N&V

NEWS & VIEWS H1/2022

Augmenting reality

Enhancing your view in challenging times

ALSO IN THIS ISSUE:

Canaccord Genuity Wealth Management

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Investment features

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Richard Champion, Deputy Chief Investment Officer, UK

Michel Perera, Chief Investment Officer

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Patrick Thomas, Head of ESG Portfolio Management

Stuart Dickson, Senior Investment Director, Adam & Company

Welcome

The tragic events unfolding in the past few weeks with the Russia – Ukraine conflict are at the forefront of my mind, and my heart goes out to those affected. I, and everyone at Canaccord Genuity Wealth Management (CGWM), stand with Ukraine, and we urge all parties to work towards a swift and peaceful resolution.

On 8 March, our CGWM and Adam & Company colleagues came together on International Women's Day for a panel discussion about what #BreakTheBias means to them, and to share their moving journeys and experiences. I was both struck by – and proud of – how positive people's experiences at CGWM were. Undoubtedly, the best business decisions are made when a range of different viewpoints are taken into consideration – and at CGWM we see our individual differences and diversity as a key strength that helps us make the right choices for you and your wealth.

I am pleased to announce that we are planning to acquire the highly respected wealth management firm Punter Southall Wealth (PSW) in the coming months. PSW's ethos of putting their clients at the centre of everything they do strongly aligns with our own, making the acquisition a natural fit. PSW has a highly distinctive and lower-risk inflation-beating approach to investment management. Joining forces will create additional capacity to scale our financial planning and investment management expertise – benefitting both our clients and colleagues – and we will gain new offices in Guildford, Birmingham and Newcastle.

Environmental, social and governance (ESG) is high on our agenda. We recently won a City of London Wealth Management Award for the best approach to ESG investment, voted for by industry and clients – thank you if you voted for us! We are investing in tools such as data software to help us measure and reduce our carbon footprint – as an organisation and in our portfolios – to help us reach our 'net zero' target by 2050.

With the end of many COVID-19 restrictions, what will our new 'normal' look like? On page 4 of this edition of News & Views we talk about life after the pandemic, how this could impact what we choose to invest in and how we plan our wealth in a post COVID-19 world.

A top priority for us at CGWM is to try to mitigate the effects of higher inflation for you as an investor. With that in mind, we take a look at the topic from every angle. On page 8 we give our latest thinking on the outlook for inflation, and ask whether the 1970s can tell us anything about our situation now.

Did you know that a shortage of chips (or semiconductors) is one of the causes of rising inflation? On page 16 we discuss how this could affect investors, while on page 22 we consider investing longer term, and where there might be future value for you. Could tech companies still be good options? Or you might be currently considering how inflation could affect your retirement income – on page 13 we focus on what to consider to maximise returns from your pensions despite persistent inflation.

