

Restarting The World

A pandemic like no other. Governments around the world have been given little choice but to lock down communities to control the spread of SARS-CoV-2, generally referred to as coronavirus. The impact has been devastating, the human and financial cost incalculable. And well done Saudi Arabia for choosing this precise moment to launch an oil price war.

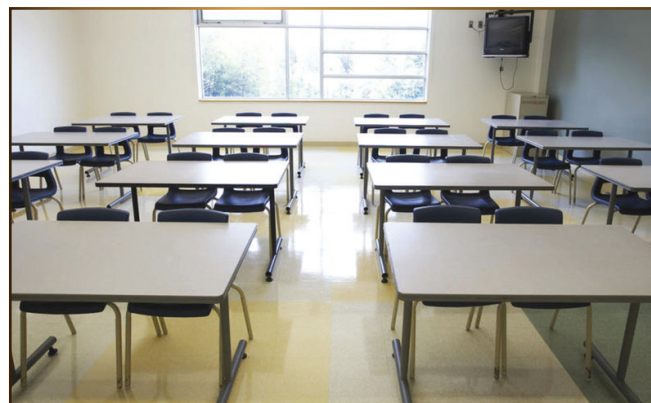
For world leaders, the uncertainty of the situation puts them in a terrible position; damned if they do and damned if they don't. Their response, after some stop-start, has been to pump-prime like fury, cutting interest rates and providing financial assistance to the neediest.

In stock markets, sellers have overwhelmingly had the upper hand. In sterling terms, global equities have fallen by around 15% year-to-date, a return flattered by the weakness of the pound which has lost 6% of its value over the same period. This is a time when toilet rolls and hand-wipes are highly sought after, not stocks and shares. Coronavirus is a human crisis first and foremost, but there will be a big financial price to pay as well.

As we enter the second quarter of a so-far turbulent 2020, businesses are gradually stepping up to meet the challenge of providing medical equipment and testing kits as well as accelerating the development of vaccines. Good news from this quarter is essential if governments are to have some reason to lift the restrictions which they have imposed on their citizens.

And lift they must. We are only a few days into lockdown and if it turns into weeks, there will be social mayhem. So far, the response to various government diktats has been one of compliant resignation of the fearful kind. Fortunately, and unfortunately, the weather in the UK has so far played ball and the sun has shone. Lining up to buy food in the misery of horizontal rain will test the new-found solidarity of those standing outside, even the queue-loving English. For the last 6 months, the population has been battling floods, storms and all sorts of weather-related misery. Now Mr. Blue Sky has arrived and everyone has been ordered to stay indoors. Fine, maybe, for days. Unenforceable if it lasts for long weeks.

Meanwhile, the economy has shuddered to a standstill. JP Morgan forecasts that US economic growth will fall by 10% in the first quarter of 2020 and by 25% in the second quarter. Unemployment is predicted to at least double to more than 8%. Companies are suspending dividend payments to preserve cash



School's out for summer...and so is everything else.

to see them through and retracting earnings guidance. This is corporate mayhem, but with a significant human cost.

Society as we know it cannot withstand this sort of shock for long. People have to go back to work, schools and shops need to be reopened and the economy resuscitated. Nobody knows this more than governments whose income in the form of taxes is collapsing just as the debt burden increases. For some left wing parties, this would be called a strategy; for today's largely free market conservative governments, it is an impending disaster.

We cannot predict an exact end to this coronavirus misery. We can say with certainty, however, that there will be an end, because there must be one. As ever, our professional focus is on capital markets and looking after the interests of our clients. But writing from the echo chamber of our largely empty offices we are constantly reminded of the human consequences of this episode, the likes of which we hope never to experience again. We wish all our readers well and look forward to writing a more upbeat and hopefully mask-free edition of the Investment Briefing in July.

Russell Collister

CHIEF INVESTMENT OFFICER - APRIL 2020

Reasons To Be Cheerful, 1, 2, 3

"A bit of grin and bear it, a bit of come and share it, you're welcome, we can spare it." (Ian Dury, 1977)

As standard procedure, the telephone lines of stockbrokers and investment managers are recorded to verify dealing records. Imagine my embarrassment, when, about 20 years ago, I received a call on my dealing line from my husband who (for japes) pressed his Nokia 3310 up against the speaker of his car stereo, playing the first stanza of 'Plaistow Patricia' at generous volume. While I couldn't possibly repeat the opening lyrics of this song in civilised company, alien as it was to my upbringing on a diet of Catholicism and Duran Duran, they just about sum up my reaction to market behaviour over recent weeks. This memory evoked another classic by the late Ian Dury who, despite the media's largely successful attempts at inducing mass panic, once promised us three reasons to be cheerful.

