

Speirs & Jeffrey Stockbrokers

Winter Newsletter 2010



Sector focus on
utilities

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Looking back over
ten turbulent years

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Speirs & Jeffrey has over one hundred employees all working from our office in Renfield Street in Glasgow. Here we would like to give you a flavour of some of the people behind the scenes.

Introducing Susan Gordon



Susan joined Speirs & Jeffrey in 2007 and is a member of the S&J Securities team. This team focuses on institutional investors such as leading fund managers and the primary focus of Susan's role is to identify investment ideas.

Brief Career History:

After graduating from Glasgow University as a Bachelor of Accountancy in 1984 I joined Peat Marwick Mitchell in Glasgow as an apprentice Chartered Accountant. I qualified in 1987, worked for six months in the Paris office on secondment but returned to Glasgow to move out of the profession and into commercial life. I joined Allied Provincial Securities in 1988 and worked on a variety of

corporate finance transactions. In 1990, I joined the institutional sales and research team at Allied Provincial and have worked in the small and mid cap institutional stockbroking arena ever since.

Why did you join Speirs & Jeffrey?

In 2007 I was working for a London-based small cap broking firm which had expanded rapidly in providing services for Alternative Investment Market companies and my colleagues and I felt increasingly marginalised by this focus. We had long recognised that Speirs & Jeffrey had a very similar ethos to our own - to focus on the needs of the client at the heart of the business. When the opportunity arose, I was delighted to move. Investment decisions are made on the basis of independent, thorough research and a reasonably long term investment perspective. The much greater experience of the S&J research team in large cap and overseas stocks has also been complementary to our own small and mid cap bias.

What do you like best about your role?

There are two aspects of the job which I most enjoy. Firstly, I have the benefit of access to senior industry figures to discover firsthand information about a company, its management and plans for the future. Secondly, I enjoy the challenge of communicating a great investment idea to an experienced institutional fund manager in the space of a time-constrained telephone call.

Tell us about one of your more interesting meetings?

Site visits are an integral part of forming an investment view on a stock. Over the years I have visited all sorts of manufacturing facilities, including sausage skin factories, polythene bag manufacturers, five-a-side football facilities, magazine and book wholesalers and pretty much everything in between! Some are more interesting than others and the opportunity to wander around the studios and back lot of Pinewood Shepperton late last year was a highlight.

Personal details:

I am married with three early to mid teen children and have lived in the west end of Glasgow for the last twenty years. My husband is a finance director also based in Glasgow. My children tell me that this makes dinner table conversation incredibly dull unless they intervene with some chat about The X Factor or the merits of the latest PlayStation games!

Hobbies:

I have always been involved in family activities and for the past several years I have been treasurer of a local community sports club. I like to go to the gym on a regular basis and also go running with a friend whenever the weather permits. In 2009 I completed the 5k Race for Life with some colleagues from S&J.

If you hadn't been an investment professional, what would you have been?

I would have liked more time to study English literature. Alternatively, I would settle for being Cheryl Cole!

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SECTOR FOCUS: Utilities

The utility stocks have underperformed the UK stock market over the last twelve months. At first sight this is surprising since many of the shares offer attractive dividend yields, but the companies also carry substantial debts. Recent market conditions have made investors cautious and focused their attention on 'recovery stocks'. Utility shares have suffered because of their unexciting image.

There are several types of utility companies in the UK. Water companies have their operations focused on the UK, with the share prices driven by the prospects for the next review by their regulator. Others like Centrica (the owner of British Gas) and the electricity transmission company National Grid have significant interests in North America. We also research the German group RWE. While the bulk of its operations are in Germany it operates in other European countries (in the UK it is the owner of the electricity distribution business npower).

A recurring theme in the industry is the drive towards renewable energy. This includes the use of wind power and hydro electric plants but also plans for nuclear power stations. At present, most of the UK's electricity is generated from gas or coal but Centrica and Scottish & Southern Energy are members of consortia with medium term plans to build nuclear facilities. The British

authorities are concerned about increasing reliance on gas supplies originating in the former Soviet Union. Referring to the risk of gas supplies to the West being disrupted the chief executive of RWE noted recently that 'a warm living room cannot be taken for granted.'

The industry has also seen a move towards consolidation. In the UK nearly all the companies created by the privatisations of the early 1990's have been swallowed up into larger groups, but there are still opportunities for acquisitions of medium sized utilities in the US. The condition of the existing electricity distribution networks in the UK and US is debatable, but there is need for considerable ongoing investment to keep the lights burning in homes and offices. This investment will only be made if the operators are allowed a reasonable rate of return which in turn feeds through to their shareholders. The utility companies realise the responsibility to their investors is to deliver sustained growth in the dividend. A policy of steady medium term dividend increases is welcome.

We think utility groups should have significant, but not excessive debt on their balance sheets since they generate solid and predictable returns from their assets. We expect utilities such as Centrica, National Grid and Scottish & Southern Energy to return to favour in due course.

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Capital Gains Tax 2009/10

With the end of the tax year approaching, it is time to consider capital gains tax planning. The timing of Easter means the last business day this tax year will be Thursday 1 April. Clients should prepare and confirm their CGT position with tax accountants in good time before this date.

Speirs and Jeffrey's comprehensive annual CGT note is available online at www.speirsjeffrey.co.uk. This can be viewed or downloaded. Please note however that from this year onwards the note will not be automatically printed and posted to all. If you would like a printed copy please contact us.

