Economic and Investment Update Conference Call Transcript – 22 April 2021

Nick: To everyone a warm welcome on this chilly day to this morning's call. I do hope everyone is well and looking forward to some greater freedoms, as the economy begins to open up over the coming months. During the next 40 minutes or so, we plan to discuss the outlook for the economy and issues pertaining to our investment strategy before answering some of the questions you have submitted – for which many thanks. And if our discussions provoke further thoughts, then do please email or call us, and we'll be delighted to discuss them with you at a later date. We aim to finish the call at or before 12 noon. Before we go any further, it is a regulatory requirement to inform you that London Wall Partners is authorised and regulated by the Financial Conduct Authority, and the views expressed in this call do not constitute formal investment advice or recommendations, which can, of course, be provided separately and individually as appropriate. Also, the content of this call is the property and copyright of London Wall Partners, a recording will be available, and none of the comments should be used or taken out of context without prior permission. Full details about performance can be found on our website, www.londonwallpartners.com. Thank you.

Those of you who have become regular listeners will be familiar with my two colleagues joining me today, but for newer listeners, let me briefly introduce Stuart and Ian. Ian McCafferty is one of the UK's leading economists, and from 2012 to 2018 he was a member of the Monetary Policy Committee at the Bank of England, his career spans the City, the CBI and BP, as well as other institutions. He joined London Wall Partners as a member of the Investment Committee and a Senior Advisor in the Spring of 2019 and as well as working with us, he is a visiting professor at Kings College London and a senior advisor to Oxford Economics. Stuart is the Investment Director at London Wall Partners. He joined the firm just over five years ago, following his role as head of global equities and fund manager selection as the in-house fund manager at the National Grid Pension Fund. He has been a City stalwart for many years, having also worked at HSBC and other institutions. Good morning to you both and welcome to the call.

Ian: Good Morning Nick.

Nick: Since our last call in January, we have witnessed the start of the largest and most rapid vaccination programme in history, several new vaccines have been announced or rolled-out, with 13 already in use in different parts of the world, and a further 26 in advanced testing stages. The pace of the programme has been impressive; by April 21st, yesterday, some 928 million vaccine doses had been delivered in over 150 countries, and global vaccinations were running at over 15 million injections a day. As of last week, nearly 7% of the world's population had received at least one dose of a vaccine. But country by country, the progress has been mixed.

Some Asian countries outside China have little pressing need for urgent vaccination, having controlled the virus in its early stages by other means. For those countries where the virus has been virulent, a number have made rapid progress, with the US, the UK, Israel and Chile, and several others already vaccinating over 30% of their populations. Canada and Europe are now starting to catch up, but in parts of the third world, lack of access to vaccines, administrative problems or cost have made progress somewhat slower.

So, while we have made astonishing progress in recent months, the virus and its economic implications will be with us for some time yet. In the UK, we are all looking forward to the gradual relaxation of restrictions now starting, but in some parts of the world, such as the EU and Brazil, new lockdowns are still being imposed to stem the spread of the disease.

Nevertheless, the appearance of the vaccines is now breaking that key link between the level of infection and the incidence of both series illness and death, and this will be critical in reducing the need for lockdowns and other economic restrictions, allowing the global economy to move to something closer to normal over the next six to twelve months.

So, financial markets, which are notoriously forward looking, have started to focus less on the evolution of the pandemic itself, and more on what the post-pandemic world might look like. On the one hand, they see a rapid resumption of global economic growth, which has supported some sectors of the equity market, but on the other hand they worry about the possibility of higher inflation, which has caused bond yields to rise. In addition, we are entering a new era for government debt levels, which have been pushed up sharply as a result of the pandemic related fiscal support measures, while Central banks will be thinking about how to reverse some of the immense monetary stimulus that propped up economies last year.

This morning, we thought we would examine some of these issues and our best estimate as to how the global economy might fair in the next couple of years. So, my first question to Ian is: are financial markets right to be expecting such a rapid recovery, or are they over-optimistic?

Ian: Well, since the start of the year, most forecasters have become increasingly optimistic about the prospects for 2021, and I think their upbeat views are based on a number of factors. First, the experience of last autumn shows how quickly economies can bounce back once restrictions are lifted. The bounce that we saw in GDP in the third quarter of last year, as lockdowns eased in a number of countries, was impressive. And, as the vaccine programme starts to reduce the mortality rate of the virus, the need for domestic lockdowns decreases, and that should allow a significant opening up of many economies over the second half of this year.