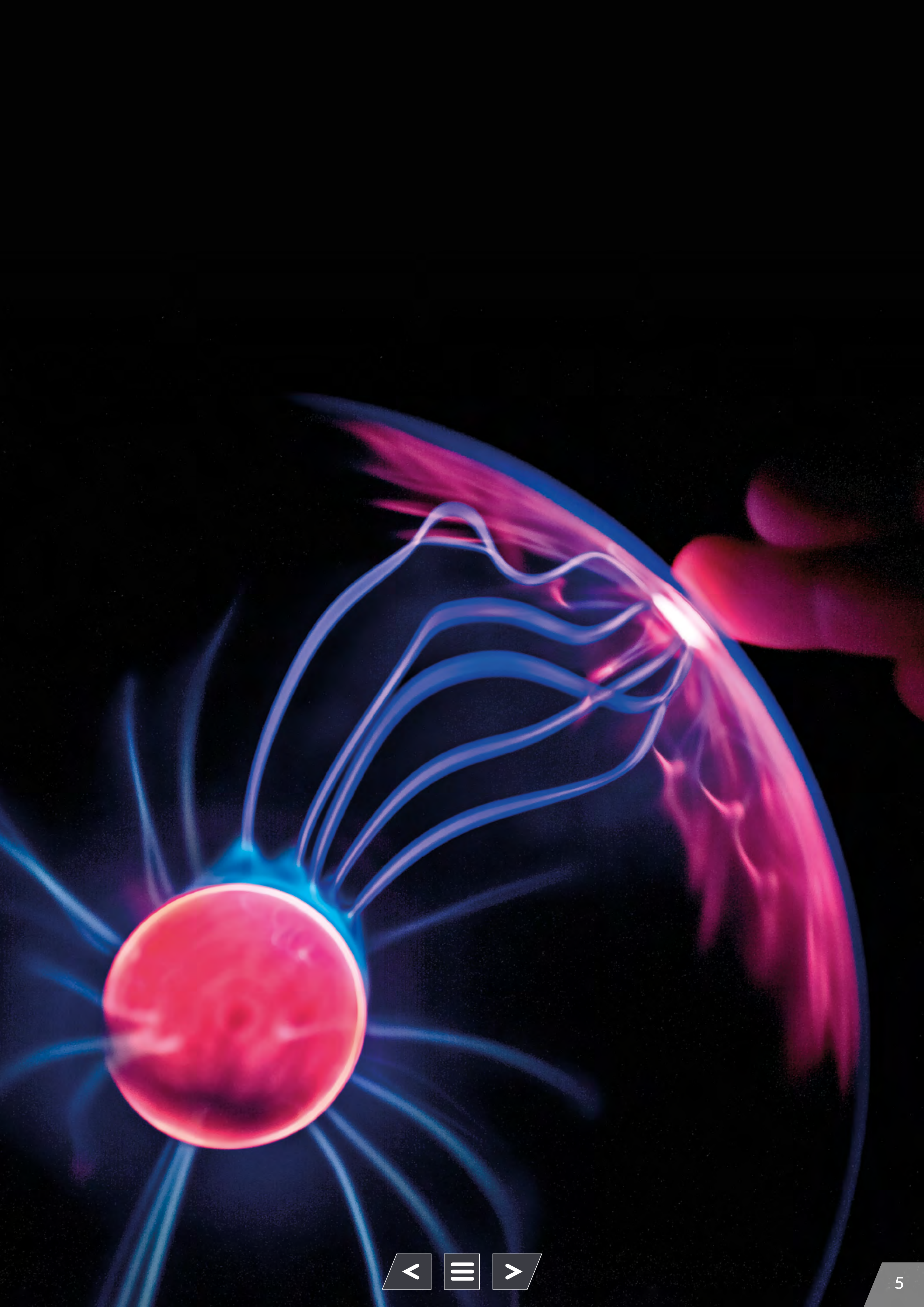
I hope you enjoy this edition of News & Views. As ever, if you have any questions or comments, don't hesitate to get in touch.

David Esfandi, Chief Executive Officer, CGWM

Richard Champion,
Deputy Chief
Investment
Officer, UK

The opposition of events

In 1919, Winston Churchill wrote how day by day 'the opposition of events' can profoundly change the challenges we face. This has rarely been more appropriate than it is now.



What the post COVID-19 investing world might have looked like before Russian tanks, artillery, missiles and planes began their onslaught on Ukraine a few weeks ago is very different to what the new realities on the ground now mean. The impact of Russian aggression has accelerated trends that were already simmering under the surface, but are now bubbling furiously on top.

We have identified a number of areas where the new, more dystopian investing world is likely to change.

Interest rate rises

The onset of the pandemic saw official interest rates in most of the developed world brought down to lows never seen before – either close to zero or, in the case of Europe, well below. Before the invasion of Ukraine, we had assumed that interest rates would go back up to more normal levels, even in Europe. It was a process already under way in the US and the UK. Indeed, the market wobble early in 2022 was down to the speed at which investors had begun to factor in rate rises, driven in part by inflation that was higher and more persistent than previously anticipated.

