News & Views

Q3 | 2018

Forward thinking

Assessing the markets' long-term prospects

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Will the US mid-terms come up Trumps?

Pensions – forecasting your future

Helping charities reach their goals

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Welcome

To say we are all Brexit fatigued is probably an understatement, and it is no surprise as we pass the two-year mark since the referendum result. However, by far the most common question we are asked by clients is how they can protect their wealth in the event of certain Brexit outcomes.

Despite all the noise however, we are constructive on our market outlook, as you will see from Michel Perera's article on page 4. Yet again, he debunks investor concerns by looking at the economic fundamentals. Yes, we have returned to normal volatility levels, however we would not be surprised to see a decent rally before the end of the year.

Of course, politics will affect investors to some extent, so we continue to keep a close eye on sterling, equities and specific sectors, knowing that stock picking will become more critical as things develop in the UK. Further afield we have the US mid-terms ahead, and Michel provides his view on the potential political and economic repercussions should Trump lose seats (page 11).

Also in this edition of News and Views, Wealth Planning Director Simon Moore breaks down pensions. Pensions never seem to get simpler, so our article on page 17 is designed to help you ensure your plans are on track for the future you want. On page 14 we celebrate clients who take on the huge responsibility of being a charity trustee. As charity governance comes increasingly under the spotlight our Investment Director, Charles Cohen, explains how CGWM might be able to help.

Over the years, we have made significant technological investment to enhance our client experience. As such, we are delighted to confirm that our Wealth Online portal will soon be accessible via an app. It will offer you a flexible mobile-optimised dashboard, document storage and secure messaging. For our institutional clients, we are also working on broadening our capabilities so that they can place trades electronically and seamlessly. We are ever committed to bringing our clients the best return from their wealth and increased satisfaction at every touchpoint, so we welcome any ideas that you may have to improve your experience with us. Do not hesitate to get in touch, should you have any suggestions.

At CGWM, recruiting top-quality people is fundamental to our strategy as we continue to grow and build on our success. We have recently recruited a number of team members both on and offshore and we would like to take this opportunity to welcome our new colleagues.

I hope you enjoy reading this edition of News & Views. As ever, we welcome your feedback; if you would like to get in touch with me or your Investment Manager, we would be delighted to hear from you.

David Esfandi,
Chief Executive Officer, CGWM

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Michel Perera,
Chief Investment Officer

No reasons to be fearful

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One of the reasons why markets have been volatile and directionless this year is the number of worries quoted by many investors. Fascinatingly, this 'wall of worry' changes very quickly, highlighting that market negativity rests on flimsy excuses rather than solid ground.

The current 'wall of worry' includes:

- The late economic cycle: according to many commentators, the bull market has been going for too long – surely the next recession is looming
- Rising interest rates and yields: the Federal Reserve (Fed) will hike until the economy can't take it
- A rising US dollar – this will hurt everyone
- Company profitability at an all-time high, which means margins have nowhere to go but down
- Rising oil prices, which will send inflation sky-rocketing
- Italian politics – in fact, politics in general ...
- Trade wars, whether declared or not
- Emerging market collapse, with the problems seen in Venezuela, Argentina and Turkey spreading to other countries
- Expensive equity markets.

We believe the real picture is quite different – these concerns may continue to be quoted by many investors but markets will in fact slowly grind higher. Let's start by debunking some of these concerns ...

When will the bull market really end?

The vast majority of market strategists apparently expect a US recession in 2020 (or earlier). And where the US leads the economic world, most other countries would follow suit – and at least slow down sharply. There are a couple of things about this consensus that jar with us, however:

(1) If everybody expects something to happen, it probably won't

(2) The standard view in the markets is always 'two years to the next recession', as it pushes the deadline for selling, while giving you a feeling of prudence when you manage your money.

Bull markets tend to end when a recession comes along. But there are other reasons: financial crises, large wars, revolutions, etc, although most of the time it is the end of the economic cycle that triggers the bear market – so it's crucial to know when it's likely to happen. Forecasting a bear market is tricky though, and most investors either forecast phantom bear markets or fail to see them coming at all.

For what it's worth, here is our take on when and how it's likely to occur.

To hunt for the next bear market, we should look at economic fundamentals, leading technical factors, consumer and corporate excesses and outrageous valuations. Taking each in turn:

Fundamental indicators

- Soaring inflation – but the current 1.8% core personal consumption expenditures (PCE) and 2.2% core consumer price index (CPI) do not register on that scale
- Exhausted consumers – we are miles away from that
- Some part of the world collapsing (other than Venezuela, where might this be?).

Technical indicators

- An inverted yield curve, where long-term debt yields fall below short-term debt yields
- Real interest rates – i.e. net of inflation – pushing 1.5-2%
- Financial stress such as obvious corporate bankruptcies.

There is currently no sign of any of these.

Excesses

- Over-gearing for an investment boom, like the late 1990s when capital expenditures (capex) soared; we are just starting to see some capex now – companies have geared up but only to buy back their shares, while individuals have deleveraged massively throughout this cycle
- A housing crisis? The Case-Shiller House Price Index is rising steadily at 6.5% (not a crisis)
- Consumer crazes? Maybe cryptocurrencies, but the amounts are minute.