Israel, I think, is a very good example of this. It has succeeded in deploying its vaccine programme very rapidly, and even after the reopening of their economy in early March, the number of new cases has continued to decline. They fell from 400 per million to 40 per million over just six weeks. It appears to have reached what you might call the tipping point, at which sufficient of the population are protected to allow a reopening of the domestic economy without a further large wave of the virus. And other countries, including now the US and the UK, are becoming close to those protection levels that allowed Israel to start opening up. And I think more countries are likely to follow suit to hit that sort of tipping point over the course of the second half of the year.

In addition, I think the emergency support, put in place by many governments, has done its job. Unemployment and the number of company failures have both remained much lower than predicted at the start of the pandemic, or what might have been expected given the unprecedented falls in GDP that we saw around the world last spring. We might well see some company failures as economies begin to gear up, but overall, the degree of scaring from the pandemic restrictions, that everybody was so worried about in the early stages, does appear to have been much less than was initially feared. And thirdly, I think consumers have seen their savings increased significantly over the past year, as they have been unable to spend on leisure and travel, to the extent that they start to run down their savings as things open up, that will add a further boost. And finally, a number of key governments are keen to use fiscal policy to boost the recovery. In the United States, President Biden has announced his American rescue plan worth some 1.9 trillion dollars, which will boost US GDP by over three percentage points this year alone, while in the UK, the March budget announced significant tax breaks for corporate investment, and a new infrastructure bank.

So, overall, I think conditions for a rapid recovery are now falling into place. Although, of course, beneath that broad brush picture, there are going to be some distinct winners and losers, and it's also the case that this upbeat outlook only holds if we do not encounter further setbacks with the pandemic itself.

Nick: You say, "if", Ian, and surely that must be a very big "if". The downside risk to that optimistic picture must be significant?

Ian: I think the main risks still lie with the health issues, rather than the economics themselves. I think there are still big risks around the virus, as with all viruses, it has a tendency to mutate, so there's a constant risk that an even more virulent or deadly strain emerges, particularly one that might prove invulnerable to the vaccines that we currently have. And in terms of lockdowns, that will take us back close to square one. And the longer it takes for the vaccine programme to reach all parts of the world, the greater the risk of such a mutation emerging. Then there are the risks around the production and the safety of the vaccine. Two vaccines have now been linked with blood clots, although these do appear to be very rare occurrences, but they might deter vaccine take-up. And we've got supply chain issues, or supply issues in the manufacture of what is a very sophisticated product. And we've also got the possibility or the threat of vaccine nationalism, in which individual governments threaten to disrupt complex supply chains by blocking trade in vaccine components, and all of those things could delay matters, relative to what we've seen so far. So, although vaccine development and roll-out is currently going better than expected even a few months ago, we're not out of the woods just yet.

Nick: You referred earlier, Ian, to winners and losers. Can you talk into that a little bit more for us, please?

Ian: Yes, it does look as if the advanced economies are likely to come out of the crisis more quickly and in a better state than the emerging and developing world. And I think this is one of the key themes that we've seen in the latest IMF World Economic Outlook, this big divergence of performance between the two sides. Countries that depend on tourism and commodity exports have been hit particularly hard, and, as the IMF points out, many of the emerging and developing economies have been much less able to protect their economies through active use of fiscal policy, as we've seen in the US, the UK and Europe, for example.

And I think that this divergence between the different economies is likely to continue through much of the recovery.

First, and even with the slow start that we have seen in the EU, advanced economies are making much more progress in their vaccine programmes, and this, I think, will be the biggest single factor in determining the pace of recovery over the next year or so. Amongst emerging and developing economies, vaccine rollouts are generally slower, with many dependent on vaccines from China and Russia, and those are being rolled-out rather more slowly than the Pfizer, AstraZeneca and Moderna that we are using here.

Also, it is the case there are two big emerging economies, Brazil and India, are now emerging as key COVID hotspots, unfortunately, and they're finding it hard to control the number of cases. So, the recovery in global economic activity, I think, is going to be led by the advanced economies. And within that, those that saw the sharpest falls in GDP during the lockdowns, and that includes the UK, Spain and parts of Eastern Europe, they're likely to see the biggest bounce as they reopen. But policy is also going to play a big part and the enormous fiscal stimulus announced by President Biden, is expected to generate US GDP growth of some 7% for 2021.

I think in East Asia, the bounce will be less, as countries such as China, South Korea, Taiwan and Vietnam managed to contain the virus without imposing blunt national restrictions, so they've got less far to recover.

But even with these regional and national divergences, the world economy is forecast to grow by some 6% in 2021, and over 4% in 2022, and those would be the fastest growth rates since the 1980s. And I think there is a growing consensus that the damage to the world economy from the pandemic is going to prove far less than that that was caused by the global financial crisis of a decade ago.

