Economic and Investment Update Conference Call Transcript – 8 July 2021

Nick: Good morning everyone, I do hope you are well and enjoying the summer even though we are not yet free of all travel and meeting restrictions yet. This is the latest in our series in what have become regular quarterly client calls in which we discuss the outlook for the economy and issues pertaining to our investment strategy. This we hope to do over the next 40 minutes or so before answering some of the questions you've submitted, for which many thanks; if our discussions provoke further thoughts, do please email or call and we will be pleased to discuss them with you at a later date.

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Those of you who have become regular listeners will know my two colleagues joining this call but for newer listeners, let me briefly introduce Stuart and Ian. Ian McCafferty is one of the UK's leading economists and from 2012 – 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 and he joined London Wall Partners as a member of the investment committee and a senior adviser in the Spring of 2019; as well as working with us, he is a visiting professor at Kings College London, a member

of the Government Senior Salary Review Body and a senior adviser 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 at the inhouse fund manager of the National Grid Pension Fund; he's been a City stalwart for many years having also worked at HSBC and Kleinwort Benson. Good morning to you both and welcome to the call.

Ian and Stuart: Good morning.

Nick: Over the last few months, the global vaccination programme has continued to break records with over 20% of the world's population now having received at least one dose, that is up from 7% in April. By mid-June, the daily vaccination rate had doubled compared with April to 33 million a day and 2.5 billion doses have now been administered globally, which is amazing. Recent news of the number of Covid cases has also been positive as global case numbers have more than halved since the peak of the second wave in March.

In spite of that fact, our social and professional lives continue to be somewhat constrained by social distancing and movement restrictions, though progress in suppressing the pandemic is now allowing the global economy to stage a remarkable recovery. We discussed this at some length in our last call when Ian described the factors that would drive a rapid bounce-back in activity – he talked about the deployment of vaccines reducing the need for lockdowns, the effectiveness of the government support programmes in preventing major structural damage to our economies, the desire of consumers to spend once they were able to do so again, and the degree of fiscal support deployed to support the recovery. And so it is proving, in spite of the emergence of several new variants of the virus.

Early data for the second quarter suggests that a rapid recovery is now underway; clearly the travel and tourism sectors are still heavily constrained but for most of the global economy, this recovery is expected to continue at a rapid pace over the second half of the year. As a result, economists have been upgrading their forecasts for the year as a whole and the world economy is now expected to grow by over 6% in 2021, the fastest rate in over 40 years.

But the market euphoria at the prospect for a swift recovery from the worst recession in 300 years has been short-lived, the very speed of the recovery has led to serious concerns about inflation, markets are unsure whether the low stable inflation regime of the past two to three decades is now coming to an end, or whether central banks will be forced to raise interest rates more aggressively than previously supposed; so my first question to Ian this morning is, should we be seriously concerned about inflation?

Ian: Thank you Nick – after a long period in which everyone was more worried about deflation, the focus has suddenly shifted, markets and investors were somewhat spooked by the inflation data we saw coming out through the Spring, a modest acceleration in inflation had been expected but not to the extent that was reported. Amongst the advanced economies, the most dramatic rise in consumer price inflation came in the US where the inflation rate picked up from 1.4% in January to 5% in May and that is the fastest pace since the summer of 2008.

In the Euro zone, inflation doubled from 1.2% to 2.3% and in the UK tripled from 0.7% to 2.1% and markets are also worried about more inflation in the pipeline as the latest data from China showed an annual rise in factory gate prices of 9%, the highest since 2008. But these sharp rises were driven by some very specific factors, mostly related to the pandemic and the opening up of the economy. First, compared with a year ago, energy prices are sharply higher. Last Spring, as the pandemic set in, Brent Crude Oil price fell

to close to $20 a barrel but has now returned to around $75 a barrel and that is pretty close to its pre-pandemic average and as a result the prices of heating oil, natural gas and petroleum have all increased sharply over the course of the last year.

Second, the disruption to international supply chains caused by lockdowns has brought shortages in some key goods and components, made worse by the dislocation in shipping logistics which have also caused freight rates to rise dramatically. The Baltic Index, an index of costs of container freight, has risen from just under $2000 to just over $6000 since last June and this has compounded the price increases for internationally traded goods and components. Now, one of the most acute shortages is in the semiconductor industry. Part of this has been caused by the pandemic itself where suppliers scaled back production as orders were cancelled but were faced with rising demands for consumer electronics and cloud infrastructure as the lockdown persisted. It has also been affected by trade politics between the US and China as well as new phone rollouts and the demand for crypto currency, so the index of chip prices has risen by 15% in the last year and this is now feeding through into the prices of consumer electronics.

The most severely hit amongst the users of such chips are the automobile manufacturers which have both cut back production and raised car prices.