Valuations

These may have been high at the beginning of the year but all markets have de-rated sharply. The US is now back to average historical price-earnings ratios and the rest of the world is even lower. Earnings have soared and the markets have moved sideways.

This bear market checklist shows that we are still quite far away from one, but need to watch the forerunners, such as excesses in spending, soaring interest rates and collapsing sectors.

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> The rollercoaster rise for oil prices has had very little impact on core inflation, which is what central banks focus on for monetary policy.

Does political risk affect markets?

In the 1950s and 1960s, we had the Cold War, the Bay of Pigs, the Cuban Missile Crisis, the Berlin Wall and the Vietnam War. Yet it was the biggest bull market ever.

That doesn't mean we have no concerns about politics. Political events, however, (apart from world wars or revolutions) tend to create only short-term noise in markets. Whether we are looking at the Italian government changes or the trade war headlines between the US and China, many investors jump on the political worry bandwagon and sell after political change and yet, historically, markets tend to recover from this volatility and revert back to fundamentals.

Will the oil price rise kill the economy and the markets?

Oil prices have a love-hate relationship with the economy. Some parts of the economy are helped by higher energy prices, others suffer from them. For a country like the US, with a large shale oil industry, energy earnings are a large part of the stock market and, as long as other sectors are not overly harmed by rising costs, the balance could be neutral or even mildly positive.

For resource-poor industrial exporters Germany or Japan, rising oil prices are undoubtedly negative. We have to bear in mind, though, that the world has become much more energy efficient since the 1970s, when an oil price surge threw the global economy into a deep recession. Some emerging markets may still be vulnerable to these fluctuations, but countries like China have become efficient, hoarding commodities ahead of needs, so they are less subject to the vagaries of oil prices.

The consumer tends to be more vulnerable than industry. Petrol is an important item in household budgets. In the US, there is a direct relationship between crude levels and pump prices. The recent rise of gasoline from the mid US$2s to near US$3 per US gallon is a 25% cost increase for drivers who often have little choice but to drive. On the other hand, the same US consumer has just received a whopping tax cut. Best estimates are that the current rise in oil prices, if sustained, will eat up half of the tax cut, a significant chunk but not a recession-inducing move.

In the UK, Europe and other developed markets, petrol prices are much higher to start with, due to high consumption taxes. So crude price increases result in a much smaller overall rise for drivers.

As to inflation, there is generally no correlation between headline inflation (including energy and food) and core inflation (excluding it). The rollercoaster rise for oil prices has had very little impact on core inflation, which is what central banks focus on for monetary policy.

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> We recommend focusing on synchronised growth, sharp corporate earnings recovery, persistent low inflation and excellent company health.

Finally, should investors ‘sell in May (or July) and go away’?

There are many years when seasonality has had a strong influence on markets, with the spring/summer months weak and the autumn/winter very strong. There are also many years when it didn’t matter. Why? One answer is that it depends whether you are in a bull market or bear market.

In a bear market, losses tend to accumulate during the ’soft seasonality’ months, with August and September being particularly lethal. In a bull market, it’s different: you sell in May if you have made a lot of profits during the first four months, otherwise you don’t. You sell in September if you expect analysts to downgrade their earnings estimates for the following year, otherwise you don’t.

Most market participants don’t like to be called about market turmoil while they’re on the beach, which may explain why people lighten portfolios during the summer. Some geopolitical events are more likely to happen during the summer season, especially if someone wants to catch the world unawares (Saddam Hussein invading Kuwait, Russia defaulting, China devaluing). Yet seasonal factors are mainly overshadowed by fundamentals, so we recommend focusing on synchronised growth, sharp corporate earnings recovery, persistent low inflation and excellent company health.

In conclusion

After more than a year when there was no equity volatility to speak of, markets have resumed their normal fluctuations. Investors have assumed the end of the cycle is nigh and they’d better get out of the way of the next bear market. We beg to differ. The reasons given for the imminent arrival of the next bear market don’t stand up to scrutiny, and we would not be surprised to see a strong rally before the end of the year. The worry list, however, will keep everyone guessing for some time.

If you would like to know more about our views on markets and the outlook for your investments, please speak to your Investment Manager or call us on +44 207 523 4500. We’ll be pleased to explain how our experts stay at the forefront of economic changes and opportunities.

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Richard Champion, Deputy Chief Investment Officer, UK

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Proceed with caution

The second quarter has been a rollercoaster for the UK market, with the FTSE 100 hitting its all-time high in May (at the time of writing).

The period started just as the global risk-off correction was coming to an end (there was a double-digit stock market fall worldwide in February). As you may recall, this was driven by fears of a trade war between the US and China, combined with worries that interest rates in the US might rise more quickly than originally anticipated.

At the same time, sterling, which in the depths of the post-Brexit referendum plunge had fallen against the US dollar to around US$1.21, had by early April climbed back to nearly US$1.44 – a bounce of 18%. However, with a large portion of the profits generated by UK-listed companies coming from overseas, the recovery in sterling hit the value of these profits in pounds and pence, which meant the UK as a whole has struggled to make as much headway as other international markets.