Now that a war is raging in Europe, central bank calculations are far more complex. On the one hand, economic activity will be lower due to a shock to confidence; on the other, inflation will be higher (see next section). The spectre of stagflation – weak growth and high inflation – is stalking central bank corridors. Outside of outright deflation (i.e. a decrease in the general price level of goods and services) this is one of the worst environments for policymakers.

Under these circumstances, we now expect interest rates to rise, not as far as previously predicted, but possibly to stay high for longer.

Continued inflationary pressures

As COVID-19 spread, inflation initially plunged. Later, as the response to the pandemic developed and people successfully transitioned to working from home or were given furlough money or direct transfers from their governments, consumers started to spend heavily on goods, typically using online retailers. This surge in demand, alongside COVID-19, disrupted ports and placed supply chains under severe pressure. Many goods became scarce, from semiconductors to building products; from new cars to washing machines. This drove up prices, in some cases very sharply.

Prior to the Russian invasion, most experts predicted that the spike in inflation would start to moderate as supply chains readjusted, consumers began to rebalance their spending towards travel and leisure rather than goods, and capacity was added to the system.

The deep shock to supply chains from the Russian invasion has seen this thinking reversed. Russia and Ukraine are major suppliers across a wide array of commodities, from wheat to crude oil, natural gas and a variety of key industrial metals. The prices of these are soaring, which means earlier hopes that inflation would start to moderate from April onwards have been dashed.

As a result, we now believe that inflation will peak much later in 2022 and at a significantly higher level, and that uncomfortable levels of inflation will persist for longer, as the impact of price rises spreads through the economy.

"The onset of the pandemic saw official interest rates in most of the developed world brought down to lows never seen before."

Bond yields

After falling sharply at the start of the pandemic, since the middle of last year bond (fixed interest asset) yields rose strongly, as markets priced in a return to normality and robust economic growth. Now, however, the picture is much more complicated. Higher inflation argues for higher bond yields, but weaker economic activity argues for lower. We still expect the former sentiment to prevail and that bond prices are likely to remain weak.

Equity valuations

An environment of higher bond yields, persistent inflation and rising interest rates isn't a good one for equity valuations. As a result, more highly valued areas of the market may continue to struggle until there is clarity on where interest rates may peak. The wider market is not expensive, however, and as growth moderates, we believe worries over interest rates will reduce. As a result, we still think it might be worth holding equities in portfolios.

Government spending, borrowing and taxation

Prior to the Russian invasion, we had foreseen continued falls in government spending as the extraordinary measures put in place to combat COVID-19 were removed. Now, however, there is clearly room for a marked increase in defence spending, while greater economic uncertainty may mean a tempering of previously announced tax rises and weaker corporate tax revenue.

This means improvements in government fiscal positions are likely to take longer to come through than expected, meaning that borrowing is likely to stay somewhat higher than previously forecast.

Impact on climate change transition

With Europe clamouring to wean itself from Russian energy, one result of the invasion of Ukraine could be a postponement of climate targets to enable a swift transition away from Russian supplies. By the same token, increased energy costs will make alternatives more competitive against carbon-based fuels.

Confidence amid confusion

We had previously anticipated a healthy return to more normal financial market conditions: we saw interest rates moving progressively higher and bond yields rising steadily, but neither in a way likely to derail economic activity. Hence our confidence in equities persisted, even if the rotation away from growth stocks[1] into value stocks[2] appeared set to continue.

The invasion of Ukraine has clouded these expectations with uncertainty. Much higher interest rates are now in doubt, while inflation seems certain to rise higher and last longer than previously forecast, which argues against fixed interest assets. We have seen a big shift towards more defensive areas of the equity market while this uncertainty persists. Nonetheless, as valuations adjust downwards for the more exciting sectors, like technology, we are beginning to see glimpses of good value emerging. As awful as the events in Eastern Europe are, the volatility such times cause often throws up investment opportunities for those brave enough to seek them out. While we recognise that this may be a deeply concerning time for our clients, history supports our continued belief in equities.