Nick: So, it does look as if, God willing, we should see a marked recovery in the world economy over the next year or so, but isn't such rapid growth going to be hugely inflationary? In recent months, markets seem to have become very exercised about much higher inflation to come, causing a significant sell-off in bonds through the spring. We have had over 10 years of very subdued inflation, but are we entering a new era, Ian?

Ian: Well, a number of recent surveys of investors has suggested that inflation is now perceived as a bigger risk to financial markets than the COVID pandemic itself, but I do think we need to put this into some form of perspective. The recent moves in major bond markets have only taken yields back to the levels that prevailed before the pandemic struck. And as such, I don't think that's consistent with a sharp acceleration in inflation, relative to where we were in early 2020. Now, I do think we are going to see some pick-up in headline inflation in the coming months, but this is, to a large extent, due to the annual comparison with very weak prices a year ago. As the pandemic began, the Brent crude oil price fell from around $60 a barrel, to closer to $20 a barrel, but has since regained its pre-pandemic levels. And that, and other short term price movements, will push inflation in major economies up from less than 1% last summer, to much closer to the 2% that major Central banks target over the course of this summer and autumn. And if oil prices were to rise any further, I think inflation might even slightly overshoot those central bank 2% targets.

But really, the key question we have to answer is whether we are likely to see a significant sustained rise in inflation that would really mark the end of the low inflation era. And on this, I remain relatively confident that inflation is most likely to remain under control in the coming years within that 2% paradigm that we've lived with for the past 20 years or so, and I think there are two reasons behind this.

The first relates to the structural factors that have delivered low inflation for more than a decade. And the second is more cyclical and relates to the state of the economy and the economic policy as we come out of the pandemic.

But let's take the structural one first. And there, I think, the key factors that have driven very low inflation over the past couple of decades are still with us. Those are primarily – the globalisation of world trade and production and the changes in labour force dynamics. And neither of these is expected to depress inflation as much as they did over the past 20 years, with more concerns about the security of supply slowing the pace of globalisation, and the gradual aging of the world population starting to shift the dynamics of the world force. But these fundamental trends are not going into reverse, they are simply slowing relative to the recent past. So, the longer-term conditions for low inflation persist, and are likely to go on for some time yet.

Nick: Can I just step in there – what about the more cyclical shorter term, why will the rapid growth of the next couple of years, combined with the supply disruptions caused by the pandemic, not combine with the fiscal and monetary policy support that has been put into place through the recession, to drive inflation sharply higher on a 2-5-year view?

Ian: Well, I think first, the pandemic recession has left the world with a significant degree of economic slack, and that is a very good proxy for underlying inflationary pressures. So, although we might see a temporary pick-up because of the weakness last year, I don't think it'll last. The IMF estimates that even with the release of pent-up spending and the rapid rates of economic growth that are now expected for 2021 and 2022, that slack will not be used up until 2023. By then, I think, policy conditions will have changed, monetary policy support is likely to have lessened, and in terms of fiscal policy, while most advanced economies look set to continue their fiscal support through 2021, thereafter, plans indicate a start to deficit reduction to address their debt to GDP ratios. So, by the end of 2022, the world economy will no longer enjoy the boost from expansionary policy, and therefore, I think, GDP growth rates will begin to slow to more normal levels, and that in itself will limit inflationary pressure thereafter.

Nick: Fiscal policy does seem to be enjoying something of a revival. For years, we have focused on how independent Central banks were steering the economy. Is that no longer the case, do you think, Ian?

Ian: I think the balance between fiscal and monetary policy is changing. For the past 20 years, monetary policy has been the primary tool for setting the direction of the economy, and that was particularly true during, and since, the global financial crisis of 2008. But although monetary policy was extensively used early in the pandemic, with the major Central banks all announcing new rounds of quantitative easing, most of the support since has come from Finance Ministries using taxes and public spending. And that focus on fiscal policy, which had taken a back seat since the 1970s, I think is likely to continue after the pandemic. When we look at the United States, which is leading the way, where we have not only the $1.9 trillion rescue plan to boost the economy as it emerges from the pandemic, but we have also got proposals from President Biden for another $2 trillion of additional spending on public infrastructure, industrial policy, health and care and climate change. All of this will be at least partly paid for through proposed increases in corporate taxes.

