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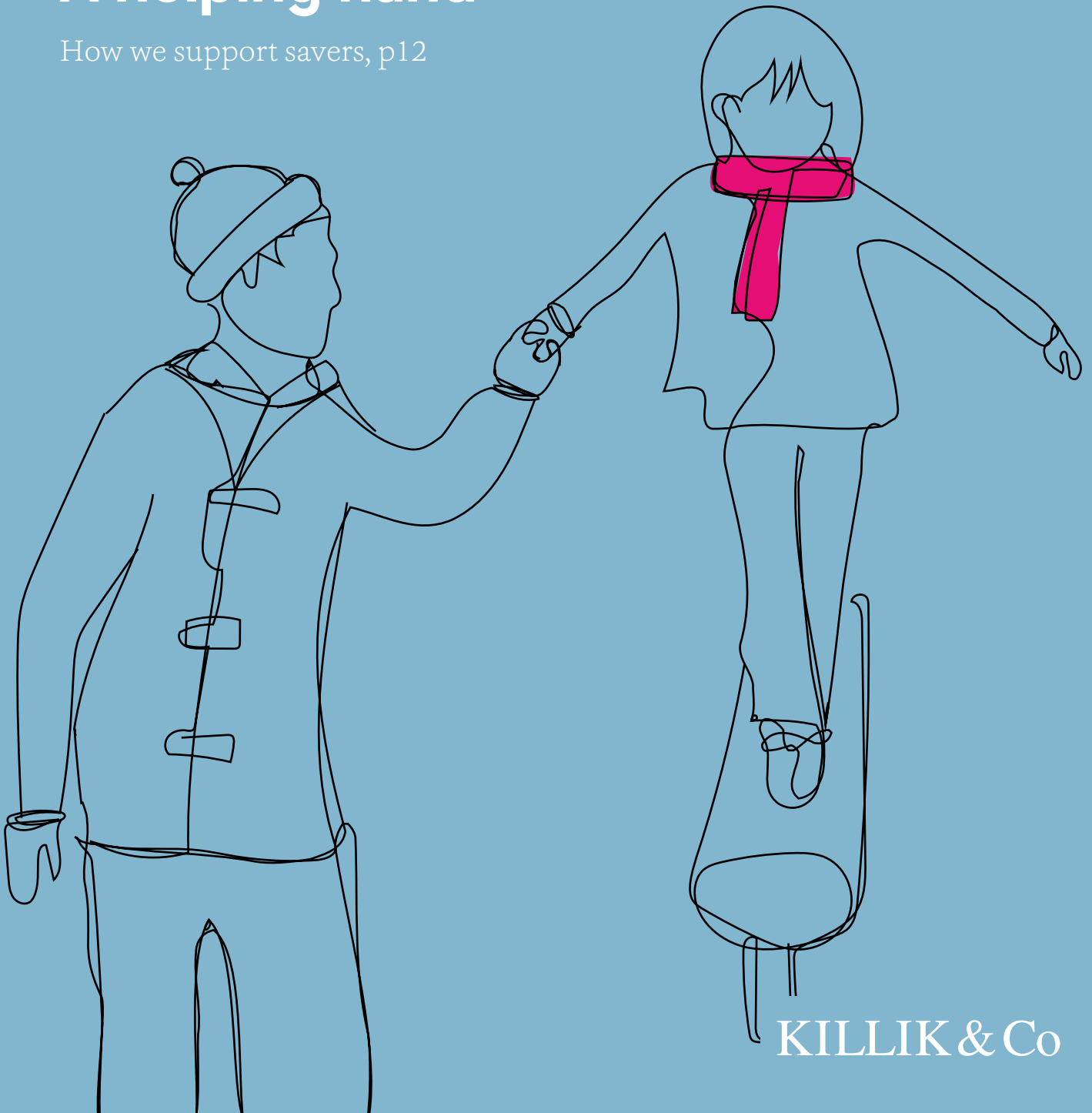
WINTER 2024

Confidant

Acting for clients as they would want
to act for themselves

A helping hand

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Avoiding potholes

Tim Bennett

Head of Education



2023's list of things investors might prefer to forget includes: geopolitical conflict, stubborn inflation, high interest rates and a sluggish economy. Simon and Rachel analyse this backdrop further on pages 6-8. However, they conclude on a brighter note – all this gloom had a negligible overall impact on major global stock markets. Which sets the scene for a few thoughts from me as we enter 2024.

Let's imagine we could zoom back in time and revisit some of the seismic events of the last few decades. These encompassed a Dotcom boom and bust, an Asian collapse, the last financial crisis and 2020's lockdown. In all cases, life got pretty uncomfortable for investors in the short-term. Yet, here's my point – how many of them will still be feeling the fallout in 2024? The reason that most probably won't be is that anyone who stayed invested throughout should have come through the lot relatively unscathed.

However, it's a different story for anyone whose knee-jerk response was to sell. As Paul has reiterated on many occasions, this usually happens for two reasons, both of which epitomise the phrase, "act in haste, repent at leisure." One is sheer panic, a natural

but also costly human reaction in both emotional and financial terms. That's because it leaves an investor with a market timing headache, in the form of getting their re-entry point correct. This is compounded by the fact that the market may recover pretty quickly, even after a big drop. Studies from JP Morgan suggest that if an investor misses the "best investing days" (which usually follow the worst) they do permanent damage to their subsequent long-term wealth, as compounding can't then work its full magic. The other reason people sell when they shouldn't boils down to a lack of planning. When a cash shortage forces them to dump stocks, they can end up paying a high price if the market subsequently climbs.

Worse, following big falls some sellers seemingly get out of the stock market and then never return, presumably stung by their losses and fearful of another big dip. They allow a string of in-built and unhelpful psychological biases (such as "loss aversion", "anchoring" and "crowd-following") to dominate their thinking. If they then sit in cash as a result, the subsequent damage to their wealth may be catastrophic thanks to the cumulative effect of inflation.

That is why I regularly return to two themes. One is the importance of managing your emotions as an investor. The second is always maintaining a "rainy-day" fund that will get you out of a sudden cash emergency, whether triggered by illness, redundancy, or an unexpected property repair. A decent cash safety net will stop you bailing out of stocks unnecessarily, and potentially at just the wrong time if mass panic sets in.

In that context, I have three short reminders for the new investing year. The first one is that stock markets look to the future, ignore the present and forget the immediate past. I recommend all investors do the same. Secondly, volatility is the price we pay for performance, and will always be integral to stock markets. As such, accept the possibility of more in 2024. Thirdly, make sure you are correctly positioned, financially and psychologically, to cope if and when markets wobble. As ever, please do speak to your Adviser if you want to find out more.

I hope you enjoy the rest of this issue of Confidant. Please email any feedback to editor@killik.com ●

COMING UP

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Saving successfully

Paul Killik

Senior Partner

As we move into 2024, Paul explains that, although the way we access saving and investing is constantly evolving, the core principles of effective wealth building remain timeless.

Since I founded Killik & Co, 35 years ago in 1989, much has changed in the world of saving and investment. Major reforms during the 1980s culminated in the “Big Bang” of 1986, which threw the doors of the London Stock Exchange wide open and ushered in a new global era for the London markets. The arrival of the Personal Equity Plan in the same year then changed the retail market forever by offering proper tax incentives to private investors. They duly snapped up shares in all sorts of enterprises, ranging from steel to airways and utilities, under a vast privatisation program.

Fast-forward to today, and I am delighted to see many of our clients, from right across the age and wealth spectrum, enthusiastically embracing the investing opportunity afforded by carefully curated, global share-based portfolios, supported by our evolving myKillik technology. Meanwhile, anyone seeking a simpler savings solution can easily access our Silo app, which facilitates effortless fund-based investing and gifting from the palm of a hand.

However, energising as our part in this journey towards a true UK shareholder democracy has been, I have two concerns. The first is something I have highlighted in several recent Confidant articles and won’t revisit here – more still needs to be done to reinvigorate the London market and open it up fully to retail investors. The second is rooted in the speed of technological change we have seen over the last few decades and will continue to see now that the transformative potential of artificial intelligence (AI) is becoming clear (see page 9). Whilst we have always

embraced innovation and harnessed it for our clients, I worry that left unchecked it may knock away the time-tested, and very human, pillars of any successful long-term saving strategy. So, this quarter I would like to recap four of them.

Keeping it simple

The great US investor Warren Buffett once commented that investing isn’t easy, but it should be simple. And what could be simpler than regular saving? It comes with several well-documented advantages. These include the fact someone doesn’t have to remember to do it, once the relevant electronic instruction is set up, nor do they ever have to worry about market timing.

Exploiting those benefits, with the minimum complication, was the premise on which our Silo app was originally built. It has since evolved to facilitate not just regular tax-effective saving, but also one-off “boosts” to take account of windfalls such as bonuses, and more recently gifting between family generations. Which brings me to my second pillar.

Working together

I am part of a cohort known as the “baby boomers.” The financial tailwinds we enjoyed included several house price booms, the security blanket provided by defined benefit (a.k.a. “final salary”) pensions and a more generous State that funded university tuition fees amongst other things. However, those days are now well and truly gone.

Today’s younger generations face multiple headwinds. These include, trying to pay for their own education, funding an expensive first home and, in many cases, raising a young family. And all of this without an employer backstopping life after work as before. As a result, the Bank of

Mum and Dad, and even the Bank of Grandma and Grandpa, have never mattered more. That is why I would encourage families to talk to each other face to face and find ways to pass wealth down the generations tax-effectively, ideally as early as possible (see pages 12 and 13).

Providing support

Meanwhile, let’s not forget that life isn’t just tough for young people. Inflation, higher interest rates and a slowing property market, are combining to put pressure on even the most generous family budgets. Throw in mounting uncertainty about the future tax status of private school fees (see page 22), plus the difficulty of funding life after work, and any hard-working person could be forgiven for feeling pressured. But that is precisely what we are here for. Our highly skilled Advisers can listen carefully, bridge difficult family issues and help our clients to find a path through life’s many financial challenges. To support that process, we have developed a comprehensive modelling tool called Killik Lifetime Planning – please ask your Adviser about it.

Being present

In that context, I have never believed in remote, or impersonal “robo” advice. Quite the reverse. That is why we established high street branches many years ago, where our clients could engage with us by simply walking in off the pavement. I am delighted to see some of them evolving into our modern and accessible Houses of Killik, the third of which has just opened in Chiswick.

At that juncture, I shall sign off and leave you in the very capable hands of my daughter Georgie, our Deputy Senior Partner, and Phil Sole, our Chiswick Relationship Manager. ●

Staying local

Georgie Killik

Deputy Senior Partner

Georgie and Phil introduce the latest House of Killik in Chiswick and explain how it will support existing and new clients in the local community.