On the Isle of Man (and just about everywhere else) consumer-facing smaller businesses are reeling from the social impact of COVID-19. It pains me to see local enterprises issuing vouchers for deferred spending, crowdfunding to stay solvent, or closing their doors, perhaps permanently. Larger companies, however, have greater options. Amidst the gloom of mid-March, one of the world's largest food distribution companies, **Sysco Corp.**, which forms part of our **Pound a Day American Selective** portfolio, provided us with two updates. The first informed us that the company was distributing 2.5m free meals to the needy nationwide. A tick in the box for social awareness. There was also solace for investors, as their shares have since rebounded by over 40%. Like many proactive mega-capitalised firms with access to cash, the company also revealed that it had drawn down additional credit facilities of \$1.5bn, now maintaining \$2bn of cash on hand. With many fingers in many pies (quite literally), Sysco reminded us of its flexibility to defer capital expenditures on non-urgent projects and reduce variable expenses, tightening receivables while also developing new source revenues. The company is using its considerable expertise and economies of scale to provide much needed additional services to the retail grocery sector, currently strained by panic buying. In the UK, a statement was issued by the safety and medical equipment specialist, **Halma PLC**, which reported strong operations across all units, especially Infrastructure Safety (which provides solutions for water scarcity, food security and medical services). Moreover, we have seen the creation of "Ventilator Challenge UK", a consortium of fourteen firms backed by engineering specialist, **Smiths Group PLC** and including **Rolls-Royce PLC**, **BAE Systems PLC** and **Renishaw PLC**, sharing intellectual property and manufacturing firepower to create 10,000 new medical ventilators. Necessity remains the mother of invention. Most certainly, this crisis has thrown into stark contrast the varying fortunes of big and small, as the former divert capital expenditure, draw down credit facilities, borrow from capital markets at near-zero finance costs (more of that later) and use their vast economies of scale to protect margins.

When the world last went barmy in 2008, I was an investment manager in a team of one, sharing ideas with me, myself and I. One strategy I deployed was to protect drawdown from portfolios by taking profits from cyclical holdings and buying AAA-rated corporate bonds, then yielding 4-5%. This turned out well, benefiting from the subsequent massive yield compression, as interest rates were systematically slashed in the following decade of financial repression. Interest rates have since seen the central bank version of a dead cat bounce, a feline culled by co-ordinated action of central banks which have brought overnight lending rates within a shave of the zero bound. Selling shares in high quality

companies (like Sysco or Halma) to cash now would be the equivalent of selling a silk purse to buy a sow's ear. As for tactical cash allocation, Peter Lynch, a former celebrated fund manager at Fidelity, delivered impressive returns for his investors during his thirteen-year tenure (annualising 29.2%), based on the adage that "stocks are relatively predictable over twenty years. As to whether they're going to be higher or lower in two to three years, you might as well flip a coin to decide." Of course we

appreciate the stomach-lurching uncertainty of the current situation: we too have skin in the game and it's also feeling somewhat burnt. However, unlike bonds (with fixed maturities), we are investing in company cash-flows and earnings over the next decade or two, not just for the next six lean months.

So, what is my third reason to be cheerful? On 16th March 2008, an 85-year-old investment bank called Bear Stearns narrowly avoided bankruptcy, sold to the highest bidder (JP Morgan Chase) for \$2 per share. On 15th September that year, Lehman Brothers filed for Chapter 11 bankruptcy. Despite these portents of the Great Financial Crisis, the Troubled Assets Relief Programme (TARP) was not signed into US law until 3rd October 2008. Interest rates in the US were quickly slashed but, as suggested earlier, corporate borrowing was still expensive compared to today's giveaways. Political manipulation and concerns about bailing out the bankers got in the way of damage limitation. The situation was even worse in Europe. A lack of fluid monetary and political mechanisms meant that their financial crisis did not peak until 2010-2012. Throwing a cliché into the mix, this time it's different. We have a humanitarian crisis accompanying a global pandemic, involving mass unemployment, overburdened healthcare systems and creaking global travel infrastructure. This is a clear pass for politicians and policymakers to throw the baby and bathwater at the problem, thinking later about fiscal probity once the crisis has passed. Within one week, we have seen eye-watering, globally co-ordinated backstops offered to credit markets, interest rates slashed (even) further, while front line fiscal aid has been dealt out for struggling industries, the NHS and the gig economy. Never has fiscal generosity been so inexpensive and easy to grant (apart from some inevitable bipartisan squabbling in US Congress). Cheer might not feature on the agenda this summer but hold tight and this crisis (and my swearing at market monitors) will eventually pass.