The third factor driving inflation is the service sector, as restaurants and other leisure services have re-opened, they have increased their prices, most probably to recoup some of their losses of the past year; now this appears to be a perfect storm but these are all essentially temporary or one off price increases; the crude oil price is unlikely to rise much further, given the effect of current prices of US shale oil production, and as the disruption to shipping logistics wanes, price levels should start to ease and even in the global chip industry, analysts believe that the shortages should start to disappear next year. And, as economies reopen, service sector businesses will see increased sales volumes allowing them to cover their costs without further price rises.

So, for the rest of 2021, I think we will see relatively elevated inflation, at least in comparison with recent years, and for 2021 as a whole, global inflation is now expected to average around 3.8%, that would be the strongest annual rise since 2011 and 2012. And it also means, that for a number of key countries including the US and the UK, inflation will overshoot the 2% target set by their Central banks.

But inflation is a year-on-year calculation and after 12 months, this Spring's price rises will start to fall out of that calculation, so by this time next year, I think inflation rates will be easing back closer to the levels of the past few years. Such faster inflation, that we are seeing in 2021, would only become ingrained if we were to see this Spring's price rises repeated or critically, faster growth in wages; but with unemployment around the world now higher than before the pandemic, the risks of a wage price spiral appear quite limited. The key central banks, that is the Fed, the Bank of England and the ECD, have all emphasised the temporary nature of this spike in inflation and bond markets, after some initial disquiet, do seem to have taken this on board. Bond yields rose sharply in February and March but have since stabilised at close to the levels prevailing before the pandemic when inflation was of course still under control.

So, I don't think we will see the sort of regime change that we saw in the 1970s and 1980s that unleashed a long period of high inflation. When looking beyond the current spike, it is clear that the longer-term factors that have kept inflation so low over the past two decades, that is the globalisation of oil trade and production and the changes in labour force dynamics, are still in place; and another crucial difference from the 1980s is the current global architecture of independent central banks with inflation targets. Unless politicians were to dismantle that architecture, central banks will still be required to deliver their low inflation targets, so I do think that the era of low, stable inflation is unlikely to end any time soon.

Nick: Thank you Ian, that is very insightful, and we will come back to one or two of the subjects that you have mentioned, such as semiconductors and crypto currencies and so on, but doesn't this mean that central banks will have to react to inflation overshooting their targets and raise interest rates?

Ian: Well, as long as they consider the overshoot to be purely temporary, they will, in the jargon, "look through it" and not react. Central banks have always "looked through" short-term inflation volatility but recently we've seen some new guidance on their thinking and this, I think, makes "looking through" the current spike even more likely. Having consistently undershot their inflation targets over the past decade, the key central banks have all indicated that they will want solid proof that inflation is going to hit their target rate sustainably before tightening policy – so as long as they see the current pickup as temporary, they will keep policy on and that when they do tighten, they will start only gradually.

The most explicit guidance has come from the US Federal Reserve which has subtly altered the way in which it describes its mandate. Instead of targeting a fixed target of 2%, the Fed is now targeting a sustainable average of 2% and that gives it a little more flexibility to hold rates lower in order to help reduce unemployment and not to have to react too quickly.

That is not to say that rates will remain at their current emergency low levels forever. If the world continues its rapid economic recovery, I fully expect that the degree of monetary stimulus now in place will start to be reduced in the middle of next year or so.

Nick: So interest rates will be going up, is that right?

Ian: Well, monetary policy is no longer just about how central banks set short-term interest rates. Relative to ten years ago, they now also have several unconventional instruments in their armoury, including quantitative easing, forward guidance and yield curve control, and they see this new range of monetary instruments as a "monetary toolbox", with different tools having subtly different effects, each to be deployed depending on the particular economic circumstances. This is a change from when I was at the Bank of England, when the unconventional tools, especially QE, were seen simply as interest rate changes in another guise, and rate changes were regarded as the dominant policy tool.

So central banks now have more of a choice about *how* to tighten policy – which tool in the policy toolkit to use first. In my day, central banks believed that policy would be tightened first by raising interest rates, with any unwind of their QE programs coming only much later; but that thinking is changing and there are now growing concerns that if the level of QE deployed during the pandemic is left in place, that central banks might run out of ammunition for any future downturns and as a result, central banks are now hinting that they might reverse their QE programs before raising interest rates.

Now that could be either passively by allowing their bond purchases to mature or more actively by selling some of their stock of bonds back to the market. So having seen interest rates fall to 300-year lows and big increases in QE programs last year, I do think we will see monetary policy tightening in 2022 as the global economy shrugs off the pandemic and this will probably be through a mix of modest interest rate rises and some reductions in QE holdings. But that tightening, I think, is likely to be gradual and will still leave us in a world in which interest rates, short and long, are still significantly lower than they were before the global financial crisis.