What is House of Killik all about?

Georgie: Back in 2017, we pioneered a series of events in Mayfair designed to make the world of finance and investing more accessible. We did that via a programme of workshops, coffee mornings and seminars that spanned everything from the nuts and bolts of tax planning through to behavioural psychology and investing in alternative assets. In short, there was something for everyone, regardless of their existing knowledge and experience. That success led to a decision to run a pop-up in Soho the following year featuring a week-long series of events connected to improving financial wellbeing. With the House of Killik concept by then thoroughly road-tested, we seized the opportunity to open a permanent location on Northcote Road in Battersea soon afterwards. That worked very well and so Esher followed. Chiswick is the third location to adopt this model.

Why Chiswick?

Phil: We have been based there for many years and have an established client base. As such, opening a House of Killik on Devonshire Road was a natural progression. Further, having done extensive research,



Phil Sole

Relationship Manager

which included being part of a high profile “Pub in the Park” event over two summers, we know that there is a lot of demand for what we can offer amongst young people and families who may have never engaged with us before. With the feel of a West London village, and a tightly knit family-based community, Chiswick therefore remains a good fit for us.

How did you become the Relationship Manager?

I joined the firm in 2016 as an Assistant Wealth Planner but quickly progressed both my qualifications and experience to the point where I could offer a full range of advice to clients. When the Chiswick role came up, I jumped at it. I have always been comfortable helping people at every stage of their financial journey to navigate investment management, financial advice, planning support, or a mixture of all three. I am also local to the area, which is important when it comes to forging relationships and staying accountable.

How will you balance the needs of existing and new clients?

In a nutshell, by ensuring they both receive the highest levels of service from us. Like our other Houses, this one is a local location, backed by a much bigger central operation which is home to experts across everything from equity research to tax planning and probate. As such, all clients have access to a comprehensive one-stop shop but in a relaxed and convenient setting.

I hope that the newly designed House in Chiswick creates an inviting and unthreatening space for informal face-to-face conversations. At a first meeting, for example, we may just try to find out about someone’s personal and financial circumstances and what they are hoping to achieve. The next steps will depend on what we hear, as there is definitely no “one size fits all” approach. Sometimes we may only need to confirm that someone is on



the right track. Equally, we don’t expect everyone to “know what they don’t know” - it’s our job to discover any gaps so that we can help our clients to achieve their long-term ambitions.

What sorts of problems are you solving?

Phil: They are many and varied. For instance, we often help people who want to start investing but lack the time, knowledge or confidence to get the ball rolling. We may just need to create a simple strategy via our saving app Silo – it offers an effortless and straightforward way to regularly put money aside for the future. Alternatively, we might be asked to support someone who is further on and trying to create a more complex financial plan for their children, siblings or parents. Increasingly we find that the “Bank of Granny and Grandad” may want to help with school fees or a first-time property purchase, for grandchildren. We can organise things securely, tax-efficiently and in a way that meets the needs of everyone involved. Another hot area is pensions and the challenge of funding life after work. We solve problems ranging from pension consolidation to boosting a fund or deciding on the most effective way to draw it down. We are often also asked to advise on passing assets through the generations. The bottom line is that we try to take the stress out of important financial decisions, whether straightforward or complicated.

Georgie: A key part of our drive to make investing as accessible as possible is financial education. Anyone in the area can pop in for a chat and just ask questions. They also have access to our full range of popular collateral, whether our “How To” guides, Killik Explains and Market Update videos, Confidant, or regular digital and live events. Finally, I want to reiterate that we have made a big commitment to Chiswick because we intend to stay there for years to come. ●



Remaining positive

Rachel Winter

Partner

Our Market Update presenter takes a look back at an eventful twelve months for the global economy and highlights why we are cautiously optimistic about 2024.

January

2023 opened with most investors relieved to close the door on a bruising 2022. That year, both equities and bonds struggled to the finish line (see also page 8). Most analysts credited that to fifteen years of loose monetary policy. Before the Global Financial Crisis, bonds and equities tended to move in opposite directions, and combining the two was therefore a reliable way to reduce the overall volatility of investment portfolios. Years of low interest rates, however, had the effect of bolstering both asset classes before rising interest rates pulled the rug from under them during 2022.

Against that unpromising backdrop, there were nonetheless reasons for optimism as a new year began. Although UK inflation was still above 10% at the start of the year, in the US it had come down to a more palatable 6.5%. Meanwhile, plans were announced by Beijing that would re-open the Chinese economy, following a lengthy spell of partial lockdown.

For technology investors in particular, excitement was also starting to build about a new artificial intelligence (AI) chatbot called ChatGPT. Launched in November 2022, within just two months it had racked up 100 million users. That put the technology sector, and the NASDAQ Composite index in particular, firmly back on the radar for 2023.

February

As winter kicked in properly, fossil fuel prices deflated to more sensible levels after spiking in the aftermath of Russia's invasion of Ukraine. Annual reports

published in early 2023 laid bare just how profitable these surges had been for the oil majors. **BP** and **Shell** posted record annual profits, but **Saudi Aramco** topped the leaderboard with the highest ever recorded in the sector.

Although renewable power had been a key area of focus up until 2021, coal also returned to the forefront of the energy debate in 2022 as many countries battled to create an adequate supply of power. Commodities giant **Glencore** duly reported a record annual profit, with more than half of the total coming from coal.

These results helped to put a tailwind behind UK stocks, after a period during which the FTSE 100 index had faced criticism thanks to its lack of technology exposure.

March

Fears about the banking sector resurfaced in March, following the unexpected collapse of Silicon Valley Bank (SVB). Popular with venture capital firms, it had made the mistake of investing customer deposits into long-dated government bonds. These fell in value as interest rates rose, meaning SVB was caught in a brutal liquidity squeeze as cash demand escalated.

That episode spread fear amongst bank shareholders and customers alike. Any institutions that were perceived as relatively risky suffered huge deposit withdrawals as investors panicked. The biggest casualty was **Credit Suisse**, which ended up being sold to **UBS** in a deal hastily engineered by the Swiss regulator.

April

Sticky inflation in the UK remained a concern when the April CPI figure came in at 10.1%, against a US number less than half as high. Investors began to ponder whether UK interest rates would have to rise more aggressively

to get prices back under control. Since global capital tends to flow in search of the best rate of return, the pound started to noticeably strengthen against the dollar.

May

With the growth of AI continuing unabated (see also pages 16 and 17), ChatGPT recorded 180 billion visits in May alone. **NVIDIA**, a US company that designs semiconductors that are critical to AI processes – including the ones ChatGPT was trained on – continued to benefit from being in the eye of a growing tech tornado.

Little wonder that the future regulation of AI was also starting to make headlines. Geoffrey Hinton, dubbed 'the godfather of artificial intelligence', resigned from Google in order to speak his mind about the dangers of its rapid future development. Already anxious about the potential impact on their livelihoods, the Writers Guild of America called its first strike in 15 years, with the use of AI in scriptwriting cited as a key area of contention.

The banking crisis also rumbled on, as regulators in the US took control of **First Republic Bank** and arranged a sale to investment banking giant **JP Morgan**. It had been under huge pressure from the moment it was perceived to be facing similar issues to the failed Silicon Valley Bank. That quick reaction seemed to reassure equity markets.

Meanwhile, Far Eastern investors were enjoying something of a purple patch thanks largely to Japan's stock market. It is worth noting, in that context, that the MSCI World Index, arguably the most popular global benchmark, now has a 50% higher weighting to Japan than it does to the UK.

June

After ten consecutive months of raising interest rates, the US Federal Reserve



left them unchanged. This bolstered US equity markets as investors took some comfort that the interest rate tightening cycle might be close to a peak.

Yet, although the outlook for the underlying US economy was also looking more positive, things elsewhere appeared less rosy. Optimism following the reopening of the Chinese economy at the start of the year, for example, had been fizzling out for months, and a set of weak export data was enough to snuff it out entirely.

Meanwhile, Britain continued to lag the US in the race to get inflation under control. Against a reading of 8.7% new data, showing that wages were also soaring, sapped confidence. Whilst the relationship isn't linear, rising wages typically lead to higher inflation. As a result, the yields on UK government bonds rose as market participants priced in further interest rate rises.

One victim of this challenging cycle was the UK water industry. So much so that the UK government was forced to hold emergency discussions about the prospect of taking Thames Water into public ownership, after it amassed huge post-privatisation debts from 1984 onwards. This vital utility provider to London and the South East has been struggling to manage interest payments as financing costs have risen.

July

As temperatures soared across Europe during a mini-heatwave, US technology stocks remained popular. Investor interest in a group of seven mega-cap companies, dubbed the "Magnificent Seven" by the press, persisted – they are **Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA** and **Tesla**.

High points included Apple's record-breaking dominance of the iPhone sector and Meta unveiling Threads as a rival to X (formally known as Twitter). Elsewhere, **Netflix** revealed that its crackdown on sharing passwords had led to a significant increase in subscribers.

August

Stock markets paused for breath as the holiday season got into full swing. Improving macroeconomic data drove some concerns that more action might be required to fully rein in inflation.

Worries about the Chinese economy also grew as further problems in the troubled property sector surfaced. **Evergrande**, the property giant struggling under the weight of its \$300bn of liabilities, filed for bankruptcy protection in New York. **Country Garden**, another major Chinese property company, was also feared to be at risk after missing the interest payments due on some of its bonds.

September

Overall demand for renewable power remained strong in 2023. However, the viability of new projects was abruptly thrown into question when the UK government's auction of contracts for offshore wind projects failed to attract a single bid. For companies operating in the renewables space the cost of new infrastructure has risen significantly on the back of rampant inflation, which continues to put pressure on the government to guarantee higher prices for the power generated.

In the still popular tech space British chip designer, **Arm Holdings**, published the prospectus for its IPO. The firm's product is used in 99% of the world's premium smartphones. Formerly listed on the London Stock Exchange, Arm was bought by **Softbank** in 2016. Following widespread speculation that the company might return to London, its decision to list in the US was taken as something of a snub.

Elsewhere, high street shops lamented a sharp increase in theft – the rate has soared as a cost-of-living crisis has deepened. British retailers called on the government to do more to help, as US retailer **Target** announced that it would be closing nine stores in the wake of a wave of shoplifting and violence towards its staff.

October

Microsoft put itself back in focus after reporting a jump in quarterly profits and finally closing out its acquisition of gaming giant Activision Blizzard. CEO



Satya Nadella is now widely regarded as one of the world's greatest corporate leaders. The firm was quick to recognise the potential of ChatGPT owner **OpenAI**, having invested in the company back in 2019. A 49% stake helped to drive Microsoft's revenues and bottom line in 2023.