But that renewed focus on fiscal policy is not confined to the United States, the UK is also going down this road. And greater fiscal activism is now supported by the IMF and World Bank, who, for many years, were the high priests of fiscal conservatism, so I do think that, with that support from the IMF, that other countries are likely to follow that fiscal activist route. And, at the same time, central bankers are beginning to realise the limits of what they, and monetary policy, can do. So, I do think the era of central bankers – as when I was one, being looked as being masters of the universe – is now over, although of course monetary policy will remain important, both for the coming economic cycle and for financial markets.

Nick: It's a great privilege to be working with a former central banker. And as a rate setter, as we move into economic recovery, where do you think interest rates are likely to go from here, Ian?

Ian: Well, I think the first thing we have to think about is that monetary policy is no longer exclusively about how Central banks set short-term interest rates. Stimulated by the pandemic, Central banks have changed their thinking about how they conduct monetary policy and how best to influence economic conditions. Relative to 10 years ago, they now have several unconventional instruments in their armoury, including quantitative easing, forward guidance, yield curve control, as well as that traditional method of controlling the rate at which they lend overnight to the commercial banking system – what we call Bank Rate in the UK or the Fed Funds rate in the United States, for example. And they now see this new range of monetary instruments as a monetary toolbox, a phrase first coined I think by the deputy governor of the Bank of England, and they see it as having different tools with subtly different effects, each to be deployed depending on the particular economic circumstances at hand. And this, I think, is quite a big change from what central bankers tended to think five or ten years ago, when those unconventional tools, and especially quantitative easing, was seen as interest rate changes in another guise, and that rate changes would stay the dominant policy tool. And I think that this change in thinking is going to have an important bearing on monetary policy through the economic recovery.

Nick: In what ways do you think? What should markets expect?

Ian: Well, the Fed, the Bank of England and, to a lesser extent, the ECB, have all signalled that they are likely to conduct monetary policy differently in coming years, and this is really in two ways. First, bruised by that consistent undershoot of their inflation targets that we've seen in the 10 years since the global financial crisis, they have indicated that they will want solid proof that inflation is going to hit their target rate sustainably, that it's not simply a temporary rise followed by further inflation weakness. And that, I think, is likely to mean that they will probably start to tighten policy slightly later in the inflation cycle than they would have done previously, and once they do, the pace of tightening will initially be only gradual. And I think the second change is their choice of how to tighten – which tool in the policy toolbox to use first – is likely to be different than they had previously suggested. Since the global financial crisis, Central banks had believed that any required policy tightening would be achieved first by raising their discount rate – the traditional policy tool. Any unwind of the QE programmes would only come much later. This would move rates away from the zero-lower bound, returning them to levels at which they could then be moved in either direction thereafter as required.

But since those further large injections of QE, that we saw during the pandemic, attitudes are starting to change, and there are now growing concerns that the higher level of existing quantitative easing might be a constraint on Central banks' ability to use if further in the event of a future downturn. And so, they are now starting to think that they might sell some of the bonds bought in their QE programmes before they start moving short rates, a reversal of the previously expected process.

Now, I should stress that I don't expect any action from Central banks in the near future. Significant policy tightening – however it comes about – is unlikely until sometime, I think, in 2023. But I think both changes I've outlined suggest that we will be staying a world of low, short interest rates for quite some time. And how monetary policy tightening is delivered, when it eventually comes, could have some interesting ramifications for bond markets, so I, for one, will be keeping an eye on it.

Nick: Well, that's good. Ian, you have painted an encouraging picture for the outlook: continued low interest rates, fiscal support and the opening up of our economies. All these point to a longish, relatively stable economic cycle over the next few years, but where could it all go wrong? What are the key risks? And, does anything cause you to lose sleep at the moment?

Ian: I have to admit, Nick, I seldom have trouble sleeping! But I can see some ways in which this upbeat outlook might be knocked off course.

We start the cycle with elevated public debt levels and high asset valuations. Both of those can continue for some considerable time, as long as interest rates remain low. But if governments don't reduce their budget deficits and stabilise their debt levels by the time that interest rates start to rise, they, and financial markets, could face some difficulties. I think there is a window before Central banks start to normalise policy, but I worry whether that window will be long enough, because history often suggests that governments can become wedded to spending money, particularly at key points in the electoral cycle. So, that's my first risk.

And then I think there are a number of risks that really lie outside the realm of economics. The pandemic is not yet over and could yet cause some problems, and other natural disasters could always strike. And global politics does seem somewhat more febrile than for some time, with the more aggressive expansionists attitudes of both China and Russia, as well as the possibility of disturbing regional conflicts. So, while things might look to be improving, it's unlikely to be plain sailing, making a careful, well-thought-out investment strategy a key element in wealth management.