If you have any questions or concerns about how you can navigate this period of uncertainty and higher inflation, please get in touch with us. We would be very happy to discuss your options with you.

[1] Growth stocks are companies that are expected to deliver better than average organic revenue and earnings growth over the medium term.

[2] Investors looking for 'value' seek out stocks which they believe have been undervalued by the market and are trading for less than their intrinsic worth. They are viewed as trading at a lower price than justified when measured against metrics such as earnings, profit margins or sales.

Michel Perera,
Chief Investment
Officer

Taking a closer look at inflation

Inflation has been the dominant topic affecting investment markets for a year now and rates are continuing to rise. This has been driven by two different factors:

Firstly, the COVID-19 lockdowns meant that most of us were stuck at home with little or no outside activities and we all gorged on buying goods for our home, work, entertainment or healthcare. In principle, this one-off surge in consumer spending should be ending soon as we run out of extra savings and have satisfied our home improvement needs.

Secondly, unfortunately, the double whammy came with the Ukraine invasion, sending energy and commodity prices sky-high literally overnight, in an eerie reminder of the 1970s. As a result, the dreaded word 'stagflation' (meaning high inflation and low economic growth) has resurfaced.

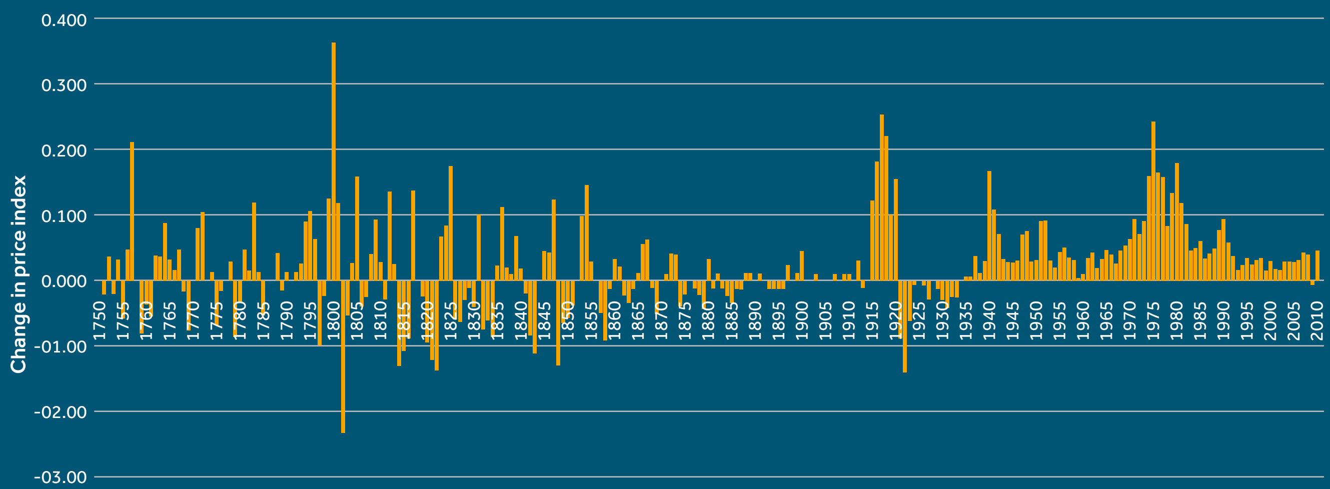
In order to determine where we stand now, and what may be to come for investors, it is important to look at the comparison with the 1970s but also at a longer historical time frame. When we look at the stagflation of the 1970s, we can see that it has superficial similarities with our current experience, in that commodity prices soared and fed into inflation for the economy as a whole. The differences, however, overshadow the apparent resemblance – see the illustration on the right.

Inflation – a brief history

Taking a longer perspective, we have hundreds of years of inflation history to rely on (mostly the cost of grain and other foodstuffs, and even metals). Periods of inflation were visibly followed by deflation and vice versa. Indeed, the graph below looks almost symmetrical on the upside and downside.