November

Echoing auction woes earlier in the year **Orsted**, the world's largest developer of offshore wind power, announced £4bn of impairments after withdrawing from two projects in the US. It blamed rising construction and financing costs. The impact was felt across a weakening wider renewables sector.

Meanwhile, unexpectedly weak US jobs data suggested that higher interest rates were starting to hit economic growth just as a welcome lower UK inflation reading showed that higher rates were having their intended impact. Together, these data points were taken by investors as a signal that interest rates had peaked on both sides of the pond. Renewed confidence was also evident amongst income-generating, non-equity assets, such as infrastructure funds.

December

The government clearly intended its Autumn Statement to be an early, if largely unexciting, Christmas present. In comparison to the tumultuous 'Mini Budget' of 2022, a relatively unspectacular package of measures didn't cause much of a ripple across markets.

As 2023 recedes into the backdrop, investors remain hopeful that interest rates will start to be reduced in 2024. Several measures of sentiment confirmed the resulting improvement in the equity market's mood as 2023 came to an end. So, whilst the last few years have shown that unpleasant surprises can come from anywhere, investors may legitimately hope for a calm start to this year. ●



Choosing carefully

Simon Marsh

Chief Investment Officer

Following a recent webinar, Simon discusses the themes that are shaping the investing landscape with the equity research team, and some of the stock ideas that play to them. For information about future webinars, please speak to your Investment Manager.

Taking stock

2023 was a pretty volatile year for equity investors. As recently as the third quarter, data from the American Association of Individual Investors suggested that nearly half of the respondents to their sentiment survey were feeling gloomy. Meanwhile, the “Fear & Greed” indicator, run by CNN, was showing “extreme fear.” However, it is always worth remembering that when sentiment is this poor, history suggests that markets can be close to their point of maximum pessimism, at which point they often turn upwards. The fourth quarter stock market surge was a case in point. However, we should not entirely forget about something that puzzled investors for much of the year and which Rachel revisits on pages 6 and 7 - why did bond and share prices both perform relatively poorly for much of 2022 and 2023? I think there were three factors, all of which investors should keep in mind this year.

Firstly, fears about global inflation may have receded as we enter 2024, but they persisted through much of last year. For most of the fourth quarter we got hawkish rhetoric from officials at the US Federal Reserve, even as evidence mounted that inflation was abating. Here, the Bank of England’s tone may have softened in light of the latest data, but the phrase, “higher for longer” when it comes to rates is not yet redundant.

Nonetheless, we think nervousness around price strength may no longer be warranted. Looking at recent readings of Consumer Indices for the UK, US, Germany and Japan, the trend has been

firmly downward. That chimes with drops in the recent “high frequency” real-time data from the likes of rental and employment agencies, not to mention the unofficial “Truflation” number.

The second factor that spooked investors in 2023 was a big spike in the cost of long-term borrowing, as the yield on the 10-year Treasury remained a cause for concern. It matters because it is the rate that drives the cost of other debt. The big worry is the fiscal position in the US. Some commentators have suggested, for example, that on the current borrowing trajectory, interest payments will account for about 30% of all federal spending by 2050. Given this is a challenge also facing other Western developed nations to varying degrees, it has been persistently rattling global bond markets. Divisions in the US political system, just as the Chinese have stepped back from buying US debt (alongside fears that the Japanese could do the same) have not helped sentiment.

As for the third big 2023 concern, it can be captured in one word – geopolitics. The world has rarely been this uncertain in modern times, with the war between Russia and Ukraine almost eclipsed by Israel’s operation in Gaza as fears of a wider Middle Eastern conflict linger. Then there are the ongoing worries around China and President Xi’s ambitions regarding Taiwan, which could have far-reaching consequences for global trade.

Inevitably, the barrage of bad news around all three issues sapped investor confidence for much of 2023. At a global level, it is now possible that we are seeing a rewiring of the post-World War two era, with China and the newly termed “Global South” starting to properly flex their collective muscle. For as long as this “democracy versus autocracy” battle

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Martin Maloney
Senior Analyst

rages, bond and equity markets are likely to remain volatile.

So, how have stock markets reacted to this mixed picture so far? In short, by showing surprising resilience. After all, if in early 2019 investors could have foreseen a global pandemic, a major land war in Europe, the fastest hikes in interest rates in a generation and a mini-banking crisis in the US, they could have been forgiven for running for the hills. But they didn't. Markets not only took all of these crises largely in their stride but remained pretty robust. That fact alone is a reminder about the dangers of market timing – getting two decisions right, about when to sell shares and then when to buy them back, is nigh on impossible and remained so in 2023. What's more, valuations ended the year at mostly sensible levels. Taken together, these factors suggest that equity markets should continue to deliver the kinds of long-term returns investors have become used to over the past 100 years.

That said, we are very much in a stock-picking environment. Although always aware of the bigger picture, we therefore spend a lot of time assessing the main drivers of future growth and the likely beneficiaries. With that in mind, here are our thoughts on some specific sectors and the key names we like within each.

Talking AI

Nic Ziegelasch

During a webinar last year, we spoke about generative artificial intelligence (AI) and our belief in its potential. Since then we have seen considerable progress, and been able to form a clearer view about its impact by analysing corporate data on AI-enhanced products and pricing models (see also pages 16 and 17). That, in turn, has made identifying the potential value-add in terms of future productivity improvements easier. We are hardly alone in spotting this – many of the professional services and cloud-computing companies we follow have reported extremely high levels of interest in initial generative AI projects, as businesses start to work out how it will improve their competitiveness.

Nonetheless, quite a bit of uncertainty still abounds. For many firms, AI has not



progressed much past “table stakes” – they have little choice but to build it into their business processes, just to stay in the commercial running, and set aside a lack of visibility over its contribution to future revenues and profitability.

As such, although we can see the potential size of the end market – Gartner, for example, is estimating that \$3trn will be spent on generative AI between now and 2027 – it is still not crystal clear who the ultimate winners and losers will be. We therefore think that the best investment approach is to seek out the “picks-and-shovels” suppliers that are fundamental to AI's development and adoption.

The backdrop to our first stock is the fact that generative AI demands huge data models which, when coupled with the relevant AI training, are used to generate solutions. The process of running live data through such a training model to subsequently make a prediction, or solve a task, is called ‘inference’. It requires very large amounts of computing power and storage, not to mention specialist skills and tools, which the vast majority of enterprises currently don't have. Understandably, they tend to outsource the problem to the large cloud players. Here, **Microsoft** was an early mover when it came to building generative AI infrastructure and is now the market leader in providing access to it. So much so that over 18,000 organisations use its Azure AI services.

In addition to these cloud services, it has also embedded ‘Copilot’ tools into a number of software products. These draw on enterprise data to offer generative AI insights. So effective is this approach that some of the customers in the initial programme have reported anywhere between 50-100% efficiency improvements. That makes, say, an extra \$30 per month for its “Office” suite (comprising the likes of Word, Excel and PowerPoint)

per seat look like very good value. Indeed, it creates the scope for a win-win in terms of productivity improvements for customers and revenue enhancement for Microsoft. That's why we continue to believe that it is the best-positioned software company in the generative AI space.

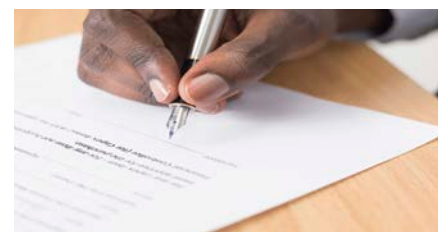
Moving beyond the “enablers”, we believe that data is the feedstock for generative AI. As such, it is clear to us that firms with access to proprietary data, or which offer platforms that pull together internal corporate data, are also likely to be winners. A key example is the UK-listed **RELX**. For more on that, I will hand over to my colleague Stephen.

Advancing technology

Stephen Timoney

RELX is something of a shining star in the technology space and yet also one of its unsung heroes. To understand why, investors should remember that ten years ago it was a leading publisher of academic journals called Reed Elsevier. But since then, it has transformed into one of the biggest tech companies in the UK, employing 10,000 technologists and investing around \$1bn in IT annually.

So, what does it do now? In a nutshell, RELX applies advanced statistics tools and algorithms to data so that it can offer professional customers the value-add decision tools that help them do their jobs. The range of applications for this expertise is huge – it could be used by a university to benchmark performance, a doctor to decide on the best way to treat a patient, or a lawyer to assess whether or not they should take a case to court. So successful has it been, that when Bank of America produced a list of the businesses that are most likely to benefit from generative AI, RELX was the only UK company to appear in the top 10.



A great example of its leading know-how is the recently released Lexis+ AI, a platform built specifically for legal work. It has access to LexisNexis's global database – that's nearly 150 billion documents and records, with over a million new ones added daily – and is fully integrated with its proprietary search functionality. That means it can tap a huge pool of verifiable, citable sources of legal authority. The result is a platform that can accurately answer complex legal questions and also create drafts of key documents. That combination of skills means it may eventually replace the paralegal function within many law firms, which could result in enormous cost savings.

In demonstrations we've even seen it elegantly handle complex litigation questions by leveraging the relevant statutes and case opinions, having screened out fictitious authorities. That puts it on the path to offering nothing less than a practical how-to guide for many lawyers. This is just one example of how generative AI is proving transformational for RELX.

Leveraging data

Nicolas Ziegelasch

Another technology-related opportunity lies in the spaghetti junction of software systems many companies have built over decades. Since they all perform different functions across multiple departments, data gets siloed and difficult to access or use effectively.

That's why the firms providing platforms that can either replace these legacy systems, or sit above them, will be amongst the winners. A prime example is a stock I have regularly mentioned elsewhere – **ServiceNow**. Its cloud-based platform is used for automating processes across areas such as IT, customer services, human resources and security. In simple terms, it overlays the multitude of



legacy systems that older businesses typically rely on and acts as a bridge between different data silos.

Recent initiatives include the release of a new generative AI product that will offer better insights and process automation to its customers, as well as partnerships with global businesses such as **Nvidia** and **Accenture**. That's why we think it will be a long-term winner as it allows commercial organisations to improve business processes without replacing older systems wholesale.

Remaining healthy

Andrew Duncan

2023 was a difficult year for the Healthcare sector thanks, in part, to the unwinding of pandemic support, which left some smaller biotech firms in the doldrums. However, we think that the longer-term investment case remains intact. That's because historic spells of short-term doubt in this space have typically not endured and have often provided an attractive entry point. Nonetheless, investors need to understand what lies behind last year's share price underperformance.