Nonetheless, in the second quarter both an improvement in global sentiment and a fall back in sterling (that we do not expect to last) have given a big boost to UK shares. This boost has been reinforced by strong profits growth, especially in the large oil and gas and resources sectors. More generally, this profits growth received a further one-off fillip from US tax reform, which has benefited a number of UK-listed companies.

Political turbulence in Europe, especially Italy, has taken a little of the shine off the recovery, and persisting news of potential US-driven trade wars scarcely provides a positive gloss to sentiment. But these more negative factors have been broadly shrugged off and the market has made good progress.

Sectorally, market leadership in the UK over the last quarter (at the time of writing) has been focused in food retail, with shares in Tesco up 25% over the period, for instance. News of the proposed merger between Sainsbury's and Asda has also pushed up the former. In Tesco's case, there is clear evidence of the benefits the company is gaining from its recently completed acquisition of Booker. The other leading area was in energy, with both Royal Dutch Shell and BP up close to 20%.

Bringing up the rear were tobacco and telecommunications. The entire tobacco sector was hit by news that in the US, the Food and Drug Administration (FDA) was looking at forcing a reduction in nicotine content in traditional cigarettes and by the increased investments needed in next generation, vaping products. The sector fell 5%. In telecommunications, BT was hit by news of a change in management and by fears over its large pension deficit. The sector also fell 5%.

A further factor underpinning the market has been a surge in takeovers – both from within the UK market, like Melrose Industries' successful £8bn bid for GKN, and from outside the UK, like Takeda Pharmaceutical's £47bn agreed acquisition of Shire. This activity implies that companies, at least, still find UK shares attractive, despite the obvious risks from Brexit, a soft economy and worries over UK domestic politics.

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> We continue to retain our negative view of the UK compared with other equity markets, although we acknowledge that there are many opportunities in companies outside the FTSE 100.

Britain – a land of unloved stocks?

Each of these last three factors has also had an impact on sentiment. The UK has only very, very rarely been as unpopular as it is today among international investors.

Whatever one's personal politics may be, most global investors view the prospect of a Jeremy Corbyn-led Labour government with revulsion. In the main, they also fail to appreciate the potential benefits of Brexit. They see the UK's fall from global growth leader in 2016 to global growth laggard in 2018 as an obvious self-inflicted bullet in the foot and Brexit as a slow-motion train wreck that will only very gradually reveal its true horrors. Even if wages are now growing faster than inflation and unemployment is extremely low, the consensus view sees better opportunities for equities in other markets.

Compound this with the fragility of the UK government's majority and its dependence on the Democratic Unionist Party in Northern Ireland to function, and the flight of international investment capital from UK assets seems logical.

We too have had a long-standing negative view on UK assets. In fact, this position pre-dates the Brexit referendum and was based on the relative weakness of the UK's long-term economic fundamentals compared with other areas of the world.

More recently, we have carefully reappraised this position, especially in the face of a number of high-profile UK equity investment managers, such as Neil Woodford and Richard Buxton, who believe that UK assets price in the many risks surrounding them and are attractive.

However, on the basis of our work, we continue to retain our negative view of the UK compared with other equity markets, although we acknowledge that there are many opportunities in companies outside the FTSE 100. Nonetheless, we will continue to monitor the situation carefully for our clients' portfolios. Compared with other developed markets, the UK has at least stopped underperforming – perhaps as the endless train of Brexit news loses its capacity to shock.

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Michel Perera,
Chief Investment Officer

Will the US mid-term elections come up Trumps?

The US is unusual among democracies in that it has congressional elections every two years. These are due in November this year.

For the Senate (the upper chamber of Congress, which comprises 100 Senators), only a third of the seats come up for election, meaning that Senators have at least a six-year tenure. However, the House of Representatives (the lower chamber of Congress with 435 voting members) could theoretically be renewed every two years.

> Since the 1950s, every market correction in mid-term years has turned out to be a good buying opportunity.

Traditionally, the incumbent president's party loses quite heavily during the first mid-term elections after two years of presidency (which seems to have no bearing on whether the president goes on to be re-elected two years later). The extent of the losses tends to correlate with the president's popularity ratings. As President Trump has generally had ratings below his predecessors, it is fair to consider whether the losses could be significant and whether this would make any difference to US policy, economic or otherwise.

The current Republican majority in the Senate is skinny (2) whereas in the House it is more comfortable (45). Strangely enough, though, it is the House majority that is more at risk, because all seats are up for election, whereas the Senate seats to be disputed are mostly Democratic-held and hence less likely to produce an upset.

All the same, the current polls would indicate a toss-up for the House majority. It is therefore no surprise that President Trump is trying very hard to produce major 'wins' in policy before the mid-term elections (summit with North Korea, trade war victory claims, renegotiation of NAFTA, deregulation in banking sector and, of course, tax cuts). His upcoming visit to the UK should be seen in that light, as it's hard to see any meaningful policy discussions occurring.

What if the Republicans lose?

Were the Republican majority to be overturned in either house, President Trump would find it difficult to work with Congress. He has not endeared himself to the Democrats and may find them unwilling to 'meet in the middle' on any significant piece of legislation. They may also curtail his executive powers on trade and foreign policy, which have been delegated to the White House but are coming up for renewal late next year.