Nick: Thank you Ian. Given that a sustained, significant pickup in inflation is one of the key risks identified by our investment committee, that is very reassuring, and it corresponds with what you have been telling us in previous calls – that the outlook is for solid growth through 2022, that we will see a return to pre-pandemic levels of activity for most economies by early next year and that inflation will remain under control. All these point to a relatively stable economic cycle over the next few years, but if the past 18 months have reminded us of anything, it is that we can never be sure about the future and things seldom go according to plan, so where could it go wrong? What do you see as a key risk to both the global economy and to markets?

Ian: Well, we do have to recognise that the future is inherently uncertain and that we cannot foresee all risks that might divert the outlook and I think this is a constant theme of our investment committee and is one of the central pillars of our investment strategy, but those risks that we can identify are essentially those that I described in our last call. I think first, we start this cycle with elevated public debt levels and generally high asset valuations; both can continue for some time as long as interest rates remain relatively low, but if governments do not start to reduce their budget deficits and stabilise their debt levels by the time that interest rates start to rise, their debt service costs will rise and they and financial markets could then face some challenges; this is a risk both to the economy and to markets highlighted by the recent annual report of the Bank for International Settlements.

And in addition to that, there are those risks that lie outside the realm of economics. The pandemic is not over yet and could still cause more problems, other natural disasters could always strike, and global politics does seem somewhat more febrile than for some time, with more aggressive expansionist attitudes of both China and Russia, as well as the possibility of disturbing regional conflict. So, while I think the outlook is improving, it is unlikely to be plain sailing and making a careful, well-thought-out investment strategy a key element of financial planning.

Nick: Indeed, thanks Ian. Let me now turn to a different issue for financial markets – the outlook for corporate profits. We have talked in previous calls about the renewed fiscal activism of governments and about the pressures placed upon government finances by the pandemic – at some stage, as we all know, someone said fiscal largesse will have to be paid for. The corporate sector is likely to face increased taxes, in that regard the recent agreement at the G7 meeting to reform the system *for* taxing multi-national companies has been described as a defining moment. How do you view the proposals and what are their implications, Ian?

Ian: Well, the agreement has certainly been greeted with some bold language, in the press statement by the UK Treasury, Rishi Sunak described the agreement as "seismic", which is the first time I have heard anyone get quite so excited about technical tax issues! But it is not just hyperbole, in a number of respects it is a significant deal, although more for what it signifies about the future than from the details of the specific reforms so far. Its key significance, I think, is that it marks a dramatic change from the previous philosophy and practice of global corporate taxation which has been going back decades.

First, it marks the further reshaping of the role and reach of government, I have spoken, as you said Nick, in previous client calls about how the pandemic is reshaping the role of government towards more activist state intervention and higher levels of spending, and the G7 agreement suggests that this more activist approach in now being extended to taxation. For the past 40 years, tax competition between countries was seen as beneficial with individual governments using corporate tax rates to attract multinationals to their countries. This agreement I think marks the end of that era, those who argued that international tax competition was a "race to the bottom" in terms of both tax rates and government revenues, appear to have won the argument.

And second, I think this agreement overturns a century of international corporation tax practice in which profits were taxed primarily where companies had a physical presence, or where they were headquartered. They can now be taxed in this agreement in jurisdictions where they make sales, however remotely, and thus recognising the shift to digital and internet commerce underway.

Nick: I will turn to Stuart in a minute for his views on this but what might it mean for some of the companies we invest in do you think?

Ian: Well, it gets a little more complicated at this point as the negotiations are continuing, but what we know so far is that the G7 finance ministers have agreed on two pillars to the tax reform. Under pillar one, the largest and most profitable multi-national companies will be required to pay tax in the countries in which they operate not just where they are headquartered, the rules would apply to the largest global firms with at least a 10% profit margin and would see 20% of any of their profit above that 10% margin reallocated for tax purposes to the countries in which they operate.

And under pillar two, the G7 countries have agreed a global minimum corporation tax rate operated on a country by country basis of at least 15% but the details of the proposals, the precise tax rate that is enacted and how many firms they actually apply to, are still subject to negotiation and discussion and some critics of its success suggest pillar one, as it stands, might only apply to a very small number of multinational companies and might even exclude Amazon, for example, on the grounds that it makes less than a 10% profit margin.

In addition, the exemption of certain sectors such as financial services which has been discussed has also still to be signed off, but there is political momentum behind the project and the G20, which includes members China,

Russia, and other key developing economies, are expected to approve the proposals at their meeting this coming weekend (9 and 10 July 2021). The OECD says that 130 countries in total are expected to sign up and if the proposals do reach the statute book, the potential tax revenues could be significant.