The first factor is COVID, which destroyed demand for quite a few healthcare companies, particularly when they relied on access to hospitals and other medical facilities. Yet, it also provided a massive tailwind for others. One example is **Danaher**. As a multi-conglomerate, it has lots of different sub-businesses serving biotechnology, diagnostics, and life sciences, all of which enjoyed a purple patch between 2020 and 2022. Last year was tougher, but we expect to see a pickup in 2024, given that the underlying demand for healthcare is largely recession-proof.

The second factor is the hype around what are called "GLP-1" (Glucagon-like Peptide 1). They have been all over the media because they are billed as potential wonder drugs for treating obesity, which could have knock-on effects for everything from food demand to airline profits. However, the directors of another of our favoured stocks **Intuitive Surgical** take a rather more sanguine view. As a reminder, Intuitive is a leader in robot-assisted and minimally invasive surgery, designed to deliver

better medical outcomes, shorter patient stays in hospital and lower costs.

Last year, the firm investigated the direct impact of GPS-1s on bariatric surgery, which involves the use of sleeves or staples to reduce the size of the stomach, and accounts for about 5% of their surgical procedures. Their conclusion was that whilst growth was slowing, as more people opted for the newer medication, demand was still relatively strong. Despite that key observation, the shares stayed out of favour alongside those of other medical device companies for much of 2023.

However, from our perspective, this is still fundamentally a growth story. Even if bariatric surgery disappears altogether – which is unlikely – demand for robot-lead procedures elsewhere will only continue to rise. As such, I think some of the recent nervousness around this sector, and Intuitive in particular, is unwarranted.



Energising investors

Mark Nelson

I'd like to turn to another important theme, energy transition. It's been a challenging period for ESG (Environmental, Social and Governance) investments and in particular certain utility businesses that were once the darlings of the market. Many participate in the development of renewable energy assets, or provide the products and services used in their construction.

Nonetheless, this remains a key theme for us, not least because of a clear and urgent need to decarbonise the global economy. The world continues to experience record high temperatures – nine of the ten hottest years have occurred in the last decade – and extreme weather events are becoming increasingly common.

Against that backdrop, decarbonisation demands a multifaceted approach. Whilst a supply-side response is

needed to reduce our reliance on fossil fuels in favour of green energy via renewables, we also need to electrify the global economy. That means switching from internal combustion-engine vehicles to electric ones and replacing gas boilers with alternatives, such as heat pumps. IEA estimates paint a sobering picture here. To achieve net zero by 2050, electricity needs to increase its share of overall energy consumption, from 20% now to 50% in 30 years' time. We also need to become far more energy-efficient, such that total consumption falls 15% by 2050. And this is during a period when the global population is expected to grow by almost 2 billion.

In that context, **Schneider Electric** remains the right play on the electrification and digitalisation of the global economy. The company operates two businesses: energy management and industrial automation. The first represents about 80% of sales. As the leading electrical franchise globally, it helps customers to make the most of their energy. It does this via products and services including the supply of low-to-medium voltage electrical equipment, building and grid automation, and critical power solutions for the likes of datacentres.

Meanwhile, the industrial automation business accounts for the remaining 20% of revenues. It helps to create safe, resilient, efficient, and sustainable processes for Schneider's customers, optimising their supply chains and transforming existing factories. We think this positions it particularly well to help firms navigate recent challenges across global supply chains, as the resulting re-shoring shift puts pressure on local factories to run as cost-effectively as possible.

The beauty of the Schneider business model is that it offers a play on two complimentary trends – energy and process efficiency. Better still, it operates in diverse end markets,



ranging from new buildings to datacentres. In the case of the latter, for example, the company has seen strong demand for larger developments where AI is starting to make inroads. Meanwhile, growth continues for Schneider's comprehensive grid offering as the electricity network operators seek to improve stability.

Cleaning up

Martin Maloney

Another key pillar of the energy transition theme is hydrogen power. We continue to think that strong demand growth and the adoption of cleaner technologies for its production will see hydrogen making a significant contribution to global net-zero emissions targets. In particular, it should play a key role in decarbonising sectors where emissions are especially hard to abate, or alternative solutions are unviable, such as heavy industry and long-distance transport.



Policy support has never been greater, whether in the form of the Inflation Reduction Act in the US, or China's Hydrogen Development Plan. That's why we regularly evaluate companies across the entire value chain, including those involved in "green" and "blue" hydrogen production, fuel-cell manufacturers, component makers and infrastructure providers. The main challenge for us remains that whilst a lot of these businesses have potential, they are also quite risky. That's typically either because their business models are immature, or hydrogen is not a core focus for them.

But that is precisely why we continue to like **Linde**. Listed in the US, its industrial gases are used in numerous daily applications. These range far and wide, from hospital oxygen supplies, to providing the nitrogen used in food chilling and freezing, or the specialty and high-purity gases needed for semiconductor manufacturing.

Thanks to its long history, Linde has a deep expertise when it comes to managing large scale production and distribution of a highly flammable gas such as hydrogen. For example, it operates the biggest hydrogen pipeline network in the world. For us, therefore, it remains a high-quality, resilient business, with strong pricing power built around long-term relationships with customers.

Trading places

Stephen Timoney

As global uncertainty persists into 2024, I'd like to finish up with the Chicago Mercantile Exchange (**CME**), one of the biggest global hubs for derivatives. As a quick recap, these are financial contracts that derive their value from something else, whether a bar of gold, a barrel of oil, a bushel of corn, or an equity index.

The CME specialises in futures and options, which are used by traders, investors, and commercial organisations to hedge financial exposures (reduce risk) or to speculate. In the case of the former, the range of users is huge. In the commodities space, for example, they may be trying to manage the impact of anything from extreme weather, disease and natural disasters to changes in government policy.

Meanwhile, across the financial spectrum there are individuals, companies, banks and even governments hedging away currency and interest rate risk. Elsewhere, fund managers may use CME products to reduce short-term portfolio price risk.

So, why do we continue to back the shares? The answer lies in the fact that when we had super-low interest rates and relative currency stability, a lack of price volatility stifled demand for the CME's products. But that backdrop has been upended in the last couple of years for all the reasons Simon flagged earlier. In a much more febrile environment, the CME should continue to thrive. We like its high-quality business model which offers some key competitive advantages. These include deep product liquidity and the capital efficiencies that arise from servicing global clients that want access to multiple markets via a single, trusted platform. ●



Managing tax

Bronwen Horten

Financial Planner

In the penultimate Wealth Planning webinar for 2023, our panel shared their thoughts about some of the ways a client can seek to reduce tax. Here are the highlights. Please note that tax treatments will depend on personal circumstances and the rules may be subject to future change. To find out more, please contact your Adviser.

Going for gilts

Peter Day

I'd like to kick off with a few gilt basics for anyone new to this area of the market. In short, these are an "IOU" issued by the UK Treasury which allows the government to borrow over different terms. An investor therefore loans the government money in exchange for what is usually a fixed income stream until the debt is paid off (i.e. the gilt is "redeemed"). Due to the fact that the borrower is highly unlikely to default, gilts are seen as "risk-free" and are therefore popular – the total market is worth over £2 trillion. Further, unlike a fixed term deposit, a gilt can be sold prior to redemption (or "maturity") which gives it a degree of flexibility. Add to that the simplicity of the return profile – a buyer knows to the penny in most cases what their annual income will be and the size of any capital gain or loss between now and redemption – and it's easy to see why they are staple holdings for life assurance companies, pension funds and local authorities.

That said, during the two decades when interest rates were close to zero, all of these advantages were offset for other investors by the perception that

gilts were low return and therefore dull. But no longer. As the Bank of England has raised the base rate, so the "yield" available on gilts has risen too (since one tends to drive the other). Better still, they can be tax effective, which is why I mention them here. That's because they fall under the "qualifying bond" rules set by HMRC which lift any capital gain out of CGT.

So, how helpful could this be? Take a gilt which was issued when interest rates were much lower and pays a fixed rate of interest of 0.25% per year with a maturity date of 31st January 2025. That's not very exciting on the income front. However, let's say this gilt was trading in 2023 at a market price of around £93 per £100 of what is called "nominal value". That means a buyer back then who holds it until it is redeemed will get the difference of £7 as a capital gain. Add this to the little bit of income on offer and you get an annual total yield of just under 5%. But that's not all. The fact any gains are CGT-free means that the "cash-equivalent" rate that same person would need to earn from a taxed savings account as an additional rate taxpayer is more like 8.5%. Suddenly, the return profile looks much more attractive, especially given the security and flexibility that comes with it.

That is why we launched a Gilt Saver product designed for clients who are happy to hand over the responsibility for finding and managing a diversified selection of securities to our highly experienced fixed income team. We think it should appeal to a number of audiences. These include investors seeking an attractive and reliable income over perhaps a shorter time horizon than is wise for anything equities based. Further, given that gilts tend to perform differently to other asset classes, it is a potentially useful option for anyone seeking a diversifier. It could also suit a very cautious investor who likes the government guarantee that sits behind these securities.



Featuring:



Peter Day
Hampstead Branch Partner



Shaun Robson
Head of Wealth Planning



Will Stevens
Head of Financial Planning



Arica Gourlay
Senior Wealth Planner

Recapping ISAs and SIPPs

Will Stevens

Meanwhile, reducing what we call the "tax drag" on investment returns has become particularly pressing given the recent reductions in some key allowances. The annual capital gains tax allowance dropped from £12,300



last year to £6,000 after 6th April 2023, and it will fall to just £3,000 from 6th April 2024. Meanwhile, the dividend allowance has decreased from £2,000 last tax year to £1,000 in this one and will reduce to £500 next year. Beyond using those, investors need to look at ISAs and pensions.

Most Confidant readers will be familiar with the ISA basics and can find out more by requesting a copy of Tim's guide on "How to save and invest tax efficiently" from their Adviser. To recap, up to £20,000 per year, per adult, can be sheltered tax-free whilst invested in a huge range of assets. What's more, withdrawals are allowed at any time, albeit at the potential cost of the loss of any future tax benefits. Later in life, ISAs can be useful when it comes to an income drawdown strategy aimed at minimising someone's marginal income tax rate.

As for pensions – the subject of a previous webinar – the main thing to note is that the annual contribution limit (subject to some affordability tests) has been raised to £60,000. Further, the lifetime allowance limit on the maximum value of benefits that can be accrued without incurring a further tax penalty is disappearing.

This does not mean, however, that pension income is tax-free. As a general rule, 75% of the amount withdrawn will be potentially liable to income tax. However, should someone be in a position not to have to crystallise a pension in this way, they can pass it on to future generations inheritance tax free.