Also, and perhaps more importantly, they may start the impeachment process which Congress has the power to do. Although the eventual outcome is unlikely to be the President's removal, the process per se would be a major distraction for Trump and Congress and would likely stall any law-making activities.

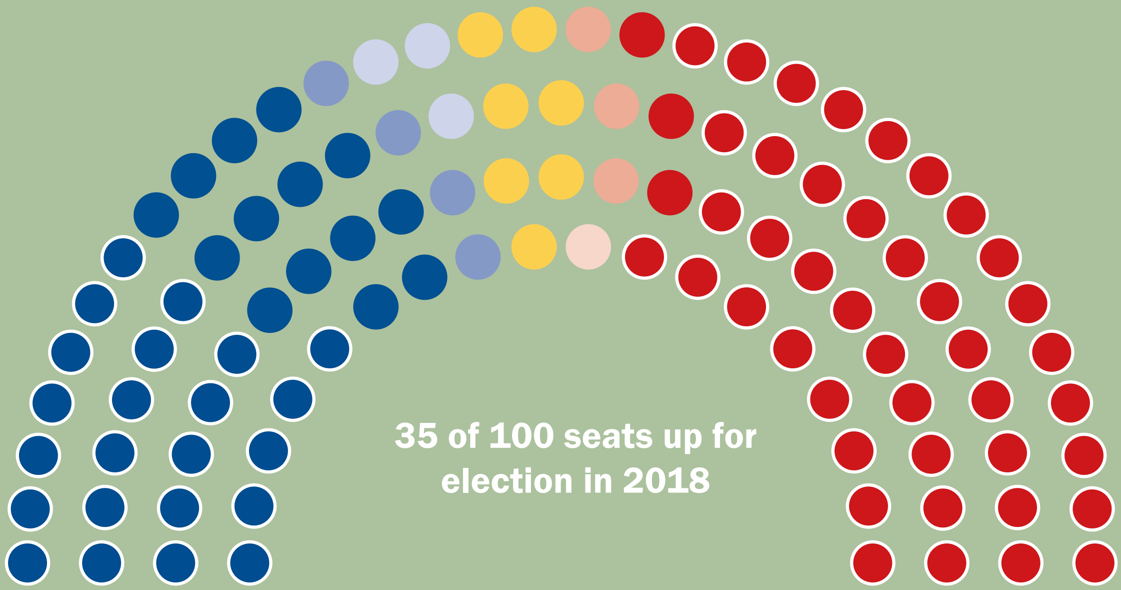
The mid-terms and markets

The markets may not always have welcomed President Trump, but, once he was set in with a Republican majority, they approved of the pro-business, tax-slashing, regulation-cutting White House and Congress. It is probable that a Democratic majority in the House would seek to limit the impact of the recently-enacted tax cuts. Such a change might rattle market nerves for a while, so the run-up to the mid-term elections may be tricky for markets and therefore investors.

Since the 1950s, though, every market correction in mid-term years has turned out to be a good buying opportunity for the next three and twelve months. We see no reason why it should be otherwise this time. World equities will probably follow the US, even if there is unlikely to be any direct impact on other countries from the November US elections.

Historically, mid-term years have sideways-moving volatile markets for the first three quarters (so far that pattern is holding true) and a blow-out fourth quarter with good returns for investors. It will be exciting to watch the elections, but equities may have a couple of difficult months along the way.

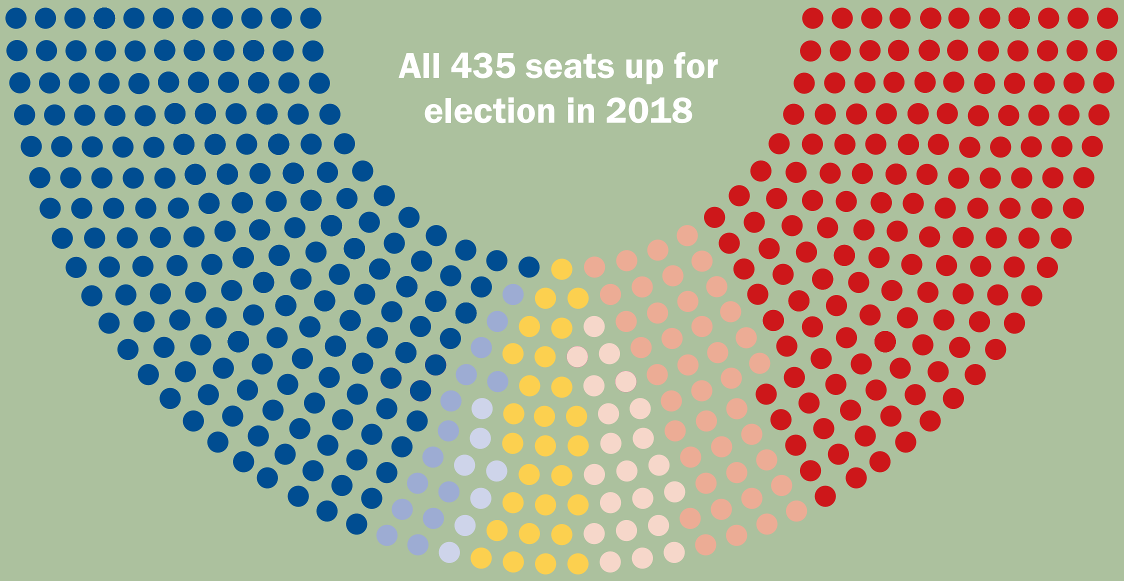
The Senate – 51 needed for overall control



