MARKET INSIGHT

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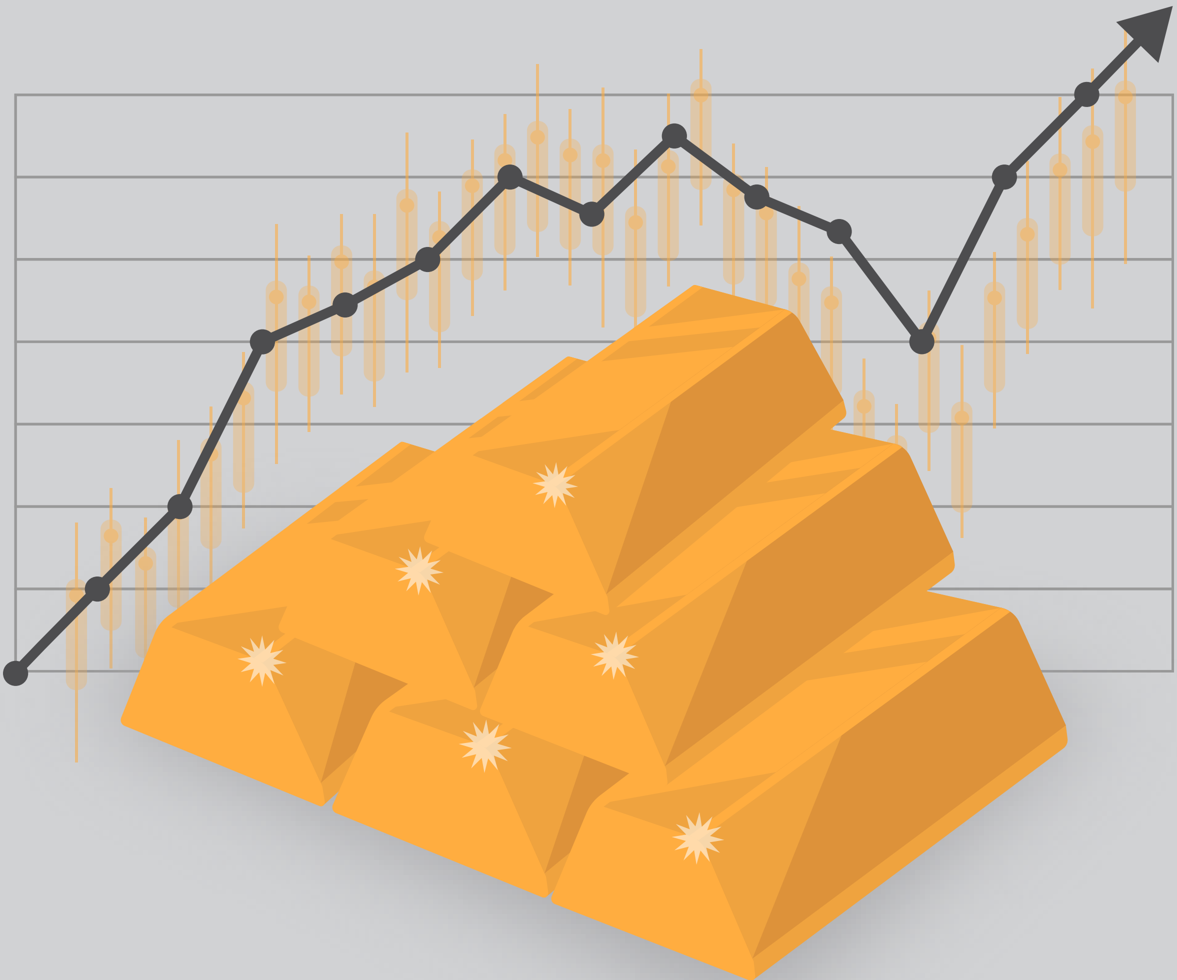
Upward Momentum



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UPWARD MOMENTUM

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER

Just six weeks on from 'Liberation Day', several significant developments have kept investors on their toes. News of a trade deal between the UK and US was positive but quickly overshadowed by a de-escalation between the US and China. The US Federal Reserve reached the unsurprising decision to hold the target interest rate steady, while the Bank of England's decision to reduce interest rates by 25 basis points to 4.25% at its May meeting caused some volatility. Bond markets had been expecting aggressive rate cuts, but the split decision caused a re-setting of expectations and declines in gilt prices.