Backing smaller businesses

Arica Gourlay

Once an investor has used up those allowances, Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EIS) are a possible avenue. These are not for everyone – they tend to appeal to those with a high surplus income and an appetite for risk. Here is a short summary.

First off VCTs. These are companies listed on the stock exchange which

invest in a range of small, early-stage enterprises. By definition, these are risky investments, some of which may fail altogether. But that is why VCT investments come with some attractive tax incentives. One is upfront income tax relief at 30%, provided you have sufficient income to offset it. There is also the potential for CGT-free growth should the underlying investments flourish, and subsequent income tax-free dividends.

As for EIS, what someone is buying into is a discretionary portfolio of very young companies. This makes them relatively illiquid. Like a VCT, there is income tax relief available on the way in and a subsequent CGT exemption with the potential for loss relief at someone's marginal tax rate. Further, there is the possibility of CGT deferral should they be, say, selling a taxable property or investment and not want to crystallise a tax bill immediately. By investing in an EIS, this may be rolled over for as long as it is held.

On top of that, an EIS usually qualifies for Business Relief because they invest in unquoted companies. This could render a portfolio inheritance tax free subject to certain conditions, a key one being that the investment is held for at least two years. This throws up planning opportunities for some investors looking to mitigate the tax impact of large disposals but in return for a sizeable investment risk.

Looking offshore

Shaun Robson

Another area worth considering here is offshore bonds. Whilst they sound exotic, the reality is more mundane – these are tax wrappers set up outside the UK, typically somewhere like the Isle of Man or Ireland. As such, they follow their own tax rules which can make them a useful place to put capital over the medium-to-long term for someone who has exhausted some of the options highlighted so far.

Within an offshore bond wrapper, it is possible to shelter a lump sum and



allow it to grow tax free, applying a principle known as "gross roll up". Like ISAs and SIPPs, they can shelter a wide range of assets including direct equities and bonds, as well as funds, typically alongside a discretionary mandate.

Income tax is only then applied when money is withdrawn, at a future point that suits an investor perhaps looking to fund life after work. Each year, up to 5% of the total payments made into the bond can be taken out with no immediate tax charge. What's more, this is cumulative and flexible. So, let's say a bond is set up with £1m invested. Then £30,000 (3%) is taken out during the first year of its life, followed by four years of zero withdrawals. By year six, up to a further £270,000 could be taken out without triggering an immediate tax liability.

Later, when the bond is finally surrendered, the total amount of any withdrawals is added to the final sales proceeds to calculate the amount of investment gain, which would then be subject to tax.

That said, for some families this liability can be mitigated via full or partial reassignment. This can be useful for someone trying to reduce their potential inheritance tax liability. For example, parents and grandparents could make an outright gift to younger family members. As non (or lower rate) taxpayers their income tax liability on eventual surrender is likely to be much smaller.

The key to successfully deploying offshore bonds is therefore planning – ensuring that money paid in can be committed for a decent period of time and a long-term exit strategy exists that maximises the overall return.

A further point to note is fees. Since offshore bonds are more complex than a basic tax wrapper, the costs are commensurately higher. And, of course, the regulatory landscape may change in the future as may someone's personal tax circumstances – all these factors need to be taken into account to ensure that any planning solution is appropriate to a particular client.

Bronwen Horton

Thank you all. I will wrap up with a reminder that further information on all of the topics discussed here, and future related webinars, is available via your Adviser. ●



Growing potential

Gordon Smith

Head of Fund Research

Gordon highlights the emerging opportunity in the smaller companies' space and four funds that play to this theme (see opposite).

The last few years have presented a series of challenges for smaller company investors. These include the lasting headwinds created by a global pandemic and, more recently, rising geopolitical tension coupled with the arrival of a new, higher interest rate era. Against such an unpromising backdrop, it is perhaps no surprise that indices tracking smaller businesses ("small caps"), which tend to be less mature and therefore more sensitive to broader financial conditions, have underperformed their larger company equivalents. However, for any investor who can tolerate volatility and is willing to take a long-term view, we think an opportunity beckons.

Analysing performance

That is because both the degree to which performance has diverged between large and small caps, and the length of time this gap has persisted, are unusual when seen in the context of historic returns. Specifically, global small cap markets have languished in each of the last five years, and by a sizeable margin, in sharp contrast to the longer-term trend. **Chart 1** highlights this by revealing that the MSCI World Small Cap Index has significantly outperformed the wider, and large cap based, MSCI World Index over the long term. What's more, those superior returns have been generated for two out of three calendar years throughout the 25-year period up to 2019.

Importantly, a more recent period of underwhelming smaller company share price performance has not coincided with proportionally lower earnings growth. That suggests the relative valuation gap has widened considerably. **Chart 2** confirms as much. It shows the

trailing price to earnings (p/e) multiple (a measure of cheapness) of these large and small cap indices. At the time of writing, the latter was available at a 25% discount to the former. It is also worth noting that while large firms continue to look expensive when seen through this historic lens, smaller ones look better value by comparison. The key question for investors is why.

Weighing up size

To understand what has been happening, it is worth noting that the broader market has been heavily influenced by a select group of mega-cap companies (see pages 6 and 7) which have benefitted from the rapid pace of technology adoption. Further, many market commentators and analysts believe that most of the gains that will flow from technology's latest, exciting iteration – "generative artificial intelligence" – will also accrue to larger companies. That's a function of the funding needed to develop this highly capital-intensive space and the fact that many of the early wins are likely to be enjoyed by businesses which own, or control, large data sets.

However, the rapid adoption of the PC and Internet in the 1990's, followed by the Smartphone in the 2000's, showed a similar initial pattern, and we therefore see plenty of opportunities emerging for smaller, nimbler players. There is certainly no shortage of academic output confirming that smaller companies in general typically command a return premium over their larger peers over the long-term. It includes notable studies by the likes of Nobel laureates Eugene Fama and Kenneth French in the 1990s, which definitively expanded our understanding of what drives portfolio returns. The debate nonetheless still rages about exactly why smaller companies tend to outperform larger ones. In our view it is likely to be the result of several



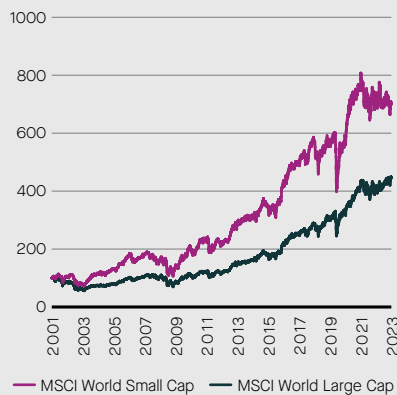
factors, including the ability of relatively immature firms to grow at a faster rate and the fact that they are researched less thoroughly which creates more frequent valuation anomalies. We think these drivers will reassert themselves at some point soon.

Making the turn

Identifying the precise catalyst for any sustained uptick in small cap share price performance remains tricky. In that context, we are encouraged by a spike in corporate activity and M&A in a number of global markets towards the tail end of 2023, coupled with an opening up of capital markets as inflation and interest expectations begin to stabilise in 2024. These tentative green shoots may prompt investors to reassess the case for global smaller companies.

If they do, they will see that some of the recent discounts available in the listed fund sector look compelling. Evidence that 2023's pessimism may have been overdone lay in discounts to net asset value moving towards the bottom end of their historical ranges. **Chart 3** shows the average discount for investment trusts focused on UK small caps. This backdrop also supports our fourth quarter coverage initiation on two funds: **Blackrock UK Smaller Companies** and **Aberforth Smaller Companies** (see table opposite). ●

Chart 1 – MSCI World (Large Cap) Index relative return versus World Small Cap Index



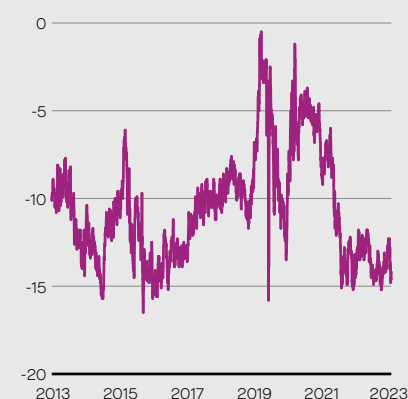
Source: Morningstar. **Past performance does not guarantee future results.**

Chart 2 – Price to earnings (P/E) multiple for the MSCI World (Large Cap) Index versus the World Small Cap Index



Source: Morningstar.

Chart 3 – Average discount (%) of London listed UK small and mid-cap focused Investment Trusts



Source: Morningstar.

Key fund data and charts

The four funds featured on this page are examples of listed Investment Trusts focused on smaller companies. In 2023, all experienced a widening of their share price to net asset value discounts, suggesting they were relatively cheap. Please speak to your Investment Manager for more details on any of these strategies.

Growth	
Blackrock Smaller Companies (BRSC-LON)	
Fund Type	Investment Trust
Manager(s)	Roland Arnold
Market Cap	£632m
KID impact on return	1.78%
Historic Yield	3.1%

This Investment Trust aims to achieve long-term capital growth for shareholders by investing primarily in smaller UK quoted companies.

The Blackrock management team seek to uncover what they call 'hidden gems' within the small cap universe by investing in the sorts of high-quality growth companies that are able to shape their own futures regardless of the wider economic environment.

Total Return (last ten years)



Growth	
Smithson Investment Trust (SSON-LON)	
Fund Type	Investment Trust
Manager(s)	Simon Barnard
Market Cap	£2,100m
KID impact on return	0.92%
Historic Yield	0.0%

This fund invests in shares issued by small and mid-sized listed, or publicly traded, companies globally with a market capitalisation of between £500m and £15bn. The managers then aim to then be long-term investors. Their focus is on companies that have an established track record of success. This may be achieved through a dominant market share in a niche product or service, or via the control of brands and patents which other firms would find difficult, if not impossible, to replicate.

Total Return (since inception)



Growth	
Baillie Gifford Shin Nippon (BGS-LON)	
Fund Type	Investment Trust
Manager	Praveen Kumar
Market Cap	382m
KID impact on return	1.17%
Historic Yield	0.0%

The managers of this fund aim to achieve long-term capital growth principally through investment in small Japanese companies which are believed to have above average prospects for capital growth.

Constituents of the portfolio often offer innovative business models and are run by entrepreneurial management teams. Typically, they are also adding value by disrupting traditional Japanese business practices.