The OECD estimates that pillar one could reallocate some 100 billion dollars of profit for taxation purposes from one country to another, while the minimum tax rate of 15% could raise an additional 150 billion dollars in revenue; so I do think this agreement marks a turning point in global tax affairs and signals a strong sense of direction even though we don't yet know all of the details and the whole thing will take a little time to implement.

Nick: Anything to add Stuart?

Stuart: Not especially – I would expect most of the companies in our model funds to be able to offset the adverse tax changes with underlying growth over a few years and overall, I would be surprised if any of our recommended fund managers needed to adjust their portfolios to address the new global tax regime.

Nick: Indeed, thank you. Ian, before we come onto you Stuart for your section, there is a third topic I wanted to ask you about this morning and that is crypto currency. It is a subject of much debate at present and is a topic we have discussed on these calls in the past. So far, our conclusion has been that the main crypto currencies traded at present are highly risky and outside the jurisdiction of most financial regulators and as such, we do not believe they are suitable investments for London Wall Partner's clients.

In recent months though, there have been a number of developments with central banks taking more of an interest and regulatory authorities becoming

more involved. As an ex central banker, how do you see crypto currencies evolving?

Ian: It is an area provoking a great deal of interest at the moment and I do think over the next few years we are going to see a good deal of innovation and change. Now as far as Bitcoin goes, it has been a roller coaster few months; its price has been effectively slashed by around $10,000 from June 2019 to September 2020. It then rose rapidly reaching a peak of some $63,500 in April 2021 before falling by almost 50% to this week's price of around $34,000.

Elon Musk and others have tweeted heavily about the currency, and Musk's tweets have swung from enthusiasm – as Tesla stated that it would accept Bitcoin in payment for its cars and was reputed to have bought some $1.5bn worth of the currency – to more caution, appearing to question Bitcoin's value and prospects and in particular its green credentials. At the same time, financial regulators have begun taking a greater interest. At the one extreme, El Salvador has announced its adoption of Bitcoin as legal tender, alongside the US Dollar. At the other, it has been effectively banned in China.

For most countries, regulations sit somewhere in between. There are restrictions around the use of Bitcoin for illegal purposes such as money laundering and drugs, but otherwise trading is mostly legal. Although in a number of countries, including the UK, trading in crypto currency derivatives has been outlawed and the major central banks continue not to recognise Bitcoin as a currency, but see it as a speculative asset with little or no regulatory protection and they do issue regular warnings of its risks and dangers. But the focus on Bitcoin and its sister crypto currencies, such as Dogecoin and Ethereum, I think, misses a wider story that is likely to become more prominent and much more interesting in coming years.

Nick: So how do you think crypto currencies will fare and how do you think things will develop?

Ian: Well, before I talk about how I think things might develop, I think it is important to get the terminology right and to understand the different characteristics of the different types of digital currency that are now starting to emerge. Let's start by what we mean by "currency" or money. At heart, there are two sorts of money, the first is physical such as bank notes or coins, the second is digital and represents money that exists only in virtual form, in a computer somewhere as a data entry. Such digital money has been around for some time, every pound you hold in your bank account is digital money, recorded in your bank's computers, and in modern economies that digital form of money predominates – about 95% of the money used in transactions in the UK is held in the form of a bank account, rather than in notes and coin, and payment – through debit and credit cards, and payment orders – is virtual.

Now for all digital money there are three key characteristics that distinguish the different types:

1) whether it is public, that is issued and backed by a central bank, or privately issued and managed;

2) whether its asset-backed or linked, to calibrate and stabilise its value; and

3) whether it uses encryption technology to make transactions more secure and secret

It is this third characteristic, the use of a particular encryption technology, usually the distributed ledger block chain technology, that makes a digital currency crypto. So, not all digital currencies are crypto, though all crypto currencies are digital.

So, let's consider the other two characteristics. It is not often recognised that the money you hold in your bank account, is not public – it is not backed by

the resources of the state, and it is not covered by that familiar Bank of England promise to pay the bearer on demand. It is "private money" created and managed by the private sector commercial banks. This digital money is effectively created whenever a commercial bank offers you a loan and credits the loan amount to your account, that is creating new money. But the banks are heavily regulated to ensure their soundness, giving asset-backing to the currency and the fact that the money is denominated as is public notes and coin, that is in pounds and pence, provides a stability of value.

Now Bitcoin and others of that ilk are also private digital money but without the asset backing, the linkage to public money and the regulation of their issuers. So, Bitcoin's asset value is determined by sentiment and short-term demand and supply and that makes its value unstable and without asset backing, inherently worthless. Its utility is also undermined by its very limited use in payment for goods and services.