The House of Representatives – 218 needed for control

Currently: 49 Democrats (inc. 2 Democratic Independents), 51 Republicans

Uncontested Democratic	Solid Democratic	Probable Democratic	Narrowly Democratic	Too close to call	Narrowly Republican	Probable Republican	Solid Republican	Uncontested Republican
23	14	4	3	7	1	3	3	42



Currently: 193 Democrats, 235 Republicans and 7 vacancies

Solid Democratic	Probable Democratic	Narrowly Democratic	Too close to call	Narrowly Republican	Probable Republican	Solid Republican
177	14	7	27	21	41	148

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Source: 270towin.com

Charles Cohen,
Investment Director

Helping charities reach their goals

Charles Cohen, Investment Director, discusses some of the challenges facing charity and foundation trustees, and explains how we can help.

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As a nation we donate more than £9.7bn to charities annually[1] – hoping our money will be put to valuable use and help fund the causes closest to our hearts. And the charity sector does vast amounts of good for our societies and communities all around the world.

However, in the wake of negative press recently – and as people cite a lack of trust as a reason not to donate to charities – charity governance, including the role of the charity trustee, is coming under increased pressure.

Trustees who volunteer to look after the investments of a charity or foundation take on a demanding set of financial responsibilities, whatever the size of the charity. They are often hardworking, dedicated people, who give their valuable time to help out the causes they support. They are almost invariably unpaid, and generously shoulder a wide range of responsibilities on behalf of their organisation. It's not surprising that the UK charities sector is always looking for trustees.

In each charity, one or more trustees will be charged with managing their organisation's funds effectively. And no two charities are the same – each and every charity has its own unique set of investment needs and objectives. The trustee(s) also need to demonstrate, to the satisfaction of the Charity Commission, that the funds are being used for the benefit of others.

That's where specialist investment expertise can help. When a trustee approaches us about our service for charities, we start by allotting them a dedicated CGWM Investment Manager who will seek to understand the individual needs of their particular charity and how we can deliver an appropriate solution.

This Investment Manager then creates a bespoke portfolio that matches the charity's individual investment goals, including its ethical standards and constraints, and adheres to its Investment Policy Statement (IPS). At the same time, it will obviously aim to achieve positive returns and build more vital funds for the charity.

What is an Investment Policy Statement?

If a charity has investments, it must have a written Investment Policy Statement (IPS) that sets out precisely what those investments should achieve, including the ratio of income to growth. It should also contain a clear strategy for attaining the charity's investment goals, an evaluation of its attitude to risk, and any specific ethical restrictions.

> “Every charity and foundation is different. The ethics and constraints for a charity that looks after injured wildlife might be completely different to those of a medical research foundation. We respect and support these differences, and work hard to do our best for every charity that entrusts us with its investments.”
>
> Charles Cohen,
> Investment Director

[1] - fundraising.co.uk/2017/04/13/caf-uk-giving-report-reveals-9-7bn-donated-2016/#.WyuFVfnwZhE

> “With so many charities like us having to do more with less, careful management of our assets and funds is a key priority. We need a strategy that hits the right balance between our investment goals and ring-fenced cash reserves – this is what we have achieved by working with CGWM.”
>
> Senior Director & Military Charity Trustee

Other Charity Commission requirements

Once a charity is of a certain size, trustees have a legal duty to keep their organisation’s Charity Commission register entry up to date and provide financial information to the Commission. This information includes an annual return, the charity’s accounts and the trustees’ annual report.

We can help trustees prepare these files and remind them when and how to send them to the Commission. We’ll explain any potential liabilities and help to avoid errors or discrepancies in the report and accounts.

Our regular updates and transparent communications ensure that the charity’s investment records and submissions are always accurate. Once a charity or foundation has entrusted us with its investment portfolio, we’ll provide them with a valuation report each quarter, including a market commentary from our Chief Investment Officer. They can also access in-depth information on our website, and view their investment account online through our Wealth Online portal.

Environmental, social and governance issues in investment

We have established in-house expertise in applying ESG (environmental, social and governance) filters to investment portfolios. This is a way of screening funds and companies, to identify those that take a forward-looking and responsible approach to ESG issues.

Rather than filtering out ‘unethical’ companies, our ESG criteria filter in ‘responsible’ companies that care about the way they operate and want to do good. Historically, this screening method has avoided companies that have later been exposed to scandal.

Other ethical considerations

If our ESG filtering is not strict enough for an organisation’s IPS criteria, their Investment Manager will screen out any other unsuitable funds or assets. As our service is flexible, we can tailor each charity’s portfolio to their exact IPS restrictions.

Are you a trustee?

If you’d like to know more about how we can help your charity or foundation with its investment and wealth management needs, get in touch. We’ll be delighted to answer your questions and provide more details of our services.

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Simon Moore,
Wealth Planning Director

Which way now? Your pensions questions answered

For many people, a pension is their largest source of income in retirement. Our Wealth Planning Director, Simon Moore, explores some of the complexities around pensions and explains how to ensure your personal plans are on track for the future you want.