Total Return (last ten years)



Income & Growth	
Aberforth Smaller Companies (ASL-LON)	
Fund Type	Investment Trust
Manager	Team managed
Market Cap	£1,104m
KID impact on return	1.03%
Historic Yield	3.1%

This investment trust aims to achieve a net asset value total return greater than that of the Numis Smaller Companies Index over the long term. Aberforth are 'value investors' who buy shares in firms which they estimate to be selling below their intrinsic value. This conclusion is reached via detailed financial and industrial analysis, combined with an investment approach that focuses on both stock market and corporate valuations.

Total Return (last ten years)



All chart data source: Bloomberg. Chart data to 3rd January 2024. Figures stated gross. **Past performance does not guarantee future results.**



Generating change

Xuesong Zhao

Lead Manager

Nick Williams

Investment Analyst

This quarter, two Partners from the Polar Capital Global Technology team explain why artificial intelligence (AI) represents such a transformative innovation and weigh up its potential impact.

What makes AI so interesting?

To answer that, we need to distinguish between machine learning (ML) and generative AI (GenAI). ML has been a very successful and powerful data analytics tool adopted by many companies over the last few years, and we expect to see continued advancements in areas such as pattern and image recognition. However, it is GenAI, which is based on a newer type of transformer-based architecture, that has dominated much of the debate around this technology since the release of ChatGPT at the end of 2022. Indeed, alongside what is known as foundation model-based AI, we believe it has reached an inflection point, with profound implications for the future. That's because it operates in a way that is much more akin to the human brain. Through an ability to process huge amounts of varied information, it can learn and make sense of disparate

points across huge datasets. That, in turn, is unlocking a wave of innovation.

Indeed, we are already seeing its transformative impact on data analysis. Estimates suggest that around 20% of the world's data is "structured."

This means it is well ordered, tagged, and stored in such a way that it can be usefully analysed using existing techniques. The remaining 80%, on the other hand, is unstructured – it comprises things like images, loose form text and audio. This has made it historically much harder to analyse, both technically and commercially. But that is precisely where this newest technology comes into its own, opening up a huge source of untapped economic potential for both companies and society more widely.

The current models being deployed are now sufficiently big and complex to facilitate "context retention", a development which is driving emergent behaviour and the ability to make inferences from the underlying training data. So far this has manifested in these AI models completing new tasks largely in ways that humans can recognise, via the likes of AI assistant

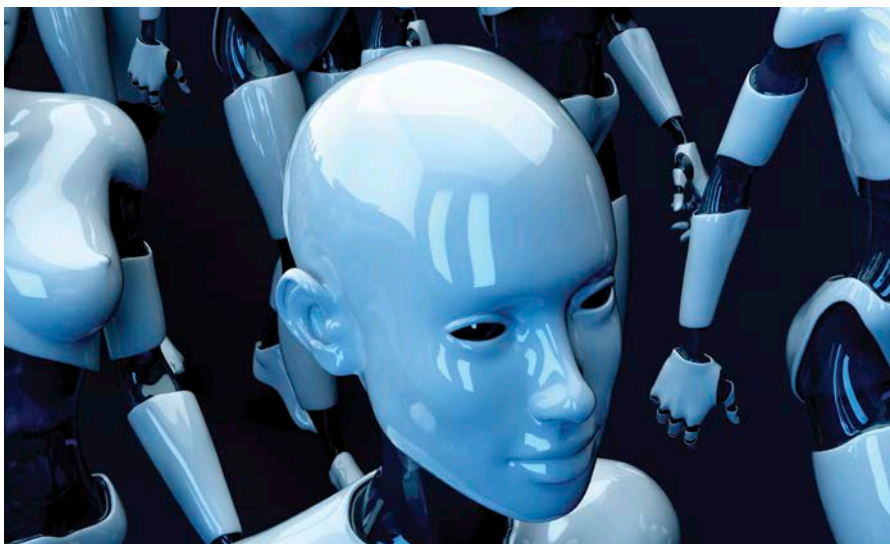
and Copilot-style applications. But this is just the beginning – before long we expect to see wholesale changes in the way work is defined and executed.

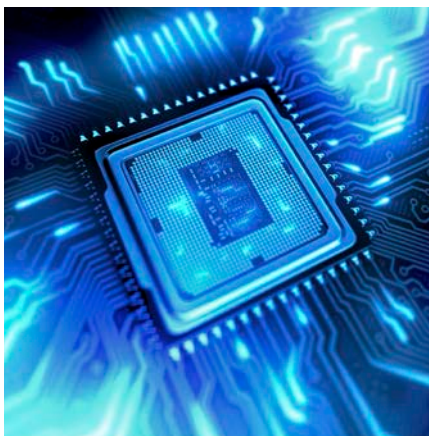
That is why, whilst we see a huge opportunity in the immediate technology and infrastructure rollout, what really excites us is the potential for whole new markets to be created. A useful parallel is to look back at breakthroughs such as the PC, internet, and smartphone. Transformative as those were on a standalone basis, they subsequently spawned much larger markets spanning software, e-commerce, online advertising, and the "app economy". The latter is now estimated to be worth \$6trn. We see something similar happening in AI, given the sheer breadth of its potential applications.

Which factors will drive, or hinder, the speed of adoption?

The advent of the smartphone and mobile internet drastically increased the ability for large numbers of people to access technology at low cost. It also underpinned the pace of what we call "technology diffusion", which has been accelerating when viewed over a multi-decade timeframe. That is a trend that we expect to persist.

In terms of potential barriers, cost is always going to be factor when it comes to the corporate adoption rate, especially as firms start to tighten their purse strings. Running the largest models, such as GPT-4, at low latency is resource-intensive in computing terms and comes with an associated financial impact. Set against that, the feedback from recent launches of the first enterprise GenAI applications suggests that the productivity gains provided by tools such as Microsoft's Copilot far exceed the marginal extra cost. As a result, demand is outstripping their initial ability to serve all of the early customer interest they are seeing.





Furthermore, once both user familiarity and the repertoire of available tools increase, and the associated productivity wins become both more visible and measurable, we expect to see AI embedded into more workflows. After all, many companies are still in the exploratory phase when it comes to deploying AI but as the return on investment (ROI) becomes apparent we would expect adoption to accelerate and drive earnings growth.

That said, there are concerns around how to ensure that AI is rolled out in a safe way. In particular, users will demand ongoing reassurances around data control and privacy. This is an increasingly important area if this technology is to proliferate, as we think it will, across industries ranging from the law, to education and healthcare.

Perhaps unsurprisingly, we have heard growing calls for more regulation recently. Voices urging caution in terms of the pace of its rollout have made themselves heard, from within both governments and other bodies. Encouragingly, the CEOs of firms such as **Google**, **Microsoft** and **OpenAI** have also chimed into this debate. What some may see as the pre-emptive involvement of the latter group is perhaps a reflection of their desire to smooth the somewhat fraught relationship between regulators and “Big Tech” in the past. This time around, there does seem to be a genuine willingness on the part of the corporate sector to engage on this topic, which should help the industry to avoid a knee-jerk regulatory reaction.

More tangibly, these concerns have surfaced across recent model

development in the form of a greater focus on “guardrails.” These safety features are designed to reduce the risk of unsavoury information leakage and improve the auditability of decision making. This direction of travel is clearly evident in the transition from GPT-3.5, which powers ChatGPT, to the upgraded GPT-4. Entire companies are now springing up dedicated to improving model decision making, understanding and auditing. Their success will be critical to winning over corporates, regulators and consumers alike. Trust and data accuracy are also paramount, as have been already highlighted by public concern around “hallucinations”, which occur when AI makes an inference (which could be medical, artistic or educational) that simply does not stack up. The ability to increase accuracy and reduce their frequency will be crucial to the speed of AI adoption in areas such as healthcare where the tolerance for error is extremely low.

Where will it have the greatest commercial impact?

The honest answer is we don't yet know. That's because no-one does. What we are fairly sure of is that AI will touch almost every sector, but some more than others in the short-to-medium term. As such, we are keeping a keen eye on its impact in a few specific spaces. One is firms that generate a lot of fairly menial, or

repetitive, work, particularly where it is built around text. AI's ability to summarise email threads or meeting recordings is already impressive. It can also distil huge volumes of information (for example, legal, numerical or medical) into key points and even first drafts. Some of these applications could be particularly transformative in industries that have historically struggled to profit from technological advances. This is perhaps because large volumes of critical information is stored on outdated, but essentially protected, infrastructure, or the existence of other barriers to productivity growth such as labour market frictions or inequality. In such a fast-moving space, we nonetheless cannot afford to “watch and wait” - anticipating where the next big changes will land will remain critical in investment terms.

How can investors get involved?

GenAI technology is new and developing rapidly. As such, we are still at the very beginning of what could be a generation-defining inflection point. Research contributions to this field are emerging from academics and corporates alike at a breakneck pace and we are seeing an ever-increasing willingness to adopt, and experiment with, AI. It is therefore inevitable that new markets will emerge that could completely subsume the existing opportunity set in their breadth and scale.

We therefore continue to believe that an intimate knowledge of the underlying technology will be required if an investor is to identify and act on the most compelling ideas. Just look back at the last twelve months during which the consensus shifted rapidly around infrastructure, in terms of whether companies should run GenAI in-house, or in the Cloud. Then there is the debate around the value of owning the underlying models – is it better to build a ChatGPT equivalent, or leverage existing large language versions? The answers will determine who are the eventual stock market winners and losers. That is why we think a fund, run by dedicated experts, is a sound choice for an investor who is fired up by AI's game-changing potential but remains unsure about how to best gain an exposure. ●





Desensitising portfolios

Mick Gilligan

Head of Managed Portfolio Services

Mick highlights a fund that should be able to absorb the impact of interest rate changes relatively well.

The fortunes of most investments are tied closely to the level, and direction, of interest rates. This is unsurprising, given that any future cash flows they generate are reduced, via a process known as discounting, to an estimated value now. The discount rate duly applied is driven by wider interest rates – as one rises, so does the other. By this logic, expensive stocks (typically trading on high valuation multiples) tend to suffer more as the bulk of their cash flows usually arise further into the future.

Which begs the question - what sorts of investment can reduce a portfolio's sensitivity to interest rates? I think the answer lies in securities which have drifted out of favour, attract lower valuations as a result, and yet are capable of generating solid levels of cash relatively quickly. Enter South Korean preference shares.

Heading east

These securities originated several decades ago when the South Korean government pressured local conglomerates to raise equity in order to reduce debt. Many management teams were happy to oblige, provided they retained control of their companies. Hence, they issued what we might label a non-voting ordinary share. These do not come with either a fixed dividend or a set maturity date. Instead, a Korean preference share typically offers a dividend that is incrementally higher than that available on the corresponding ordinary share, meaning it fully participates in any income growth.