Nick: Thank you, Ian, that seems like a very poignant moment to switch to some investments. And I do hope, by the way, that that wasn't your former boss at the Bank of England calling you (a few moments ago) – it shows how live we are, but you've given us much to think about. I'd now like to turn to Stuart to discuss some matters concerning our investment approach and the funds and companies we recommend in our model portfolio – Stuart, over to you.

Stuart: Thank you, Nick. Since our last call at the start of the year, there have been two key changes in financial markets, but we have not changed our investment strategy. The first has obviously been the marked rise in bond yields that Ian referred to – long term interest rate have increased as markets have moved to anticipate the economic recovery that we've been hearing about. The fall in bond prices, which leads to those higher bond yields, has not prompted us to take any action, and this is because it's been our recommendation for a number of years that clients have as low a bond allocation as is suitable for their circumstances. We remain of the view that clients should not expect to make any money from bonds, rather they should consider them primarily as insurance against an unexpected adverse event. And we continue to believe that clients should focus any bond holdings on the parts of a market with the highest quality insurance characteristics, which we currently believe are to be found in the US Treasury Inflation-Protected market, commonly known as the TIPS market, as well as conventional UK government gilts.

As Ian said, 2021's increase in bond yields, whilst quite marked, has only taken them back to the level seen in early 2020. And in our opinion, yields would need to increase very materially from current levels before bonds offered a competitive risk return opportunity compared with company shares. And when I say very materially, our current thinking is that it would probably require an increase in yields from todays about 1% yield to 5% before we could consider advocating a neutral, rather than a negative stance on bonds for long-term investors.

The second new trend in markets in recent months has been the outperformance of economically sensitive sectors, rather than our favoured quality stocks. It has been industries which have delivered poor returns historically, such as banks and oil companies, which have been leading market indices to new highs of late. It seems probable, to us, that this short-term rally in lower quality cyclical stocks should peter out in due course, as markets are likely to stop reacting to changed short-term scenarios and refocus once more on the long term.

And, as I said at the start, we have not changed our strategy, and given there have been very few changes to stockholdings in our recommended model funds, I thought I'd use the rest of my time to reflect on developments in three of the larger underlying company holdings in our models, which I haven't discussed in detail before in previous calls.

The largest individual company holding in our aggregated recommended fund list is PayPal – the on-line payments and money transfer company. It's held by two of our 10 model funds. Given the growth of online shopping during the pandemic, it is probably no surprise to learn that PayPal had a very successful 2020, with total payment volumes across its network increasing by over 30% to nearly $1 trillion. And in 2020, the company added twice as many new customers as it did in 2019, taking its total worldwide user base to over 377 million people. This suggests positive network effects, in which PayPal's growing user base inspires more merchants to take PayPal payments, thereby creating a virtual circle are likely to continue. This impact is clear, particularly in PayPal's most mature market, the US, where they've signed up one third of all consumers.

We studied the payments industry carefully, because our model funds also have holdings in Visa, MasterCard, Adyen, Stripe, as well as the parent companies of Google Pay and the Chinese payment networks, Alipay and WeChat Pay. It is especially important for us to be able to challenge our recommended managers on these holdings, as the payments industry has attracted, and is likely to continue to attract, the attention of regulators around the world. MasterCard occasionally appears in the British press for a long-standing legal case that has reached the UK Supreme Court. And in the US, the Department of Justice this year blocked a proposed acquisition by Visa of a key provider of software to the payments industry, called Plaid, on anti-trust grounds. Meanwhile in China, it appears the government is beginning to clamp down on some of the country's internet champions, with Alibaba receiving a near $3 million fine earlier this month. However, as we've studied the industry and discussed the sector with the managers, we've been able to take comfort that there appear to be many avenues for further growth, not only from the use of online and electronic payments, but also in the intelligent use and distribution of the data generated in the online payments process. We have also come to appreciate how varied the development of the sector is in different countries. For instance, we have been used to contactless cards in the UK for many years, but the market was much slower to develop in the US, so that by 2018, which is the last year we've got data for, 64% of credit cards in the UK were able to make contactless payments, but only 3% had the same feature in America. And experts in the Chinese payments market tell us that western payments systems appear stuck in the stone age. So, as new ideas and different systems spread around the world, it seems likely to us that the leading payments companies will be able to continue to flourish and prosper.

