experience and judgement to guide all stakeholders in a charity as well as manage the purpose of the charity and deliver on its objectives.

One of the main responsibilities of the Trustee is the management of the charity's investments. Legislation allows this to be at a strategic level as Trustees are permitted to delegate the day-to-day management to a third party, like Gore Browne Investment Management.

Good governance remains at the heart of this responsibility; a clear and thorough Investment Policy Statement (IPS) is a vital ingredient to this and guides both the Trustees and the Investment Manager. Our next newsletter will also dig deeper into the requirements, function and format of IPS. We are, of course, always available to discuss these types of issues on an individual basis. We regard clients as individuals and so apply the same approach to charities as for private indiviuals; each has a different objective and the Trustees hold different skill sets and levels of understanding investments.

Good Governance forms part of ESG considerations which lie at the heart of our company and our investment strategy.

Finally, the charity sector contributes to fostering economic and social cohesion within communities. This role may be increasing in value given some of the divisions in society. Charitable activities build social capital in the form of increased trust and cooperation, and promote social inclusion, potentially bringing divided communities together.

The activities generally contribute to individual and wider wellbeing.

Put simply, people think charity is a good thing [10].

Sources:

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Powers of Attorney and Your Investments

By Simon James

At some stage, we should all ensure that we have an up-to-date Power of Attorney (PoA).

They are useful documents to have, and they provide the individual ("donor") with the peace of mind that their chosen representative (also known as an attorney) can manage their financial affairs should the donor lose capacity to do so at any point in the future.

The old style Enduring Powers of Attorney (EPAs) are still legally valid despite a change in the law in 2007. Now however it is only possible to create Lasting Powers of Attorney (LPAs) although there are still many valid EPAs in existence. It is important to note that any changes required to a valid EPA can only be made by revoking the EPA and creating a new LPA instead.

Following guidance from the Courts in 2015, it is now recommended that in any PoA a paragraph ensuring the attorney has full discretionary powers over investments is included. If needs be, the attorney can delegate investment management decisions to an investment manager. The donor may already have an investment manager and it is important to ensure that such an arrangement will continue once the donor loses capacity to manage their financial affairs [1].

The general principle is that an attorney acting under a PoA where the donor has lost capacity cannot delegate any decision-making to third parties unless expressly authorised to do so in the document itself.

Without such express authority, the attorney must make decisions on the donor's finances personally.

Without the relevant wording in the EPA/LPA, the attorney cannot open a new discretionary portfolio on behalf of the donor, nor can they instruct the investment manager to continue to manage the donor's assets on a discretionary basis. In this instance, the attorney can only invest the donor's assets through an advisory mandate rather than a discretionary mandate.

This is often inconvenient and may also present a risk to the donor's investments.

Attorneys who delegate investment decisions without express permissions in the EPA/LPA will find that they have acted outside the scope of their powers and could be personally liable for any losses suffered by the donor as a result. Investment managers may only act when the attorney has authority to appoint them, and so usually they would refuse to act if there is no specific authority.

What Can Be Done?

- If there is no appropriate wording in the EPA/LPA and the donor has capacity, they will need to revoke the current EPA/LPA and make a new LPA with an express provision enabling the attorney to delegate investment management decisions.
- If there is no appropriate wording in the EPA/LPA and the donor has lost capacity, an application can be made to the Court of Protection for retrospective approval of the investments and permission for the attorney to delegate investment management decision. This should always be seen as an option of last resort as it is an expensive and lengthy process.

If you do not have a solicitor who can check your existing PoA or draft a new one for you, we have a number of contacts whom we know well who may be able to help you.

Sources:

[1] https://blog.step.org/2016/10/04/invitation-to-members-lpa-discretionary-investment-clauses

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