The opportunity lies in the fact that a good number of these preference shares are available at large discounts. For example, at the time of writing, the gap between the two classes of share in LG Electronics is

over 50%, meaning the preference shares offer more than twice the yield on LG's ordinaries. Further, should the firm ever decide to repurchase them, given that their yield makes them a relatively expensive source of capital, a decent price uplift could follow.

Getting in

In my view, the best way to access these slightly unusual investments is via the **Weiss Korea Opportunity Fund (WKOF)**. Launched in 2013, its objective is to generate income and long-term capital growth from a portfolio of these shares. The fund itself is an investment company listed in London and managed by Weiss Asset Management (WAM). It employs fundamental and statistical analysis to find undervalued securities globally and has been investing in Korea for more than 20 years.

Specifically, the managers buy and sell preference shares based on certain criteria, including the level of any relative price discount, the dividend yield, and underlying liquidity. This strategy seems to be working - since launching in 2013, its net asset value has risen around twice as fast as the benchmark MSCI Korea 25/50 Net Total Return Index. See **chart**.

There should be further upside too, given that the WKOF portfolio trades at around a 50% discount to a comparable portfolio of ordinary shares. Key valuation ratios also paint an attractive picture in the context of a top 10 holdings list which includes Hyundai Motor Company (Vehicles), LG Electronics (Electronic appliances) and Amorepacific (Cosmetics).

Looking ahead

The wider backdrop, meanwhile, is benign. The Korean economy has ranked first in the Bloomberg Innovation Index for eight of the last nine years, having filed the highest number of patent applications relative to GDP in 2022. Further, its

sovereign debt is rated higher by Moody's, S&P and Fitch than that of Japan and the U.K.

Yet, none of this explains why the stock market has been so cheap. That can be laid at the door of poor corporate governance on the part of the major South Korean conglomerates. Fortunately, things are changing – in recent years the number of publicly traded South Korean companies subject to activist demands (many coming from local investors) has risen sharply. In 2020, none succeeded in getting their nominees onto the boards of target companies, whereas in 2022, 10 such campaigns were successful. Moreover, Korean legislators may look at widening the fiduciary duties of directors to consider all shareholders, rather than the narrower interests of 'the company'. The Korean Financial Services Commission has already put forward a plan to improve the dividend pay-out process of Korean companies to give investors better visibility.

WKOF vs MSCI Korea 25/50 Net Total Return Index



Source: Morningstar. **Past performance does not guarantee future results.**

Summing up

The Weiss Korea Opportunity Fund will not suit every investor. However, for anyone patient enough to bank the current dividend yield, whilst they wait for a pickup in the preference share market, it could offer some useful diversification. ●

Digging down

Luke Richardson

Fixed Income Analyst



This quarter, Luke answers some frequently asked questions about the Gilt Saver Service. Please note that tax treatments depend on personal circumstances.

How does it work?

This new Service was launched in September as a managed portfolio of short-dated UK government bonds (“gilts”) and other debt instruments (see below). The overall aim is to provide an attractive and predictable level of return while maintaining low capital volatility. This is achieved by a dedicated team of specialists who only invest in the highest quality short-dated sterling bonds with the aim of keeping both credit risk (i.e. default) and duration risk (a sudden change in yield) low. The fact that bond prices converge on a fixed redemption value over time means that short-dated bonds should trade close to their maturity price, further reducing the risk of a capital loss. The result is that even when bond markets sell off sharply, high quality bonds of the type we choose should suffer only relatively small price movements. Our bond portfolios are also constructed to be as tax efficient as possible, a feature that may attract investors seeking an alternative to a conventional cash account.

What types of bond can this Service hold?

The underlying portfolio is designed to maximise the overall returns from a diversified set of holdings. In addition to gilts, it can also house UK Government T-bills, other government-



guaranteed bonds, and bonds from supranational issuers.

How do gilts and UK T-bills differ?

Conventional gilts are by far the most common type of government “IOU” and most carry a fixed coupon and maturity date. UK T-bills, on the other hand, whilst also sterling denominated, do not pay a coupon and so their entire return comes in the form of a capital gain. That means they are issued at a discount to their ultimate redemption value, with maturities varying in a typical range of 1, 3 and 6 months – whereas with gilts, these tend to be longer and more diverse. Once issued, although both gilts and T-bills can be transferred in small denominations, the latter cannot be directly accessed by retail investors.

What is a supranational bond?

They are issued by entities which are formed by a number of governments in order to achieve a set of common objectives. As such, they are jointly state-owned and funded. For this reason, supranational issuers usually have very strong credit ratings. Managed according to an agreed mandate, the underlying bond issuers do not typically pay dividends.

One example of an organisation whose securities we hold is the International Development Association. As part of the World Bank Group, it is owned by over 170 shareholding countries. However, we can also hold bonds from issuers backed by a single government, such as the German development bank KfW. Government-guaranteed bonds usually come with the same high ratings as their guarantors.

Why are some of them rated more highly than UK gilts?

Gilts generally attract the same rating as the UK Government. Supranational issuers, on the other hand, are owned and supported by more than

one national government. As noted above, this means their overall rating will rest on a combination of the creditworthiness of the relevant member countries’ governments, the issuer’s own financial robustness, and the likelihood of additional future support being needed. That is why a supranational entity may be rated more highly than a national government.

How easily can money be withdrawn from this Service?

Normally, when one of our holdings matures we will rollover any proceeds by reinvesting in a carefully selected new position. That said, we can also facilitate regular cash withdrawals according to our client’s needs. In all cases, and for reasons highlighted earlier, although the risk of a capital loss at liquidation is not zero, as it is with a cash account, it is nonetheless low especially when weighed against the potential for higher yields.

How do yields compare to bank deposits?

It is important to appreciate that the yield earned by a Gilt Saver Service account will vary because the underlying bonds can change in price, albeit typically not by very much. However, that small price risk is offset by the fact that any profits earned on what HMRC terms “qualifying bonds” are not subject to capital gains tax. By contrast, the whole return on a bank deposit is potentially liable to income tax. As my colleague Peter notes on page 12, this difference can significantly boost the post-tax yield on a specific bond and, by extension, that of the Service as a whole, particularly for higher and additional rate taxpayers.

Where can I find out more?

Please speak to your Adviser if you would like further details, or for a link to our short explainer video. ●



Safeguarding consumers

Hardeep Chana

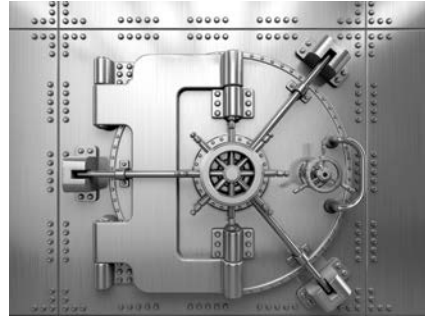
Compliance and Risk Director

Having joined the firm last summer, our New Head of Compliance and Risk explains how she sees the regulatory landscape evolving and what recent changes mean for our clients.

Why Killik & Co?

Some things in life are almost pre-destined to happen and me joining this firm feels a bit like one of them. I am the daughter of an entrepreneur who has always been a great admirer of Paul Killik. So much so that many years ago now the Telegraph's Money and Personal Finance sections were compulsory reading around our family's kitchen table. Back then we knew Paul as "the PEP (personal equity plan) man" who was busy encouraging savers to embrace the benefits of share ownership.

Subsequently, I studied Business Management at King's College London University before taking up a role at the regulator (then known as the Financial Services Authority). That opened up a fantastic opportunity to learn about different businesses, in terms of their mission, strategy, senior leadership, and approach to risk management. Indeed, I was only missing one key ingredient which was identified by my mentor at the time – I needed to go and experience compliance at the coal face. With that in mind I decided to join the industry in wealth management, principally because I was drawn to its blend of technical expertise and



client relationship management. Fast forward and my last role before coming here was at Rothschild & Co Wealth Management UK, as their Head of Compliance.

What are the main pillars of your job?

Firstly, I look to properly understand the business and how it is evolving, by which I mean the key decision makers. Then I step back and think clearly and independently about the firm's strengths and weaknesses from a risk perspective. And thirdly I advise the Partners and other staff on the wider considerations of regulation, risk and achieving good client outcomes. This might involve co-ordinating further training, alongside the implementation of controls around anything from basic data handling to more advanced cyber-security. Above all, though my role is about ensuring that everyone in the firm understands the importance of maintaining the highest levels of service for our clients whilst safeguarding their interests. The bottom line is we need to be client-focused and well-controlled so that we protect our hard-earned reputation in this market.

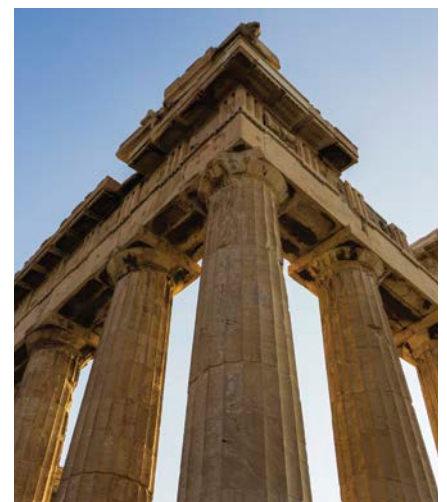
In terms of how I organise my team to achieve this, I can pick out three main areas of focus. The first is anti-money laundering, a key function that is all about making sure that, as a firm, we only take on the right clients whose identity and source of wealth we can

fully verify. Next, conduct of business. This is centred on continuously raising our standards and carrying out our regulatory duties so that clients are invested in suitable services, those with vulnerabilities are properly supported and any concerns are looked into thoroughly and fairly. Then there is risk, which is all about getting the right internal controls in place to protect clients and their assets, as well as safeguarding the business.

How is compliance evolving?

Like the wealth management industry itself, compliance doesn't stay totally static for long. For example, alongside the wider industry, the firm is moving towards a greater focus on life's "pivot points". These can include deciding to start a family, grappling with how to fund life after work, or entering the phase of life where care costs may become significant. I have to make sure that we blend the right business approach with our regulatory obligations so that our clients' interests are protected.

More specifically, with an FCA Consumer Duty hat on, we need to ensure that every solution we propose represents value for money, involves the right products and services, is



readily understood by our clients and comes with the right level of support for them. On that last point, we must be prepared to provide more when we notice that an individual is vulnerable, whether triggered by ill-health, a bereavement or old age. For example, if someone is about to go through important medical treatment, we can help by ensuring that the relevant conversations about how they are set up financially and the changes that might be necessary, are happening on a timely basis. This is our chance to show clients why they were right to spend time building a relationship of trust with us.