While PayPal appears to have sailed through the troubles of a pandemic, some other large holdings have found their trading conditions more challenging. One such is the international spirits company, Diageo, which is also a top ten holding in our models. Its best-known brands include Johnnie Walker, Tanqueray Gin, Baileys, as well as the beer brand Guinness. It has had to content with the material switch from the on-trade i.e., consumption in bars and restaurants, to the off-trade at home, as well as considerable disruption to the travel-based duty-free market. The change in consumption patterns it has seen has forced it to reassess its marketing tactics, placing a greater focus on digital advertising and e-commerce. But the reason for investing in Diageo is not just to benefit from the strong long-term growth in the premium spirits market, it is also the risk mitigation that comes from their experience gained in its long history of operating in different markets with different challenges around the world. The brand strength and resilience and adaptability of the business was reflected in just a 5% fall in sales in the last six months of 2020, and the company has further enhanced its competitive position during the pandemic by acquiring more super premium brands. Diageo is also seeking to extend its market leadership by allocating $100 million to support the recovery of the hospitality industry in 30,000 outlets in several countries.

Another top ten holding which has had to content with the pandemic is Novo Nordisk. This Danish company is best known for being the world leader in the production of insulin and other drugs to tackle diabetes. But it also addresses other chronic conditions, such as haemophilia and obesity. In early 2020 the company was asked by the Danish government to establish a COVID testing programme in the country, and the company also moved quickly to try and address affordability issues for many of its US-based insulin customers. The high list prices for drugs in the US has long been a bone of contention for consumers and politicians alike, and whilst significant discounts are available for health insurance companies, many patients are liable to pay full price. These patient challenges grew as unemployment soared in the early days of the pandemic. Novo Nordisk is justly recognised for its scientific expertise in developing new insulin formulations, such as their recently launched tablet for some type 2 diabetics, which removes the need for regular injections. Innovations such as these should help it achieve its corporate aspiration of increasing its worldwide insulin market share from just below 30% to over a third within five years. And this is a growing market, currently Novo Nordisk believe that one in 11 people in the world is living with diabetes, and this figure is projected to rise to one in nine by 2045, unless lifestyle habits change.

But Novo Nordisk isn't just relying on its scientific expertise to achieve its ambitions. To succeed, it works hard to maintain very high levels of trust with the medical profession, and also be respected as a strong corporate citizen. On the environment, they are seeking to improve the recyclability of all products used across their product life cycle, and they are tackling climate change by requiring all of their suppliers to only use renewable power by 2030. This is also the year they aim to emit no CO2 from their own operations or transportation. On the ‘S’ of ESG, the social element, they support preventative programmes to help people avoid type 2 diabetes, and they sponsor stem cell research in the hope that a cure can be found for type 1 diabetes. They also work to make insulin affordable in lower middle-income countries, as well as in the US. Novo Nordisk also has a strong story to tell on governance, not only does the Life Sciences Foundation maintain voting control and impose a long-term inclusive attitude and exemplary ethical standards, but Novo Nordisk also has ambitious workforce diversity initiatives.

I always like to use a portion of these calls to highlight ESG matters, as the names of the mainstream funds we recommend don't necessarily reveal how comprehensively responsible investment matters are addressed in our approach. Our recommended model funds don't include words like “sustainable” or “environmental” or “stewardship”. But their fund managers take governance, corporate culture and reputational issues, and the like, extremely seriously, as you should if you're a long-term investor. This means the companies they include in their portfolios typically don't include those businesses most at risk from climate change issues, as I've explained in the past, but rather companies like Novo Nordisk, which are held in the highest regard for their ESG characteristics. While I happen to choose to dwell on ESG matters while talking about Novo Nordisk, I could just as well have highlighted either Diageo or PayPal. For instance, water is the key input for Diageo's business, and the company is rated as being in the top 1% of all companies worldwide for water stewardship. And $20 million of the $100 million being devoted to helping their hospitality customers recover from the pandemic is being targeted to support social justice in the US by helping specific communities.

PayPal also has a plan to close what they describe as the “racial wealth gap”, and the company played its part in the efficient distribution of the pandemic stimulus funds to taxpayers in the US. While voters worldwide rightly expect their governments to enact policies to combat climate change and deliver sustainability and equality objectives, a lot of the hard yards will inevitably be done by big business.

I've highlighted three of the ten largest holdings in our model funds, PayPal, Diageo and Novo Nordisk, and for completeness’ sake, I should say that the other seven are currently the US accounting software business, Intuit; the manufacture of equipment for genome sequencing, Illumina; the Japanese factory automation sensor producer, Keyence; Unilever; Microsoft; Nintendo and MasterCard. We think this list appropriately reflects the careful diversification we seek to achieve in our portfolios, with those names coming from a range of countries and industries. But what they do have in common is that they are each leaders in their field.