While US equities show flat performance for 2025, UK equities are showing positive returns with the FTSE All Share and Deutsche Numis Smaller Companies (excluding investment companies) indices gaining 6.1% and 1.6%, respectively. Investor attention appears to be turning to the UK, with BlackRock, the world's largest asset manager, reportedly buying positions in UK assets across the board. Additional positive headlines come from the reporting of an agreement by UK pension funds to invest 5% of assets, an estimated £25bn, in UK private assets. Sentiment of the announcement is positive, but only time will tell as to the successful deployment of earmarked assets.

For our Stock Focus article, Imperial Brands, the UK listed tobacco company, is under review. In March, the company held a capital markets day, outlining business strategy for the coming five years to 2030. The announced targets are a continuation of the previous five-year plan, aiming to increase market share, grow earnings at high single digits, and distribute billions of annual free cashflow to shareholders via dividends and share buybacks. Success has been proven, with five-year shareholder returns of 166.01% at the time of writing, proving there's significant money to be made in an ex-growth sector with successful planning and execution.

Gold takes focus in this edition's Insight article given strong recent performance of 23.3% in 2025 thus far and 78.5% over the last three years. The asset divides opinion, with some viewing the precious metal as a hedge, or protective position, against both inflation and political volatility, while others, such as famed investor Warren Buffett, argue against the non-productive asset. Either way, holders of the precious metal have benefitted from the strong upward price momentum which has likely been driven by the 'safe haven' nature of precious metals and technical drivers of central bank buying. Whether there's more upside remains to be seen.

Overall, financial markets look to have broadly recovered from the shock of announcements in early April, with European and UK equities providing strong performance. The effects of tariffs remain unclear, despite the recent de-escalations, and will take time to feed through into corporate earnings and economic growth rates, which could produce further volatility through the remainder of 2025.

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STOCK FOCUS

IMPERIAL BRANDS

RUTH HARRIS | INVESTMENT RESEARCH ANALYST

When evaluating an equity opportunity, many investors focus on growing industries which offer opportunities to benefit from long-term market trends, such as the growth of technology, demographic change, or the shift to renewable energy. The extended market gains we saw through 2024 were bolstered by excitement about AI adoption and the growth potential of the large technology companies. It is curious then that the FTSE 100 tobacco company Imperial Brands has driven a shareholder return in excess of 75% over the last five years, despite a declining market and limited growth opportunities. In the UK, the sale of cigarettes and other tobacco products has been steadily declining since its peak in 1974, as consumers become more cognisant of the health impacts, excise duty increases, and the regulatory environment has become significantly stricter. While some peers have greater exposure to Asia and Africa, Imperial Brands derives the majority of its revenue from the UK, USA, Germany, Australia, and Spain, but has successfully delivered returns to shareholders despite operating in declining markets.

Imperial Brands is the fourth largest tobacco company globally, headquartered in Bristol with a history dating back to 1901. It has 30 factories worldwide and sells across 120 countries. Traditional combustible tobacco products remain the key driver of revenues, with brands including Davidoff, JPS, and Golden Virginia. In 1997, it bought the French producer of rolling papers and paper tips, Rizla. It also has a smaller growing presence in next generation products (NGP), with e-cigarette brand Blu, heated tobacco Pulze, and oral nicotine Skruf and Zone.

> *"While underpinned by a well-managed strategy, the investment rationale for Imperial Brands rests on the cash generated by the business and strong returns to shareholders."*

In 2021, Imperial Brands announced a five-year strategy aimed at improving its competitive standing and shareholder returns. It identified the five priority markets of the UK, USA, Germany, Spain, and Australia, where it aimed to maintain aggregate market share despite shrinking demand. Within those markets, the company identified key differentiated brands and consumption trends. Especially in NGP, there is significant variations in demand due to different regulatory and cultural environments. The company renewed its focus on the consumer, aiming to deepen understanding and relevance to those already consuming its products, as opposed to chasing broad-based appeal and losing strategic focus. While the traditional combustible business remains the focus to support profits and cash delivery, the company also looked to scale its offerings in NGP to offer additional growth opportunities. The strategy has been supported by stronger investment in technology, data, and the workforce, with results over the last 4 years demonstrating success across strategic objectives. Prior to 2021, Imperial Brands was giving up market share across the focus geographies but has since stabilised and is now growing market share.