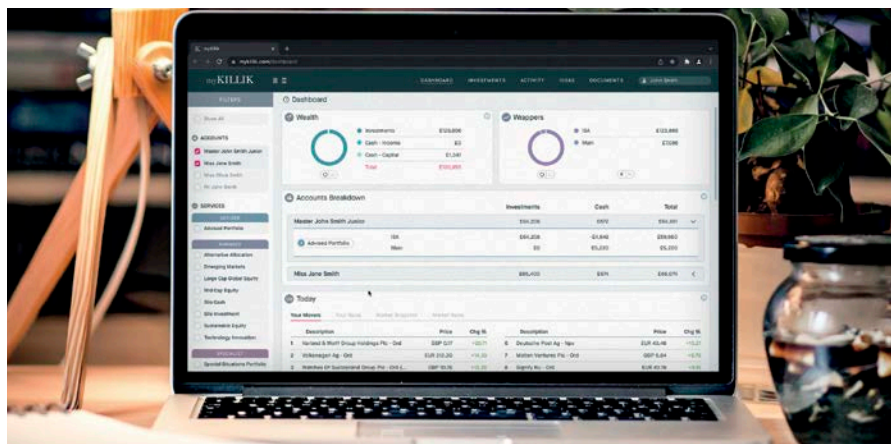
What has been the impact of the FCA's Consumer Duty regime?

As a firm, we were well-placed for it, in so far as our longstanding client-centric approach can only be strengthened by the latest rules. Indeed, they have given us another chance to reflect on how we best serve people and make some incremental but important improvements to the way we operate. As ever, these are based on our instinctive understanding of a client's needs, built on decades of experience, plus any specific feedback we receive from them.

As for some examples of recent changes, the way we are evolving the presentation of our Services should continue to make them more easily understood and accessible. Some clients will also notice us reaching out a little quicker if we become aware of a potential vulnerability that requires additional care and support. And, of course, we are always looking at ways to enhance our longstanding commitment to financial education as a way of building trust.

How are we keeping people safe online?

There's no doubt that the opportunity for clients to operate digitally in the wealth management space is expanding quickly. Here, for example, we offer online engagement via our savings app, Silo, and the bigger client portal myKillik. In terms of security, we rely on an extensive blend of hard controls (which activate when we first communicate login details for example)



alongside a continuous effort to inform and coach users on everything from password control to safe navigation around our digital tools. One area where we have to stay constantly alert to the potential risks is online scamming and we must ensure that our clients are too.

What does the regulatory future hold?

An ongoing focus on Consumer Duty is a given. We are constantly responding to a mixture of data and client feedback to ensure we have the right controls in place. These need to be well understood, internally and externally, both in terms of how they operate and what they are designed to achieve.

Alongside that, we continue to run a tight ship on financial crime, particularly when it comes to understanding the origin of funds we take on and manage.

Meanwhile, we need to be aligned with the FCA's drive for greater diversity and inclusion. Like the regulator, we are part of a journey which ensures the wealth management industry is sufficiently balanced and fully reflects the way wider society is evolving.

Then, of course, there is AI. Whilst its regulatory status is still being discussed, and at what is a relatively early stage, there is no doubt that it could transform some of the ways we currently operate. I can already see the scope for change in areas ranging from client risk profiling to customising products and solutions at scale. AI should also be able to absorb some of the more routine work that can keep an Adviser unduly distracted from the all-important direct contact with a client.

Along the way there will, of course, be new risks to manage in areas such as data security and the wider strategic integration of AI with human advice. But, as long as it is deployed and managed correctly, the overall impact should be positive for both the firm and our clients.

How do you unwind from a demanding job?

In short, by pursuing my passions outside the office. For me, a big one is the arts – living near London leaves me spoilt for choice on that score. Top of my list of artists is Auguste Rodin. Passion number two is hiking. Give me a good hill (the steeper the better) plus my trusty boots and you won't see me for dust! My favourite walk to date has to be the Great Wall of China, which took five days to complete. Next, I love travel. Whilst it's hard to pick out my preferred destinations, the Arctic Circle and Far East are hard to beat for sheer variety.



Finally, I love spending time with my wider family. I feel very fortunate that we are able to support each other through life's many joys and challenges. ●



Paying for education

Will Stevens

Head of Financial Planning

Will highlights the growing problem of funding private school fees and discusses some of the ways families can mitigate the cost. Please note that tax treatments will vary with personal circumstances and the rules may be subject to future change.

How big is the school fees challenge?

It depends on a range of factors that include the location of a school and whether, or not, a child boards. As an illustration, published annual day school fees for Manchester Grammar School are just over £15,000, whereas at St Paul's School in London, the number is more like £30,000. That rises to almost £45,000 for boarding. What's more, fees at all schools tend to rise faster than the general rate of inflation. And remember that these costs come out of post-tax income. Then there is the issue of what may happen under a future government should a 20% VAT uplift come into force after the next election (see box).

Can families reduce the number of years they pay for?

Yes, in short. However, some of the options that follow are quite emotive and depend very much both on individual circumstances and the aspirations of the children, parents (and potentially grandparents) involved. In some families I meet there is an ongoing debate about whether every child should attend private school. Parents may, for example, prioritise a child whom they feel will benefit from smaller class sizes and more one-on-one attention. Others may take the view that the eldest should go regardless, with a view to reviewing affordability for younger siblings further out.

Then there is the decision about the best entry point, which might be 5+, 8+, 11+, 13+, or sixth form only. In areas where there is a decent non-private primary or secondary school, some parents will try to get their children into them with a view to switching later to save on fees in the early years.

Separately, there is a choice to be made about boarding versus day schools. Sometimes I meet couples grappling with whether to send their children to a remote boarding school, as opposed to a day school closer to home.

What about funding?

Once we understand a family's intended educational pathway, there are a number of financial options to explore.

Certain children may qualify for a school bursary. These are given for different reasons and the reduction in fees might be anywhere between 10-100% depending on the school and the child.

For other parents, fortunate enough to have a lump sum big enough to cover school fees all the way through, there are benefits in paying up front to bring down the total amount.

Many parents are not in either camp, however, and end up paying as they go along out of either one, or two, household incomes. Where there is still a shortfall, they may need to weigh up some tough trade-offs such as:

- Deferring the age at which they plan to stop work
- Changing the family's saving priorities away from, say, funding a first home for each child
- Advancing money that would have been inherited later from grandparents
- Cashing in investments early
- Deferring paying down a mortgage, or even extending it
- Using the tax-free cash available from a private pension.

How do we add value?

Our role is to help families to identify and weigh up the variables that will influence school costs and model the impact of any funding choices in the context of their other commitments. Private school fees are such a huge part of many

parents' future financial plans that we are regularly contacted by people who already have children going through the system, or who will do so in the near future. One good thing from a planning perspective is that the timing of fees can be predicted from the moment a child is born, and we can then make some assumptions about the potential cost.

We can also help with areas such as risk management should one, or both, earners fall ill or lose a job and get involved in what may be contentious family conversations about inheritances and the scope for releasing capital early. Finally, there are various tax-efficient routes open to clients who plan ahead – the earlier these are considered, the better. ●

Asking parents

We recently ran a survey on how families are coping with the rising cost of school fees. Here is a snapshot of the results. To discuss these further, please contact your Adviser.

Amongst existing fee-paying parents:

- 24% are struggling to afford private schooling
- 18% are being supported by the "Bank of Grandma and Granddad"
- 17% are sacrificing future financial support for their children to cover fees.

If VAT is introduced:

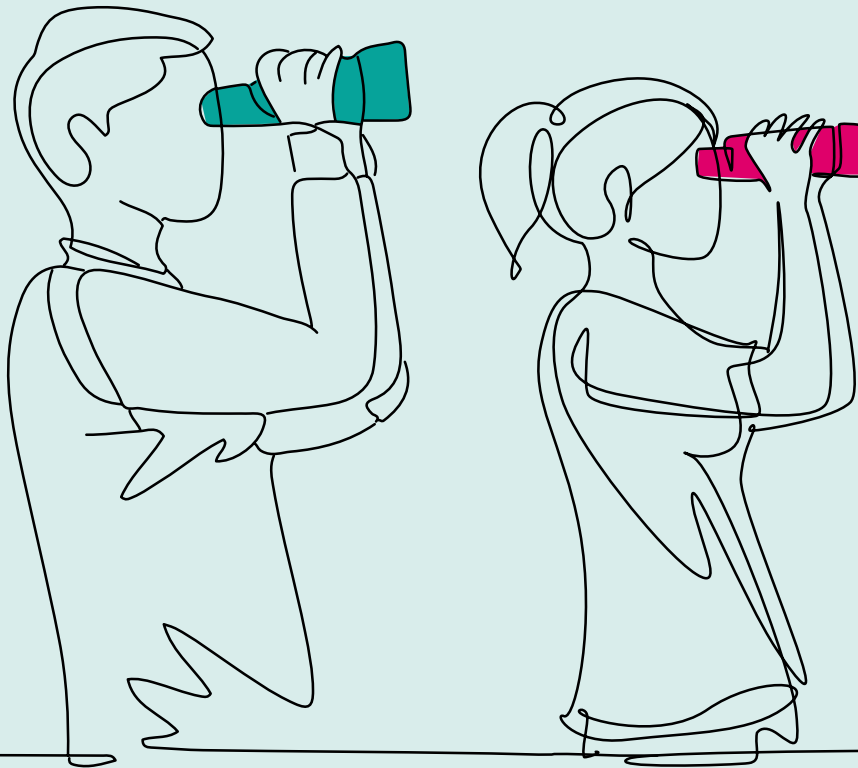
- 27% will look to make savings elsewhere
- 16% will investigate up-front lump sum payments
- 13% will consider selling investments
- 13% will seek further help from other family members
- 15% may pull their children out of private school altogether.

Two experts. One focus.

For maximum financial foresight, we believe two heads are better than one. At Killik & Co we offer an integrated Adviser Team that harnesses both **financial planning** and **investment management** expertise to give you the clarity you need.

To learn more about how we have helped clients like you, watch our Two Experts videos in myKillik.

Capital at risk.



— Save — Plan — Invest —

KILLIK & Co

— for your future —

We may not be the biggest.
But we're proud to be the best.

Voted Best Discretionary/Advisory Wealth Manager 2023 and Best Full SIPP Provider 2023 by readers of the Financial Times and Investors' Chronicle.

It's never been more important to make sure your savings and investments match your long term needs.



Capital at risk. Past performance is not an indication of future performance. Tax treatment depends on individual circumstances and may change in future.

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