While markets are currently somewhat excited about the prospects of an economic recovery as the global vaccination programme takes effect, we should not forget, that in the last five years alone, we've had the unexpected result in the Brexit referendum, the unexpected election of President Trump and the unexpected pandemic. We think it is right that long-term investors should continue to primarily focus their portfolios on high quality, well-financed, resilient businesses with protracted growth prospects, as we think this is the best way to ensure our clients continue to achieve strong returns for many years into the future. Back to you, Nick, for questions.

Nick: Thank you very much, Stuart. And I believe it should be of great comfort to our clients that we have got someone like you overseeing the investments with the great knowledge and intellect that you put into studying the industries and companies, which is terrific – thank you. Perhaps I can now turn to some of those questions we have been receiving, and again, many thanks for sending them to us. We are keen to ensure that these calls really meet your needs, and the interaction from the email questions and answers, although not quite as rich as face-to-face dialogue, does indeed help. A client has asked, what is the London Wall Partners house view – and we're getting a few questions like this recently – on Bitcoin and cryptocurrency? And what is Ian's view, in particular, on the technology and governance underpinning Bitcoin? And to what extent does he see it competing with fiat currency in the longer term? Clearly, the announcement earlier this week by the Bank of England shows that Central banks are becoming interested in the subject.

We had a similar question on the last call, and our view that Bitcoin is a speculative, unregulated instrument remains. Those on the call last time, may also remember that we had been pleased to see that the FCA, Financial Conduct Authority, issued a warning that consumers should work on the basis that they could lose all their money in cryptocurrencies. However, we didn't cover the idea of the merits of cryptocurrencies as money, nor the use of blockchain. Ian?

Ian: Well, I think we have to distinguish between the underlying technology that allows digital currencies, such as Bitcoin, to exist on the one hand, and the existing digital currencies themselves on the other. I think the technology – the distributed user, blockchain system, as it's known – is extremely interesting and has the potential to radically speed up and improve payment systems around the world, because it offers high levels of security in a real time setting. And that is why I think central banks have started to study it, and how it might be used to supplement other methods of transactions and payments in future. And I think it is likely, although this is pure speculation on my part at this stage, that in time central banks will adopt and promote such technology to create digital versions of their existing currencies to sit alongside cash and bank accounts. We saw Rishi Sunak talking about a digital pound the other day.

But in the same way that one can admire the existence of the internet as a medium of communication, one can admire the technology, but have reservations about the predominance of pornography on it, I think one can see a bright future for blockchain technology while still having strong reservations about some of its current uses.

Bitcoin and other private cryptocurrencies do not conform with the required characteristics of money – that they provide a stable store of value, a unit of account, and they are a relatively universal medium of exchange. The value is not backed by the issuers, as our currencies by their central banks, and their governance – how they are created, who by, and how much is in existence is often less than transparent. I think they are more of a speculative asset, if you like, and moreover one with no inherent value, other than what someone else is willing to pay for it. Such assets currently are inherently unstable and impossible to really value. At present it is fashionable as a speculative gamble, but if central banks were to use the technology to provide other more mainstream digital currencies, a digital dollar, or a digital pound, I'm not sure that it's clear that current popularity of these private digital currencies will continue.

Nick: Well, there you have it, there is the house view. And I think there is an important distinction to be made there between the underlying technology and the cryptocurrencies themselves, as you have done very well. So, thanks very much for that, Ian. One for Stuart – have there been any stocks in model funds which were badly tripped up by the pandemic?

Stuart: Well, fortunately, no, there really haven't been any disastrous performers, and most of those stocks which fell sharply in the spring of last year have largely bounced back. The main group of stocks that went down when the pandemic really took hold were involved in the travel industry. One model fund had a holding in Amadeus and another in Sabre, and these are both software companies which provide reservation systems for airlines. And both they and Bookings Holdings, which owns the website Booking.com, Rentalcars.com and OpenTable were all weak initially but have largely recovered. InterContinental Hotels Group, which owns royalties from its ownership of Holiday Inn, Crowne Plaza, InterContinental, and many other hotel brands, also fell as the pandemic spread, and Walt Disney did as well because it had to shut its theme parks. Probably of all of those, Walt Disney is the stand-out one subsequently, because it launched its online streaming service, from its large catalogue of films, and that's recovered it very well and it has been hitting new highs this year. And I think the only other area where there was a bit of a stumble was in some stocks in the medical sector where, obviously with COVID spreading, there was a disruption to routine surgery. So Intuitive Surgical, which makes surgical robots, and Stryker, which makes hip and knee replacements, suffered. But overall, we can say that the portfolios have proved to be as resilient as we would have hoped.