But there are two other sorts of new digital money under consideration which I think may remove many of the shortcomings of Bitcoin and its stable mates and these, I think, are likely to emerge as significant new forms of money in coming years. The first of these are called "stablecoins". These employ the decentralised crypto technology pioneered by Bitcoin and others, but they denominate their assets in an existing currency such as the pound or the US dollar and explicitly back those assets with public money to ensure their value. Stablecoin issuers require permission from their central bank to issue the currency and regulatory authorities in the US and UK are increasingly treating Stablecoin issuers more like banks. So, sterling or dollar Stablecoins are similar to existing bank account money but potentially offer a more secure and lower cost system for monetary transactions than we have at present.

And I do think that this form of private digital money may well have a promising future, to sit alongside or maybe even displace existing bank accounts, unless, and it is a big unless, central banks decide to provide such services themselves.

And central banks are seriously studying whether there is a role for a public digital currency, the second sort of new digital currency currently under consideration. For central banks this would supplement their issue of notes and coin but as the use of cash diminishes, would gradually overtake it and public digital currencies issued by the central banks would naturally offer the asset backing, the credibility and the stability of value required of money and may come to represent the payment system of the 21st century.

Now neither Stablecoins nor central bank digital money necessarily make Bitcoin and the like redundant. Stablecoins and central bank money both use the new technology to make existing transactions, payments for goods and services, money transfers, and so on, swifter, cheaper and more secure. Those who want to gamble or to use Bitcoin to hide from the authorities may still use it, but those looking for low cost, easy and secure ways of holding, transferring, and spending money are likely to find that Stablecoins or central bank money become more attractive alternatives in future and that I think is likely to have implications for Bitcoin and its lookalikes in the unregulated sphere.

Nick: Thank you Ian. I have to say, and I hope our listeners agree, that I don't think I've heard or read a more sensible and thoughtful appraisal of what is a most interesting area, and it appears that we are still in the early stages of the development of digital currencies and rapid evolution may lie ahead, especially if central banks decide to enter the arena. We will have to continue to monitor this topic and we will inform clients of important developments as and when appropriate. In the meantime, I would reiterate our belief that existing crypto currencies are not suitable for our clients unless you like gambling as their volatility and the possibility of losing all your capital makes them, for us, too high risk.

It is an area we have got to be looking at and watching and your appraisal Ian is terrific, thank you very much. I should add that Ian will be putting together

a research note on digital and crypto currencies based on what he has been discussing this morning and we will be circulating that to clients in the near future. So, thank you very much Ian and I'd now like to turn to Stuart who will talk to us about some matters concerning our investment approach and the funds and companies we recommend in our model portfolios. Stuart.

Stuart: Thank you, well I need to start really with a piece of unfinished business from our last call in April because one of the questions I was asked then was about companies held in our model funds which have been adversely affected by the pandemic. Since Covid struck, we have been very keen to emphasise that most of the companies held in our model funds have been very resilient but clearly the unprecedented reach and pace of the pandemic challenged some of the businesses both we and our recommended fund managers might normally have expected to have been relatively unaffected by an economic downturn.

So, three months ago when answering the question about stocks which have been impacted by the Covid lockdowns, I highlighted things like the airline reservation software companies Amadeus and Sabre, travel stocks like Intercontinental Hotels and medical companies, which have suffered from a decline in the provision of operations for hip replacements and other elective surgical procedures. However, I should also have mentioned Essilor Luxottica, the eyewear and optical lens business, which is a top 10 underlying holding in our model funds. As you can imagine, the work of opticians was abruptly curtailed as lockdowns began just over a year ago and it was especially remiss of me to omit Essilor Luxottica from the names I discussed because it had been featured by Michael Boyd, who you may recall is the manager of the GuardCap Global Equity Fund, at our last client investment lunch prior to the pandemic at the RAC Club in February 2020.

Those who were there may recall that Essilor Luxottica is probably best known for making Rayban and Oakley sunglasses, but it also makes spectacle

frames for brands such as Armani, Burberry, Chanel, Dolce and Gabbana and Versace. It also does lens brands, but they are probably not as high profile and branded as Varilux and Essilor and the company also operates online in the high street retail chains such as Vision Direct and David Clulow. Essilor Luxottica is also in the midst of a takeover bid for the optical retail chain Grand Vision, which will add the Vision Express label to their stable. Another reason I should have dwelled on Essilor Luxottica is that Michael Boyd not only highlighted its long-term investment attractions, due to the highly favourable demographic backdrop for companies specialising in eye care, but also to illustrate how importantly our recommended fund managers take ESG issues, especially governance matters; governance, of course, is the 'G' in ESG.

Essilor Luxottica was created by the merger of the French based lens maker Essilor with the Italian frame manufacturer Luxottica in 2018 and the initial board structure included a blend of directors from both companies. Shall we say, the leadership agreement didn't quite work out as well in practice as the merger prospectus promised, and long-term shareholders, such as GuardCap, had to engage extensively with the company to seek a resolution of boardroom tensions. Fortunately, this situation now seems to have been resolved with the appointment of a new chief executive in May 2021, a process which unsurprisingly took longer than expected due to the pandemic, and I should also say that Essilor Luxottica shares are trading near all-time highs, having recovered from a 30% fall when Covid first hit.