It was the two world wars that boosted inflation beyond recognition. Obviously, when countries spend a large part of their resources building weaponry whose sole purpose is to destroy, we waste money and the price of everything skyrockets, triggering inflation.

The value of the pound 1750-2011



Source: House of Commons Library

After WWII, the world gave itself a break from past horrors and decided to go all out in the opposite direction, caring for humans beyond any previous experience. This 'welfare state' had a huge cost for western countries, particularly with the post-war baby boom, and spawned an inflation time bomb waiting to explode, which it duly did in the late 1960s and early 1970s.

Key differences between the economic situation now and in the 70s

1970s

1 Inflation rising since the mid-60s, when the President stopped the US Federal Reserve from causing a recession.

2 Strong trade unions demanding cost-of-living adjustments, creating a wage-price spiral.

3 Energy and commodity price surges, due to inefficient manufacturing and high energy use.

2020s

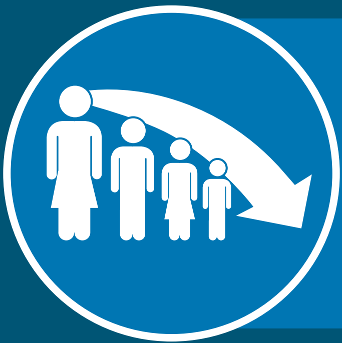
1 Most developed country central banks are independent and no longer bullied by governments.

2 Unions are no longer drafting employment contracts with cost-of-living increases.

3 Our energy intensity (units of energy per unit of GDP) is three to four times less than in the 1970s.

Forces that kept inflation low

The world wars and the creation of welfare states are therefore exceptions in a long history of moderate inflation. Where are we right now? This illustration shows the forces that have been keeping prices down for the last generation.

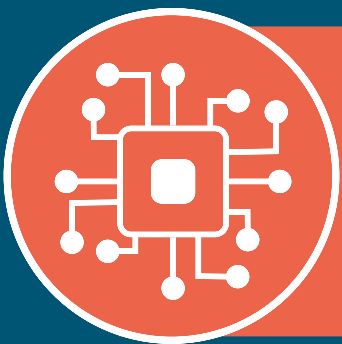


1. DEMOGRAPHICS

Population growth has turned low or negative in many advanced countries. The US, as an immigration country, is still the odd exception but could well have flat or negative demography soon. Population growth correlates with economic growth and in turn with inflation. The best example is Japan, where a falling population has caused inflation to be flat or negative for two decades. Other rich countries are likely to follow at some point.

2. GLOBALISATION

20 years ago, China joined the World Trade Organisation and Chinese industrial products flooded the world, helping to keep manufacturing costs down. Despite posturing among western politicians who want to repatriate supply chains home, very little is happening. Indeed, cheaper countries like Vietnam are helping to perpetuate this system.



3. TECHNOLOGY

As difficult as it is to measure productivity, we all use more data, information and services than we did five or ten years ago and are not paying more for it. This is keeping inflation down.

These three fundamental factors have not changed post COVID-19 and are not likely to change post Ukraine. Once energy price surges are behind us, inflation should revert back to historical levels, closer to the 2% target followed by most central banks.

There are risks, though. If the Russo-Ukrainian war drifts into another cold war (or worse), the additional military expenditure will add to inflation. The cold war end was a boon, due to the peace dividend (spending less on defence) which brought budget deficits and inflation down. A reversal would be costly.

Also, the longer the current spikes in energy and supply chain bottlenecks last, the higher the probability that firms may be forced to grant higher salaries to their employees.