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> Pensions are generally highly tax efficient, so it may be preferable to draw your pension later and use other investments for income in the meantime.

Traditionally, when you retired, your pension fund would immediately be used to provide a secured income for your lifetime (an annuity). Although there has been some flexibility around this since the mid-1990s, the 'Pension Freedoms' announced in 2015 allowed even more choice but also more complexity.

Those of you nearing retirement need to think carefully about the best decision for your individual circumstances and objectives.

First, take stock of all your pension pots

- What type of pension do I have?
- Do I have more than one pension pot? If so, where are they?
- When and how can I access the funds?
- What is the value of my pension? What benefits will it provide?
- What about other options or guarantees?

People with multiple pension pots quite often lose track of them. Visit the Unclaimed Assets Register website at uar.co.uk/customer/home to check.

If any of your pensions are not professionally managed, you should find out where the funds are invested, how this fits in with your financial objectives, how they are performing and the cost. A professional adviser can give you a clearer picture by reviewing all your pension pots and recommending ways to manage them going forward.

Second, look beyond your pension

Consider other possibilities, particularly if you're approaching your lifetime allowance (LTA) limit. A professional adviser will take the whole of your circumstances into account, including your health, overall finances and family circumstances, to consider your full range of options.

Lifetime cash flow modelling can help. This is the process of assessing your current and forecast wealth, along with your income and expenditure, to build a picture of your finances now and in the future. It can help ensure you don't run out of money – or die with too much – by showing whether your current investment approach is either excessively risky or unduly cautious.

A professional adviser can also help you consider:

- Your income needs at different stages in retirement – you might well want more income earlier on
- Tax implications – pensions are generally highly tax efficient, so it may be preferable for you to draw your pension later and use other investments for income in the meantime
- How much you want to leave your beneficiaries
- Whether or not you need a cash lump sum.

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> You need to be aware of how your pension drawdowns will be taxed in life, what funds might remain on death and how these might be taxed.

Drawing your pension

Your key consideration may well be how to draw benefits. However, you need to be aware of how these might be taxed in life, what funds might remain on death and how these might also be taxed. These are the usual choices:

- Leave your pot untouched
- Get an annuity
- Get an adjustable income
- Take cash in chunks
- Take your whole pot
- Mix your options.

Source: pensionwise.gov.uk

What to consider if you're going it alone

- Get a state pension forecast at gov.uk/check-state-pension
- Various bodies can help (e.g. the Pension Wise website, The Pension Advisory Service, the Money Advice Service and perhaps your employer's pension department)
- Beware of scams – there is increasing concern around inappropriate transfers of pension funds, and HM Treasury has launched a consultation in this area
- Considering further pension funding before you retire? Check your annual allowance, as it's not the same for everyone
- The lifetime allowance (LTA): if you have a sizeable pension, you could face tax of up to 55% of your pension fund over a certain level – or you could apply for a form of protection (such as Fixed Protection 2016 or Individual Protection 2016) – so planning is essential
- Who gets any remaining funds when you die, and how can they draw them? The Pension Freedom changes in 2015 mean that, in certain cases, it would be sensible to update your instructions.

And finally

Never look at your pension planning in isolation.

We believe everyone needs professional advice on their pension, with regular reviews. At CGWM, we offer retirement advice via our wealth planners. If you have funds invested through our investment management service, our wealth planners will work with your investment manager to ensure you have a retirement strategy built around your individual needs.

If this article has interested you and you would like to meet one of our wealth planners, we offer an hour's free pension planning consultation. Please get in touch for more information on +44 020 7523 4500.

DS Smith

Simon McGarry, Senior Equity Analyst

Founded in 1940 by David Solomon Smith to manufacture cartons, DS Smith (DSS) is a recycling and waste management company providing corrugated and plastic packaging solutions.

The recycling division provides integrated recycling and waste management services, ranging from recycling collections to full recycling solutions. Through its paper division, it supplies corrugated case materials to the packaging industry for conversion into corrugated board and boxes. Packaging – the most important division – offers several products, including retail and shelf-ready packaging, industrial packaging, hybrid packaging, bulk packaging and pallet boxes.

DSS also has a plastics division (8% of group profits) which provides flexible packaging and dispensing solutions, rigid packaging and returnable, as well as foam products.

Being the market leader in Europe's highly fragmented corrugated packaging industry, DSS leverages its superior scale by offering a pan-European solution through c200 manufacturing sites in 33 countries. In recent years, DSS has shifted from low margin paper/cardboard into higher value-add products packaging and recycling solutions such as:

- Reducing void space in packages, to reduce shipping and distribution costs
- Packages which are quicker to both assemble and pack, lowering labour costs
- Strong packages which allow more boxes to be stacked on top of one another while making them less prone to damage
- Ensuring that packages resonate with the brands
- Allowing customers to verify products electronically
- In-store point of sale display products
- Real-time package location tracking.

These solutions are extremely important to DSS's FMCG (fast-moving consumer goods) customers (90% of group sales), as most have recently seen a slowdown in volume growth. To mitigate this, they are looking to improve margins by reducing costs.