When I prepare for these quarterly calls, I always revisit the activity of our recommended fund managers just in case there have been any material changes to their portfolios which are worth highlighting. While there has been a shift in economic activity so far in 2021 as Ian has outlined, our managers have stuck to their last. Their focus on quality businesses may not have been in vogue over the turn of the year as traders favoured beaten down stocks which may recover as the pandemic eases, but the attractive

long-term growth prospects of the companies in our model funds should ensure they prosper again in due course, however events unfold.

While markets may currently be concerned about the outlook for inflation, the strong pricing power of the businesses our managers select for their portfolios gives us comfort. Given the lack of portfolio turnover news to report, I thought I would instead focus on some of the holdings our recommended funds have in the semiconductor industry which in aggregate represents nearly 2% of our company share funds. As Ian has highlighted, shortages in the semiconductor supply chain have been one factor behind the current upturn in inflation, not least because production shortfalls in the new car industry are having a knock-on boost for the second-hand car market worldwide. While some car companies have said their production may lag expectations for a further 12 months, it does seem reasonable to assume this disruption will be temporary as a key supplier of chips for cars had a fire in its factory in Japan in April, which should be in a position to get back to full production within a few weeks.

However, when we looked at the broader semiconductor market, the tightness of supply and demand could well remain, given increasing demand for high performance computing and the roll out of fifth generation or 5G mobile phone technology. And this is all before we see the next wave of new demands which might arise from the widespread adoption of artificial intelligence, advanced driver assistance systems and the Internet of Things which commentators often explain as providing the opportunity for your fridge to re-order your groceries if supplies run low.

The largest company in the semiconductor industry is Taiwan Semiconductor Manufacturing Company, which is usually referred to as TSMC. This is the world's leading manufacturer of semiconductors and while it may not be a household name it is the sixth biggest company in the world index, coming after Apple, Microsoft, Amazon, Facebook, and Alphabet in the rankings, reflecting the strong demand for chips, when it announced its 2020 annual results, the company increased its growth expectation for the next five years

from between 5 and 10%, to between 10 and 15%, and given the company's strong technological lead in producing ever small semiconductors from larger silicon wafers, this seems to be a reasonable projection. I should note that semiconductors are produced from wafers cut from cylinders of silicon and the wider the cylinder, the more economically efficient the process. In addition, smaller chips operate faster and typically use less energy, so technical prowess in these areas really makes a huge difference.

However, while the demand backdrop for TSMC appears bright, it is unlikely to be all plain sailing for the company, not least because the company is caught up in the geopolitical tensions between the US and China. As the US has tightened its restrictions on the sale of leading technology to Chinese companies, TSMC has had to focus on customers elsewhere and the company is also having current challenges from a drought in Taiwan and an upsurge in Covid cases among their employees, reflecting the experiences of many Asian countries which have suffered from prior epidemics. Taiwan had initially managed the Corona virus pandemic well, but the situation has taken a turn for the worse recently.

The second largest semiconductor business which is held in our model portfolios is Nvidia which is best known for designing chips used by computer games companies. I have commented before on how large that industry is, so maybe it is not surprising that Nvidia is the eighth largest stock in the world index, being just bigger than JP Morgan, Johnson and Johnson and Visa. I am mindful that these semiconductor companies are not typically household names so I thought giving an indication of their scale in the world index may be helpful, and as a point of reference the UK's largest company, Unilever, is the 59th largest company in the world index. Coming back to Nvidia, its recent trading has been especially strong as the architecture of its semiconductors is especially useful for mining crypto currencies. Nvidia is likely to continue to feature in the UK financial press in the months ahead as it is in the middle of buying the British chip designer ARM from its current owners, the Japanese sponsored Softbank Vision fund.

The third largest semiconductor company held by one of our model funds is ASML, with the ASM originally standing for Advanced Semiconductor Materials and the L representing Lithography. It is a Dutch company and is the 24th largest company in the world and the leading maker of machines which are used to make semiconductors. ASML are the only manufacturer of machines which use extreme ultraviolet lithography, which is the world's most advanced process for projecting and printing circuit patterns on silicon to produce semiconductors, using light.

ASML is benefitting from increasing investment in the semiconductor industry and their latest machines cost over £100m each, not least because they have over a hundred thousand parts, and with the US seeking to encourage increased production of chips in America to counter the China threat in the IT industry, ASML's growth projection also looks assured.