Mary Tait after a bear market...or is it Ian Dury?

Mary Tait
INVESTMENT DIRECTOR

Crash Diet

"Let's go to the Winchester, have a nice cold pint, and wait for this all to blow over."

(Shaun, "Shaun of the Dead", 2004)

With the sensible addition of frequent hand washing, the contents of the above quote are broadly in line with the prevailing advice at the moment. Scratch that, the Winchester is closed, socialising is discouraged, and the beer has been squirrelled away by hoarders with sharp elbows. Given today's circumstances, the pros and cons of our vast, interconnected world seem more evident than ever. Whilst the spread of COVID-19 was expedited by the ease of first world travel (con), the speed at which information can be gathered, guided by a suitably advised government, means that we can be confident and secure in our day-to-day choices (pro). However, it is possible to drown in a storm of information. Spending days sorting fact from fiction can be just as panic-inducing as being left in the dark. After all, it's far easier for the imagination to run wild with gloom as it collates the worst-case scenarios while discounting the more optimistic (and often more likely) outcomes of the story.

That's not entirely surprising, since loss-aversion bias means that we feel our losses twice as much as gains, but it can distort the real picture and even guide us towards making wrong choices. However, if we filter information down to things that are within our control, then information tends to become more manageable when translating it into action. This is true in all walks of life and within the world of diet and exercise, for example, it has encouraged a market where quick fixes are pushed at the expense of realistic objectives. People looking to get fit for a typical summer may be disappointed to find that Rocky Balboa didn't get into fighting shape after a 2-minute training montage. Likewise, whilst some souls will be disappointed to discover that "The Wolf of Wall Street" bears no resemblance to the realms of investment management, they might be reassured by the notion that we hold their long-term interests close to our hearts. In both worlds, gains can take a while to accrue and, no matter how much progress has been made, any backward step could make you question where you went wrong.

In such instances, it is the job of industry professionals to provide comfort and clarity, whether it's by spending time dispelling myths, correcting misunderstandings, or simply reassuring people that they're still on the right track. The same questions come up time and again, as it's clear that the wider world is flooded with contradictory advice in such a way that it overcomplicates even the simplest of concepts. A personal trainer by the generic name of James Smith founded a business and launched a book, by spending time repeatedly answering the same question. "What's the best way to lose weight? Answer: calorie deficit." This is a common combination, acting as reassurance that the same fundamental rules still apply when everyone and their aunt is convinced that some amazing new diet is the ultimate answer. Whilst some of Smith's clients may enjoy (or need) a more complex breakdown of how to achieve their desired goals, his audience is global which means that there is always someone else struggling to get over that first hurdle.

With all of this in mind, it has been comforting to observe so few people panicking over the recent declines in their portfolio values. Perhaps it's the result of our consistent message over



Toilet rolls and good quality shares: Both in short supply.

the last decade, at every step of the way, emphasising reliable long-term growth in favour of cashing in on short-term returns. After all, there's not much value to be gained by selling a good company when it's going to continue making money.

As an 11-year year bull market for equities officially draws to a close, this philosophy is just as relevant now, if not more so; you haven't made a loss unless shares have been sold. Whilst the total disruption caused by the coronavirus is yet to be determined, unless you have a short-term need for cash, there's little to be gained by locking in a decline when the whole market is down. For investors in our **Pound a Day Portfolio**, this will test our thesis for a bias towards companies which have been able to grow their dividends through thick and thin, with yields now reflecting valuations which are much lower than their BC (Before-Coronavirus) share prices. Well-managed companies with healthy balance sheets and a strong track record of growth will come out on the other side; they may be battered and bruised but over the longer term they will be stronger.

To paraphrase a line by Warren Buffet, "be greedy when others are being fearful" but instead of racing to the local supermarket to claim a stake in the nation's supply of toilet roll, you should set your sights firmly on the stock market. Shares are on sale and there's a limited supply.