While underpinned by a well-managed strategy, the investment rationale for Imperial Brands rests on the cash generated by the business and strong returns to shareholders. At a share price of £27, the company offers a dividend yield of 5.68% and has recently announced a shift to paying out four equal instalments through the year, offering shareholders greater predictability of dividends. In addition, Imperial Brands is active in repurchasing shares, and retired 9% of share capital from October 2022 to May 2024. It is targeting an additional £1.25bn share buyback in the 2025 financial year, with £620m completed so far. The company has an 'evergreen' buyback program, where it will repurchase shares every year through to at least 2030. The strong dividend may be attractive to income seeking investors, while the buybacks support earnings per share as the number of shares in issue decreases over time. The combination of dividend yield and buyback yield results in a total yield of 9.03%.

The company recently released interim results for the six months to 31st March 2025, demonstrating continued resilient performance and progress on strategic initiatives. In aggregate, Imperial Brands gained market share across its five priority regions, with constant currency adjusted net revenues from tobacco and NGP up 3.2%. Tobacco pricing increased by 5.9% despite a 3.2% fall in volumes, which were better than consensus expectations. NGP continues a strong trajectory, with net revenues up 15.4% and growth in all three categories. The company reiterated its guidance for the financial year of low-single digit growth in tobacco and NGP net revenues, and mid-single digit adjusted operating profit.

Despite results in line with expectations, shares have fallen sharply on the unexpected retirement announcement of CEO Stefan Bomhard, who has successfully driven the strategic turnaround since 2020. He is set to be replaced by current CFO Lukas Paravicini, who joined in 2021 from agricultural commodities and brokerage group ED&F Man Holdings, with extensive experience at Fonterra and Nestlé. With the surprising nature of the retirement spooking the market, investors will be looking for signs of effective strategy execution under the new leadership. ■

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INSIGHT

THE GOLD RUSH

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER

Amidst recent market volatility, few asset classes have shone brighter than gold. Over the last year, the precious metal has risen 37.8%, capturing the eye of investors looking to cash in on the upward price momentum. Often seen as a 'safe haven' defensive asset and hedge, a protective position, to both inflation and geopolitical volatility, many make the case for its inclusion in portfolios. Others, however, take the opposite side, reluctant to allocate funds to what they consider an unproductive asset.

Taking stock of performance, those with long-term holdings in the asset have benefited. A recent London Stock Exchange Group (LSEG) research paper indicated a multi-asset portfolio with an allocation to the precious metal would have generated both higher absolute and risk-adjusted returns compared to a portfolio with no gold allocation between 2010 and 2025. Interestingly, the divergence of returns between the two portfolios outlined in the paper became evident during 2022 amidst the increases in inflation that caused considerable underperformance of the traditional 'safe haven' assets such as government bonds. During this period, gold proved its ‘safe haven’ nature, producing flat returns for the 2022 calendar year, while a UK government bond index lost more than 20% of its value.

“In assessing the appropriateness of gold as an addition to a portfolio, multiple considerations are required... Claims of the asset being a hedge for inflation are less clear, with studies neither supporting nor rejecting blanket claims.”

While gold proved stable in 2022, returns still lagged behind the rate of inflation, calling into question the inflation hedging capabilities of the precious metal. A simplistic view may be that an inflation hedge should move with inflation, in that when the inflation rate rises, so should the price of the asset. One entry to the CFA Institute’s blog sought to test this relationship for gold. Taking data from 1979 through to 2024, the author found an unstable relationship between the gold price and inflation, with periods where the relationship is both positive and negative. The previously mentioned LSEG research paper also tested the relationship, finding that gold produces its strongest returns in moderately high inflationary periods of 0.4% or higher monthly and that while inflation is a key input, it’s not the sole force driving performance.

Aside from inflation, other influencing factors include retail, technological and investor demand, alongside central bank buying. The latter has reportedly been a significant influencing factor on gold’s performance. In its recent gold demand publication, the World Gold Council indicated significant increases in the level of central bank demand with the 5-year quarterly average volume of net purchases eclipsing the longer-term average prior to 2022. Key buyers include the National Bank of Poland and People’s Bank of China, looking to bolster strategic reserves. Investor demand also remains buoyant, with financial services provider State Street and the World Gold Council indicating significant increases in assets under management within global gold exchange traded funds.

In assessing the appropriateness of gold as an addition to a portfolio, multiple considerations are required. Strategic demand from central bank buying remains strong against inelastic supply and providing long-term support for the asset price. Investor demand, through physically backed exchange traded funds, remains more volatile and subject to changing sentiment. Claims of the asset being a hedge for inflation are less clear, with studies neither supporting nor rejecting blanket claims.

Overall, viewpoints on gold are expected to continue to differ. Longer-term strategic holders are likely to echo points made above and improved returns through holding the asset, while others continue to rebuff inflation hedging claims.

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