The last two semiconductor stocks to mention are Texas Instruments and Graphcore. Texas Instruments produces analogue chips – while computers work in digital code, us humans operate in analogue (i.e., we hear sound waves not as bytes of data, but as analogue waves of sound) and Texas has a lead in this market. Finally, Graphcore is a five-year old British business which designs chips specifically for use in artificial intelligence and machine learning applications and it is different to the other investments I have mentioned, not just because its British, but also because it is not currently listed on the stock exchange, it is held in four of our model funds which also hold a few unquoted stocks.

Before I outline why these funds invest in unlisted businesses, I must emphasise that these funds' structures are sound, and our clients are in no danger of suffering from the Woodford unquoted problem. The Woodford fund, which we didn't recommend to clients, had challenges with its unlisted holdings as it was an open-ended fund where investors could sell their part of the portfolio on any dealing day. As sentiment turned against Woodford and redemptions were made, the tradable listed holdings were sold, and the

unquoted proportion grew to be an ever-larger part of the whole and ended up as a disproportionate amount of the portfolio.

However, the four funds we recommend that invest in a few unquoted businesses are closed ended investment trusts so if an investor wishes to sell their holding in these funds, they sell their shares to another investor via the London Stock Exchange and the underlying portfolio remains untouched. Three of our four model funds which hold unquoted stocks do so as an adjunct to their main approach and often participate in latter stage private equity funding rounds, a year or two before companies seek a public listing. This enables the fund to invest in what they believe to be the businesses of the future before other stock market investors. This activity has become more common in recent years as young companies appear to be staying private for longer, for instance Amazon had been in existence for just three years when it listed in the stock market in 1997, Google was six years old when it came to the market in 2004, Facebook was eight when IPO-ing in 2012 and Spotify was 12 when it came to the market in 2018. One of the reasons that such businesses appear to be staying private longer before moving to the public arena is because they can, not only do internet-based businesses typically need less capital than start-ups of yesteryear, but also the private equity world has expanded and can fund them for longer. Also, some of these businesses want to expand rapidly to maximise their global reach before they focus on achieving the profitability that public markets typically prefer and this can sometimes be achieved more easily in the unquoted arena.

Graphcore is one such company, it is had five private funding rounds so far and there are suggestions it may seek a listing on the US Nasdaq index later this year or possibly next.

I'll finish by mentioning the fourth fund which invests in unlisted businesses; this listed private equity investment trust has a particular focus on software as a service and cloud computing businesses which, as we have described in

previous calls, is a very attractive sector with high returns on capital and growth rates. And that is me done, so back to Nick for questions.

Nick: Thank you very much Stuart. Listening to you two I am very glad I have got my money with London Wall Partners and my hard-earned net of tax savings. The great thing about being independent, of course, is that if we thought any adjustment needed making, we would make it and we do so. Perhaps I can now turn to some of the questions we have received. 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 emailed questions and answers, though not quite as rich as face-to-face dialogue, does help and I much appreciate it.

So, our first question to Ian is about the economic recovery now underway – are there any particular areas of the world that are doing better than others?

Ian: Well, some countries are doing better than others for either, or both, of two potential reasons. First, many of those currently enjoying the fastest recoveries, such as the UK and the US, are those that saw the deepest recessions in the early part of the pandemic – those which underwent the most severe lockdowns and economic disruption – so they have the furthest to make up and, in most cases, will still not regain their pre-pandemic levels of output until next year, but for the time being they are growing the fastest.

The second reason assisting countries to exit the lockdown is the success of their national vaccination programs, with certain exceptions, such as Israel, vaccination progress has been greatest in the UK, the US, Canada, Germany, Italy, France, and other parts of the EU and in China, and this is allowing their economies to make up ground the fastest. By contrast, in a number of key developing countries, such as South Africa, Brazil and India, cases of the virus remain high and vaccination has generally been somewhat slower, however

in many of these countries the stringency of lockdown has generally been lower, so the impact of the virus on their economies has been more muted.

So overall, I think that adds up to the fact that there are not huge differences between countries, especially when we look at their pre-pandemic growth records and for most countries, 2021 and 2022 look set to be relatively good growth years across the world.

Nick: And can I ask you about Brexit? Something that seems to have fallen a little bit out of the news recently – anything to say on that briefly?

Ian: Well, we are still seeing the data for the early part of the year – trade data notoriously takes a little longer to come through than some other types of domestic economic data – so we are still trying to work out to what extent trade has been affected. Clearly there is a lot of focus on a number of individual sectors – fishing, agriculture, shortages of labour in building and the restaurant industry – so I think there are going to be some effects, but it is very difficult to make a good judgement as yet. It is very easy to get carried away by anecdotes and then either claim that Brexit had hardly any effect whatsoever or that it is having a huge effect. I think the story will probably come to be somewhere in the middle; there will have been an effect on the economy of the UK but teasing that out at the moment from the impact of the pandemic is extremely difficult.