Nick: Thank you, Stuart. And talking about Disney, I was recommended a book last summer by Robert Iger, who was the CEO of the Walt Disney Company, called 'The Ride of a Lifetime'. It's a good read and it talks about the introduction of the streaming. While I'm on books, another great book I came across recently was Bill Gates' on ‘How to Avoid a Climate Disaster’ – the solutions we have and the breakthroughs we need – which I've just started and it's looking very good. So, back to Ian, what about Europe, given the slow distribution of vaccines and Brexit issues? Europe is unlikely to participate strongly in the recovery, is that right?

Ian: Well, I think it has clearly been somewhat slower, if we're being kind, in getting its vaccination programme going. But after that slow start and the difficulties that they had in getting access to vaccines, it is now starting to catch up, and in Germany some 20% of the population has now been vaccinated, with France not far behind – it is still less than the UK, but they are speeding up. Parts of the EU also remain, for the time being at least, hampered by higher infection rates and persistent restrictions on activity. But I think given what's going on, I think these will start to ease rapidly during and after the summer, so I think the recoveries are likely to get going a little later than in the US and the UK. But the forecast for 2021 and 2022 show growth in the European Union at a very healthy 4%+ for both years, and I think that does suggest that although it might start a quarter or two later, they are going to then start to benefit more.

Nick: Thank you. In the interest of time, thank you for those questions, any other questions you have as a result of this call or, indeed, anything else you think of, then do please let us know and we will attempt to answer them either by email, or do give us a call.

Many of you will know that 35 years ago I came across, and became a great fan of, a gentleman called Mr Warren Buffett, who is the Chairman of Berkshire Hathaway. And I have reminded you of his description of the timeless parable of Mr Market, as written in his 1987 annual report to shareholders, which is well worth looking up on the internet, if you're interested, and he describes the whole concept there. Now, Mr Market was as concept taught to him by Professor Benjamin Graham, while at Columbia Business School in the 1950s, about the mental attitude towards market fluctuations that Warren believes, and we and our fund manager partners agree, to be most conducive to investment success. Indeed, Stuart reminded me while preparing for today of what one of our fund manager partners said in his 2012 annual report when describing how he could have responded to, as he describes, a smart and experienced equity market observer's assertion about the prospective sluggishness of equity markets at the time. This is 2012, three or four years after the global financial crisis, and it goes like this:

I quote: "Sir, you are making a textbook error, you persist in thinking about the stock market as though it were a thing that actually exists. As though it were a homogenous entity that shows a propensity to go up and down in lockstep. Of course, such an entity does not exist, rather what we are presented with is not a stock market, but a market of stocks. What you call the market is made up of hundreds of individual companies, each with its own strengths and weaknesses, and critically each with its own destiny. Now, forget this chimera of the stock market and ignore the frankly useless predictions that experts make about where the market might be in three or even 36 months' time but instead concentrate on individual companies, and most important, remember that no one is requiring you to invest in every company. Why not just invest in good companies, they will tend to do better than mediocre ones over time."

Well, at London Wall Partners, we couldn't agree more – active long-term investing in great businesses, in some of the ones that Stuart has described, has been proven by many of the world's best investors over different eras and across the decades, whether it is Templeton, Buffett, Bolton or Smith, and others. To produce consistent and significant outperformance – this is what we are seeking to achieve for our clients, within a well-defined financial plan to suit the unique and individual circumstances of every family we serve; a plan that prudently allocates to appropriate assets, whether they be company shares or high-quality bonds, to ensure our clients' short to medium-term requirements can be provided for. And when I say clients, I mean us and our clients because, as I think everybody listening knows, we invest our own money in the same place as we do our clients and vice versa. But requirements can be provided for without having to be at the mercy of the short-term market fluctuations or, indeed, the shocks that are virtually guaranteed to arrive at an unknown time. So, a proper financial plan built on a firm foundation is one that should withstand the shocks and provide more than satisfactory results, which is, of course, is our aim, as well as providing peace of mind so we and our clients can sleep easy, and that's no reference to the drinks business or Stuart's comments on Diageo.

Well, as the summer beckons, I am sure there will be the odd glass raised and physically clinked amongst friends as we emerge from the lockdown, and in the hope that the weather will be a bit warmer than it is currently. Our next quarterly update will be on the 8th of July at 11 o'clock, but in the meantime I'd like to thank Ian and Stuart and everybody behind the scenes, and you, our listeners, for tuning in today, and we look forward to seeing you soon.

Have a great day and do let us know if we can be of any help to you or anyone else in your circle of influence or if you have any questions. Thank you very much.

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