Michael Craine
INVESTMENT MANAGER

Hitting The Re-set Button

This is my third attempt at writing this article given the daily evolution of current events, as governments and business reactions cause massive share price gyrations.

If one was to measure these declines by monitoring the yield on the FT All Share Index, moving above 6% places this crisis on a similar level to the evacuation of Dunkirk and the fall of France in 1940, as investors thought we would soon be speaking German, or the 1974 crash caused by the collapse of the Bretton Woods system of pegging the US dollar to gold. Investors who bought at such times did well, but the world has changed and now the focus of longer term success will hinge on resilience.

Having promptly reverted to working from home, I referred to an old dictionary where the definition of resilience is “springiness, bounce, elasticity, flexibility”. Well, after a few days of WFH, unlike our business model, there is not much “springiness” and “flexibility” in me. I don’t like it. I miss the banter, my colleagues, market discussions and, as a lifelong commuter, the drive to work; a time always put to good use. Perhaps I just need to sit in a car for 40 minutes each morning and night, listening to news podcasts (and, of course, the Archers) but even this broadcast is being rationed.

Considering the bigger picture, it is clear that society, businesses and governments were ill-prepared for a shock of such magnitude and perhaps that should come as no surprise. We are not ready for aliens, a solar flare or a large asteroid strike either and I don’t suppose we will start planning for these any time soon, but we will question many of our past pandemic preparations, as they are hardly new. Annual reports often have an “Understanding and Responding to Risks” section and sure enough, “pandemic” appears, typically categorised alongside terrorism and a risk appetite of “n/a”, alongside mitigations which look futile, in hindsight. Who truly considered supply and demand being hit simultaneously, made worse by an oil price war? Unlike conflict, social isolation will challenge our personal well-being, accentuated by the fact society’s elders do not have first-hand experience of a pandemic and are unable to offer words of wisdom, despite messages being passed down generations.

We are also questioning our mortality on a scale not seen since the Cold War. This time, at least, we are told to stay on our property rather than get under the stairs or table but equally, our experience will have a lasting impact on future decisions. Globalisation has brought massive benefits to many people including greater choice, lower prices, negligible inflation and higher global living standards, but the risk was always going to be a breakdown in the global supply network, which had become overly-complex. This could have been brought about in many ways; a solar flare would have had a similar impact. Regrettably, history is littered with pandemics and it is only luck which has prevented an earlier occurrence, despite numerous close calls. Society is guilty of ignoring the risks and consequences, ranging from unfunded health service contingency planning to ordinary people not having a store of food in the house or a skill-set to grow it. Many are not used to doing what they are told. We forget



Post WWII Food Rationing: Bloody Luxury.

that previous generations grew food, kept a pig or a few hens as a necessity, to make the household more resilient. At a national level, it’s only a few weeks since the press was dominated by a headline stating: “Britain does not need Farmers”, yet already we have food shortages which are sure to get worse (by our high standards) albeit nothing compared to WWII rations. Even our mind-set is awry, as people challenge the restrictions on movement and act selfishly. Where is Chief Warden Hodges when you need him to whip people into line?

Western society, from top to bottom, lacks resilience from almost every perspective, and the subsequent consequences mean that significant changes must be considered, once everything settles down. Some of these will be forced upon us, such as higher taxes necessary to pay for the rescue, which will impact our discretionary spending. This may mean that people travel less and perhaps grow more food, discovering new pastimes and hobbies. A cruise now carries extra risk, as does living in an apartment or a house with nothing more than a yard, as these have lately become prisons. Many will ask questions like: “Could I not make a lifestyle choice and work from home? Could I make my lifestyle more resilient, so the next time something like this happens my family is better protected? Could I do more to help tackle climate change at the same time?” If millions of people answer “yes”, then one must ask if consumerism could now be under long-term pressure.

There are two final questions which have potentially huge repercussions. Are we likely to see urbanisation slowing or possibly stopping, to make society more resilient? Also, if companies bring manufacturing back home, will they disperse it across the country, or concentrate it regionally? If they choose the former, much of the current infrastructure may not be under the same pressure but new projects will be required. At national level, this could represent huge losses for heavily indebted China, while also forcing change here. The Coronavirus pandemic may result in us pressing the largest “re-set” button imaginable, providing new opportunities but also new risks to the existing status quo. As investment managers, we will need to navigate carefully around these challenges which may soon become apparent.

Paul Crocker

INVESTMENT DIRECTOR

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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. 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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