Nick: Thank you Ian. A question for Stuart – you mentioned the UK's largest listed company being Unilever at 59th in the world rankings, which may surprise some people – is there anything we should read into that?

Stuart: Well, I think that when I first produced the data, I was surprised how low down the league table Unilever was, but overall, it just shows that the UK hasn't produced many leading technology companies to compete with the giants of Amazon, Facebook and Google and that seems unlikely to change in the near term. And I think the other thing we have always got to bear in mind is the relatively small size of the UK economy doesn't easily support businesses to expand globally so I think it is unlikely we will ever see some really big companies in the UK but, as clients are very aware, we don't recommend funds which focus only on the UK, we think it is better to try and find managers who look worldwide for the best investments, so I don't think there's anything necessarily to read into that statistic.

Nick: And one of the fund managers that we work with was giving an update to investors this week and mentioned about the FTSE 100 being largely un-investable - do you have anything to add to that?

Stuart: Well, a lot of the big UK companies are banks, mining companies, oil companies, and even though there are obviously two particularly large healthcare companies – Astrazeneca and Glaxo – if we'd been talking two years ago, I'd have been telling you that Glaxo was one of the world's leading vaccine producers but it missed out, it didn't have a product that worked for the Covid market, so even that has fallen by the wayside and it is obviously being taken to task by an activist at the minute. Generally, we do not see UK companies being particularly highly represented in the global funds we recommend with the managers looking for world class leading businesses and not that many come from the UK.

Nick: Indeed, and as we have said in previous calls, it is a market of stocks rather than a stock market that we are looking at, so thank you Stuart and to you Ian for your very helpful thoughts which are much appreciated. That is all we have time for today, but we would be delighted to hear from anyone listening live or to a recording to address any further questions of any kind whatsoever. As many of you may have heard me say before, a productive investment strategy for family money, we believe, starts with overall planning and it is a little bit like building a new house on a plot of land or completely refurbishing an existing one. One starts with the architects, the structural engineers, the quantity surveyors, to determine the requirements before employing the builders to execute the plan. There are so many facets to one's personal finances, whether it be succession and tax planning, expenditure requirements or the change with different phases of life, residential property sales or purchases, or business realisation, and all of these must be considered to formulate a proper plan for execution. From there, appropriate asset allocation can be decided upon to then invest with confidence in long-term productive quality assets that we have spoken about on this and other calls – recordings of which are available on our website.

And this can, of course, be done without the need to get over excited about short term market price fluctuations of a collection of good, bad, and indifferent stocks. Of course, because life is dynamic and we experience change, reviewing and adjusting on a regular basis is critical to the mission of appreciating capital, which is why we have annual and half yearly reviews with our clients as well as ad hoc matters that arise randomly and whenever.

Often, people come to us as prospective clients, normally through existing client referrals and recommendations, with significant under-investment in quality assets and over diversification, which, of course, normally dilutes performance. Given our investment outcomes during the last five years to the end of June this year from the planning, allocating and investing we have carried out for our clients, which have been significantly in excess of industry averages, don't be surprised at how many people around you may be

suffering the consequences of this industry underperformance. Of course, five, six or seven percent, for example, does not look like under performance when measured against relatively benign inflation or low interest rates, but it does when you see what is possible from really good planning, thoughtful appropriate allocating and quality investing which has been in the double digits.

Often people are unaware of what is available and it relies on others to spread the word like when we share the merits of a good restaurant or a holiday destination and we are very grateful to have been blessed with amazing clients who appreciate their capital appreciating and do let others know of our existence, as most of our work, as I said before, comes from referrals and recommendations which has to be the best way. So do please keep letting us know if you think there are people who we may be able to help and while we cannot guarantee anything, we are, of course, always open to a conversation and we would love to assist your friends, colleagues, or family members, where appropriate.

I would love it if you have got a moment to provide us with feedback, we often get one or two emails from various listeners to say thanks, but if I could make a particular request to provide some feedback because it is always helpful – could we have added anything? And particularly, there have been a couple of mentions about doing a Zoom call. For the last six occasions and this one we have done it by way of a call, but it would be useful to hear if anyone has anything to say about that. So, I thank you in advance for that and it would be most encouraging and helpful if you could provide some feedback and we will respond to all emails.

In the meantime, we hope you have a great summer and enjoy the festival of sport that awaits us, especially this weekend with the Wimbledon finals and the Euro football. We were going to talk about the performance of Sterling last night, but we didn't want to fall foul, if you'll pardon the pun, of the serious nature of our business by being over flippant. Thank you to everyone

who dialled into our call this morning and thank you again to Ian and Stuart and everyone behind the scenes.

We plan to hold our next quarterly call on Wednesday 6 October 2021, and I do hope you will be able to join us then. In the meantime, enjoy the rest of your day and thank you very much once again.

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