DSS continues to grow its European market share (currently 15%) both organically – taking corrugated market share in every quarter since 2012 – and via acquisitions, particularly in Eastern Europe where it is underweight.

European packaging continues to grow much faster than economic growth, thanks to a range of factors:

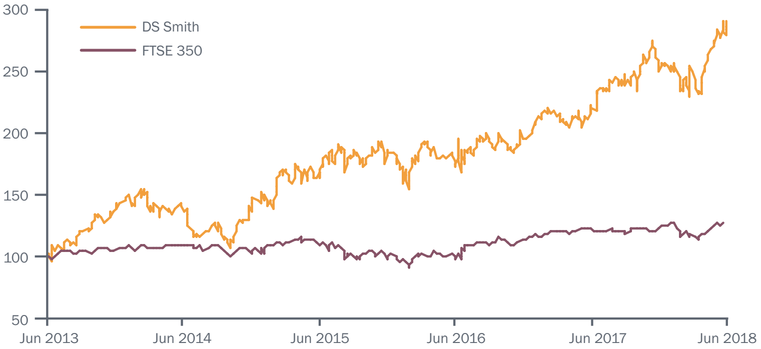
- E-commerce is outstripping bricks and mortar
- Europeans spend 50% and 40% as much online as their US and UK compatriots (this gap is likely to narrow over time)
- Families are getting smaller, which leads to smaller average package sizes but more packages.

In 2017, DSS acquired 80% of a family-run packaging business called Interstate Resources for US$1bn, giving it a well-invested platform for expansion into the US. With 17 of DSS's top 20 European customers having significant US operations, and given that the European packaging market is five years ahead of the US, there's a huge opportunity for the business to follow its European customers into the US. Indeed, Mondelez and Procter & Gamble have been openly supportive of this strategy.

Admittedly, the P/E (price earnings) multiple has re-rated from the 10-year average of 12x to 14.4x. However, given its ability to offer high-quality, environmentally friendly and innovative solutions coupled with the recent expansion into the US, we see this as a good way of leveraging both the environmental and e-commerce structural growth trends.

Share price	**579p**
12-month high	**579p**
12-month low	**444p**
P/E 12-month forward	**15.2**
Dividend yield 12-month forward	**3.1%**
Dividend cover 12-month forward	**2.2**
Net debt as at 30/4/2017	**£1.14bn**

Source: Bloomberg and Quest®
Note: Data above and performance data as at 14 June 2018.



Past performance is not a reliable indicator of future returns.

Becton Dickinson

Marc Pullen,
Senior Equity Analyst

Becton Dickinson (BD) is a leading global medical technology company, manufacturing and selling medical supplies, devices, laboratory equipment and diagnostic products.

The company was founded over 100 years ago and, following last year's CR Bard acquisition, it is now divided into three business segments:

- BD Medical (55% sales): devices principally for medication management and delivery
- BD Life Sciences (29% sales): products for collecting and transporting diagnostics specimens, diagnostic systems and laboratory equipment for cellular research
- BD Interventional (16% sales): CR Bard's vascular, urology, oncology and surgical specialty products.

Over the last three years BD has completed two transformative acquisitions that should ensure that it remains a leading player in the rapidly consolidating medical device sector in the US. In 2015 it bought CareFusion for US$12bn, with the transaction doubling the size of the BD Medical segment, making it a leader in medication management. Last year the company spent US$24bn on CR Bard, further strengthening its position in medical management and infilling areas of weakness in its product portfolio.

The addition of CR Bard's vascular access devices to BD's existing products means that the company should be able to address c85% of the medication management market.

In the short term, BD's fortunes rest on its ability to extract significant revenue and cost synergies from the CR Bard acquisition. The company expects the transaction to be immediately accretive and is looking for a two-percentage point per annum improvement in its operation margin over the next three years. On the cost front, the company plans to realise some US$300m of annual cost synergies by 2020, with the recent successful integration of CareFusion giving us confidence that it should deliver on its post-acquisition targets and successfully integrate CR Bard.

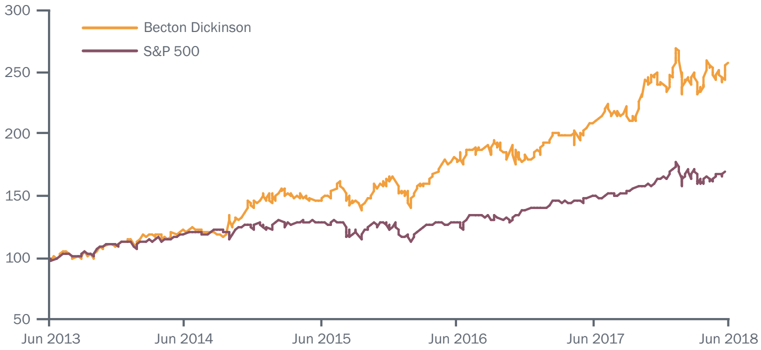
Longer term, BD is front and centre of the global megatrends that are forecast to drive demand across the healthcare industry: an ageing population in developed markets and a rapidly growing middle class in emerging markets. Furthermore, in the more specific space of medication delivery and management there are several key healthcare challenges driving growth, such as rising medical costs due to medication errors and increasing antimicrobial resistance, both of which should underpin growth for the foreseeable future.

