Radnor View

Hope for the best, plan for the worst

11th January 2022

I don't know what is happening in the country as a whole, but certainly in my bit of London (Blackheath), life this weekend appeared to be reverting to "normal". The gym was heaving, its car park nearly full and the streets and the farmer's market were at capacity. It is hard to believe it was last like that a whole two years ago. With Covid developments seemingly on an improving trend, the consumer background in the UK at least in the short-term looks set fair.

However, last week's trading update from Next (NXT-LON) outlined five areas of economic uncertainly which made forecasting for them *"unusually difficult".* These were:

Pent-up demand & savings	To what extent has the buoyancy of the last nine months been the result of pent-up demand combined with the spending of savings accumulated over the pandemic? How much of this will reverse out as we move through next year?
Travel and leisure	Will the return to spending on overseas holidays and other social activities depress demand for discretionary goods?
Essential goods inflation	To what extent will inflation in essential goods and services (fuel, electricity, food, etc) reduce discretionary spending on clothing and homeware?
NEXT goods inflation	To what extent will the inflation in our own selling prices, estimated at around 6% in the second half (see below), serve to depress the demand for our products?
Tax and interest rates	To what extent will the 1.25% increase in National Insurance and possible increases in mortgage rates affect discretionary spending?

All good questions and an honest appraisal from a company that has turned guidance into an art form. To the list above, we could also add **global supply chain issues** which have been a factor in a number of downgrades/profit warnings in the last three months.

These are issues that all companies should be addressing, but many of course will choose not to be quite as overt as Next. But they cannot be ducked, because investors are going to be probing for answers so careful consideration needs to be given to the structure of results statements, in particular any Outlook section.

Don’t be an ostrich……

Investors like management teams to be insightful, proactive and honest*. They need to understand the dynamics of the business and the factors affecting it. Even if there is a short-term issue detracting from performance, over the longer- term these management qualities will be rewarded.

While forecasting a problem may not be valuation enhancing, remember, that approach is far less value-destructive (to both price and reputation) than pretending it is not there and being forced to ‘fess up’ later on. Do not put yourself in the position of needing to answer the question “why didn’t you tell us?”

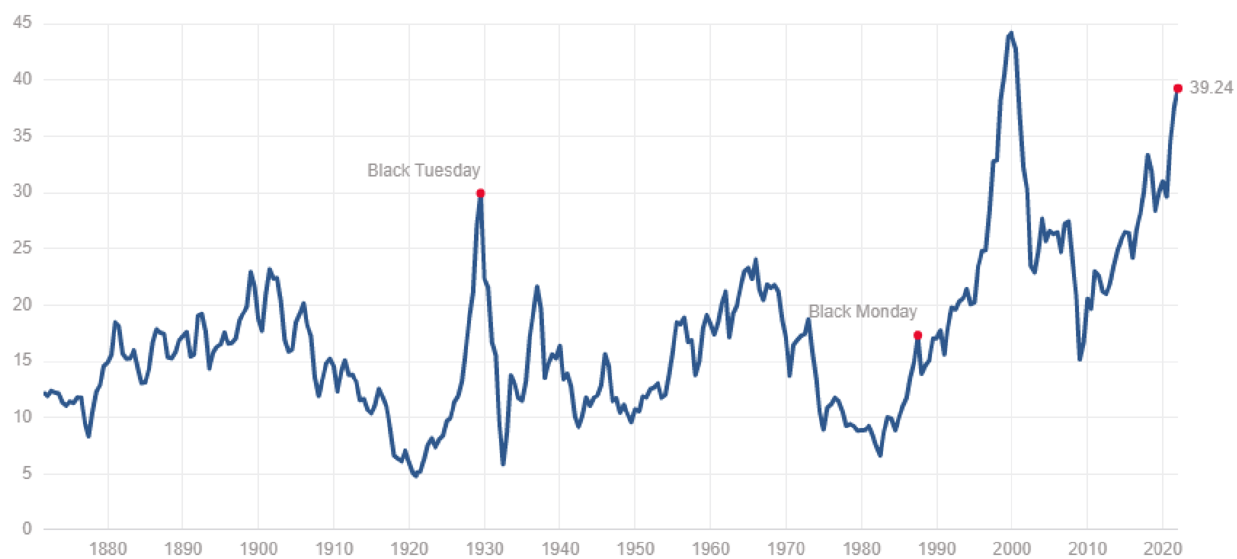
Radnor works closely with its corporate clients on exactly these type of considerations. Being up-front and honest is an attitude that enables companies to differentiate themselves and *ceteris paribus*, achieve a better rating.

** and failing that, lucky!*

….get out there!

Of course, the big discussion right now is focused on the path for inflation and interest rates and what this means for the outlook for markets globally. As I was fast-walking on the treadmill at the aforementioned gym, the FT (some credit where it is due) provided some thought-provoking stuff.

There are plenty of reasons to worry about the US market in particular, from rising energy prices, the bubble characteristics of SPACs, tech stocks (60% of the growth stocks in the Russell 3000 index make no money..), the absolute P/E (see chart) and the Fed tapering that is set to occur.



Source: Shiller

The UK market is generally regarded as ‘cheap’ (no big tech stocks, Brexit overhang etc) but any unwinding in the US market will inevitably have an adverse effect as global markets are rarely out of sync. Investors in equities could go very “risk-off” in 2022, at least for a short period, so what should companies do to plan for this (remember the title)?

Aside from being very upfront and clear in messaging (see above) this is a time when an extra effort is required to get in front of potential new investors, especially if you do not enjoy the greatest liquidity in your stock already. If one or more of your key investors is forced – through liquidity issues of their own (fund outflows for example) – to sell, then it is of enormous benefit to have some potential buyers waiting in the wings. There have been examples in the last couple of years of “capitulation sellers” wreaking havoc on individual share prices and it is not a position that you want to be in. Share price recovery can be very protracted and option packages can quickly submerge, never to recover.

Looking outside of the “normal” pool of institutional investors is critical because if the markets sell off, it is likely that a lot of fish in that particular pool will be swimming in the same direction. Finding alternatives is not always easy though and it takes time to build a relationship – investors will rarely buy just on the back of one meeting. Planning a structured investor engagement programme that works, takes time.

Market risks may be increasing, but this means more than ever that it is a time to be looking out and not in.

This is where a specialist like Radnor will add value. Our institutional contacts are deep and wide, from the very large to the very small, from behemoth to boutique, from the familiar to the esoteric. Hidden pools have more interesting fish!

And finally....as a reward for getting this far...two topical questions..

What variant of Omicron might make you stupid?

And

If Alpha = 117, Beta = 1,351, Delta = 16,172 then Omicron = ??

Answers by email, any prize will be dependent on who wins 😉

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ENDS.