- The annual capital gains tax allowance (CGT) should be utilised where appropriate, both to ensure that portfolio balance is as strong and relevant as possible and that base costs are raised to ensure maximum future flexibility. This has particular importance as we face the probability of a steep increase in the rate of CGT soon. At present the CGT rate is 18%, but a number of leading accountancy firms suggest that this may not persist for long given the UK's dire fiscal deficit.
- The personal CGT allowance for 2009/10 is £10,100 (£5,050 for most trusts). Indexation and taper relief were withdrawn in April 2008 and gains are now calculated 'straight'. Net gains above the allowance are charged at a flat rate of 18%. Any asset acquired before 1 April 1982 is rebased to the asset's value at 31 March 1982.

- Portfolios should be balanced to diversify risk. Use should be made of established brought-forward losses not utilised. Current unrealised losses should also be considered and potentially crystallised to address other areas where longstanding gains are embedded and portfolios therefore still lopsided.
- There is still scope to use current CGT freedom to transfer assets tax-free between spouses and between civil partners. This concession may not remain available indefinitely.
- For many, ISAs offer sanctuary from CGT with particular advantage for those on higher rates of income tax. One route to fund an ISA subscription can be via Bed & ISA 'transfers'.
- Those currently fifty or over can subscribe up to £10,200 into ISAs now, while for others the limit this year is £7,200. As from 6 April 2010 the allowance will be £10,200 for everyone over eighteen. With the backdrop of increasing taxation on non-ISA holdings and tighter constraints on pension contributions - consider making new ISA subscriptions.

As ever, S&J will be delighted to be as helpful as possible with CGT assistance. Please remember however, that S&J are stockbrokers rather than tax accountants and we are keen that clients involve their tax advisers where appropriate.



Ten Turbulent Years

by Alastair Hunt

Looking back on the “noughties” decade, investors have suffered more than their fair share of trials and tribulations. The decade began with the tail end of a modern day dot-com bubble and ended with an old fashioned banking crisis.

In 2001, stock markets had already turned down and were in the grip of a severe bear market when the World Trade Centre was attacked. In an attempt to stem the panic, central banks slashed interest rates to emergency low levels but in doing so, sowed the seeds of the greatest credit boom in history - and the subsequent credit crisis we are now suffering.

From the trough in 2003 to the peak in mid 2007, all asset classes rose in tandem, but this time the focus for the general investing public was property. Fuelled by cheap debt offered by banks which had completely disregarded the borrowers' ability to repay, investors jumped on the property bandwagon, certain that prices could only go one way. It was only when the sub-prime borrowers in the US started to default on their expiring “teaser rate” loans that the cracks began to appear in the system.

These loans, which had been converted into bonds and complex derivatives, were sold to banks and financial institutions around the world. Such actions did not change their toxic nature. Reassured by the historically low default rate on US

home loans, these bonds were snapped up and used as collateral by banks to create even more loans. When it became apparent that default rates were soaring, the value of debt held by banks around the globe was called into question and lending between banks froze. Some of the oldest names on Wall Street folded and in the UK we witnessed the first run on a British bank in over a century. Instead of marking the worst of the crisis as many had thought, this was just the beginning. A house of cards was collapsing and governments were forced to pump billions into the system to prevent financial meltdown. This process is still ongoing today, albeit out of the glare of public view.

The great unknown is whether the engine will keep turning once the jump leads are removed.

This time round, in eerily reminiscent fashion to 2001 central banks have again cut interest rates to historically low levels. However, the level of stimulus employed as a proportion of GDP has far outweighed any other period in history, even the period post the crash of 1929. Now that stock markets are again rising and credit in the banking system is beginning to thaw, Western authorities are believed to have done enough to save the system. The great unknown is whether the engine will keep turning once the jump leads are removed.

Having been burned by two bear markets in just ten years, investors would not be blamed for thinking that long term equity investment is fatally flawed. This would certainly be the case for those who had invested their hard earned cash in equities back in 2000, when equities were overvalued. Adjusting for inflation, the annual return on the FTSE All-Share has been minus 1%.

Over the decade, other assets have been superior. After inflation, the best performer has been gold, returning an annual 11.4%. This was followed by property, returning 5.3%

despite the decline in 2008. Even corporate bonds (3.1%) Government Gilts (3.3%) and cash (1.3%) have beaten equities in the last decade, highlighting the importance of diversification.

Markets will recover eventually long before the real economy turns.

So why bother with the risk and potential sleepless nights of holding equities? The past ten years have been highly unusual and you would have to go back to 1941 to find a ten year period as bad. Looking back at twenty, thirty and forty year periods, it is clear that the longer you hold stocks, the more likely it is you will materially profit. Investing at the end of a lost decade can provide spectacular returns: investors who took the plunge at the end of 1974 made 149% in 1975. 2009 also ends on a more positive note after a substantial 54% rally since the spring. When a severe market shock forces excess

capacity out of the system, solid companies can flourish in an environment with less competition from weaker rivals.

Worries over run-away inflation or a government debt default are perfectly logical but could take years to materialise. No matter how challenging or uncertain the current environment, markets will recover eventually and long before the real economy turns. Valuations may not be as compelling as the market bottom in March 2009 but many fundamental measures suggest that equities are still worthy of consideration for long term investors, particularly as a means of protecting purchasing power against the ultimate ravages of inflation.

Stock markets will always be driven by fear and greed which is why the boom-and-bust cycle cannot be eliminated despite what some politicians may believe. It is a natural, self-regulating mechanism of our capitalist society but one which has been distorted by continual government intervention and hence is so difficult to predict.