In terms of global growth, both CareFusion and CR Bard were relatively US-focused businesses, so there is a significant opportunity for them to leverage off BD's existing global infrastructure.

Finally, following the completion of the CR Bard acquisition, BD will have some US$20bn of net debt by the end of this year, with a forecast net debt/EBITDA (earnings before interest, taxes, depreciation and amortisation) ratio of 3.3x for 2018. Although this ratio is elevated it is not unmanageable, given that BD's interest cover is forecast to be 8.0x this year, while the company's prodigious free cash flow should facilitate debt repayment.

BD's shares are relatively cheap compared to the Quest® US Healthcare Equipment and Supplies Sector. The sector trades on 25.6x 12-month forward earnings with a 0.9% dividend yield compared to BD on a 12-month forward P/E (price earnings ratio) of 18.7x and a 1.4% dividend yield.

Share price	**US$232.8**
12-month high	**US$246.3**
12-month low	**US$191.3**
P/E 12-month forward	**19.3**
Dividend yield 12-month forward	**1.4%**
Dividend cover 12-month forward	**3.9**
Net debt as at 30/9/2017	**US$4.7bn**



Source: Bloomberg and Quest®
Note: Data above and performance data as at 14 June 2018.

Past performance is not a reliable indicator of future returns.

G4S

Simon McGarry, Senior Equity Analyst

With 570,000 employees, G4S is the world's leading global, integrated security company, delivering security and related services in 125 countries.

Pre 2013, G4S had a tumultuous few years. In 2011 it aborted a £5bn purchase of ISS due to a lack of support from shareholders. In 2012 it was accused of having 'let the country down' after the government was forced to deploy 3,500 troops for the Olympics, while in 2013 it was found to have charged for tagging UK offenders who were dead or in prison. As a result, it was banned from bidding on UK government contracts and CEO Nick Buckles resigned.

Ashley Almanza took over as CEO in June 2013 and quickly set about streamlining the group. Fast forward five years and G4S is a completely different company. Businesses with lower returns have been sold, knocking more than £1.6bn off net debt. Bidding discipline and risk management have been improved, and its vehicle fleet now benefits from telematics and route planning technology.

Margins have recovered to previous peak levels, and should move higher. G4S is now focused on its primary businesses and driving revenue and margin growth through upselling to clients and providing more value-added (higher margin) services.

One such service is 'Cash 360', where G4S effectively assumes the back-office function for retailers, recycling cash within their business, thus reducing the need for external collection and counting services, as well as working capital requirements. In 2016, Cash 360 won a five-year US$201m contract for half of Walmart's US store network. This appears to have been well received by Walmart, who asked G4S to give the keynote address at their annual technology forum.

The 2017 full year results published in March were encouraging. At constant exchange rates, revenues for G4S's core businesses grew by 3.2%, while operating profit rose by 4.2%. However, if we exclude the Middle East and India, which are experiencing temporary headwinds, core operating profits grew by 10.9%.

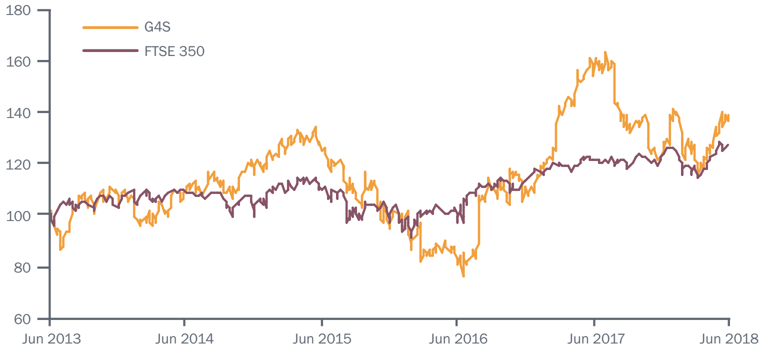
Cash generation is also much improved, with net debt/EBITDA of 2.4x, compared to 2.8x in 2016 and 3.3x in 2014. With four closures and nine disposals in 2017, it continues to recycle capital away from underperforming non-core businesses and into higher-growth businesses offering better returns. However, there is still scope for efficiency savings, with management targeting a further £90m-£100m of annual cost savings (c20% of 2017 operating profit) by 2020.

Future growth is likely to be robust, given that the highly fragmented security market is growing at 5%+ annually. G4S should continue to gain market share through a mix of economies of scale, greater use of technology and the increased globalisation of its clients. With legacy headwinds now fading, a stronger balance sheet and an attractive valuation (12.9x 2019 consensus earnings), we remain positive on the company's long-term prospects.

Given that G4S still has significant scope for further cost cutting, operating efficiencies and organic growth, we feel that at 13.3x 12-month forward earnings it still provides an attractive entry point.

Share price	**280p**
12-month high	**341p**
12-month low	**238p**
P/E 12-month forward	**14.0**
Dividend yield 12-month forward	**3.7%**
Dividend cover 12-month forward	**1.9**
Net debt as at 31/12/2017	**£1.5bn**

Source: Bloomberg and Quest®
Note: Data above and performance data as at 14 June 2018.



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