Investing for the future

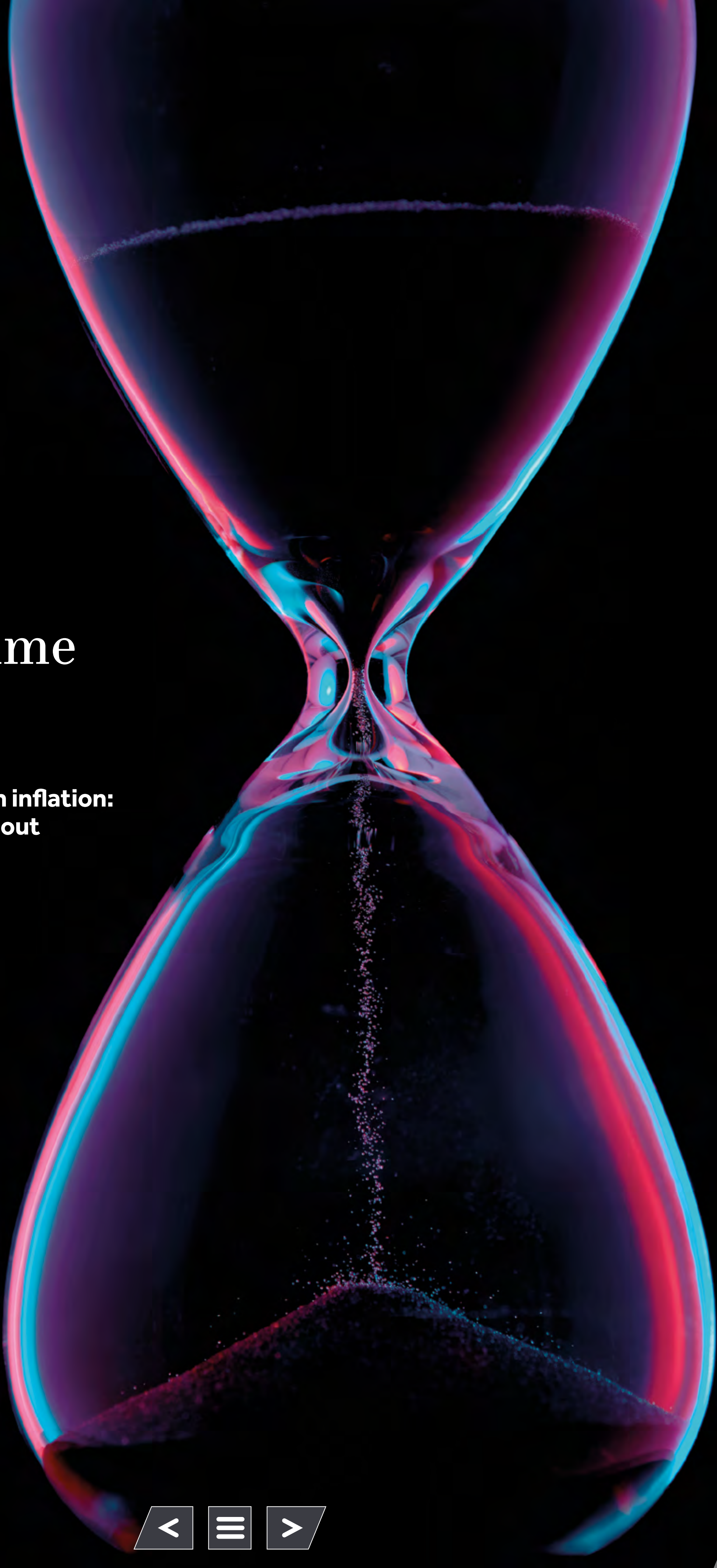
On balance, the structural forces keeping prices down are likely to win out, perhaps not over the next couple of years, but afterwards. It is vital that we invest for inflation right now, but this may have to be superseded at some point by another investment policy as inflation subsides.

At CGWM, we're managing our clients' discretionary portfolios for inflation – for both the short-term and long-term challenges. If you have any questions about the impact of inflation, or anything else, please contact us.

Matthew Phillips,
Director of
Wealth Planning

When is the right time to retire?

Retiring in times of high inflation: eight things to think about



For the first time in generations, many people may now need to think about the impact that inflation could have on their retirement income, and to consider whether they can afford to retire yet.

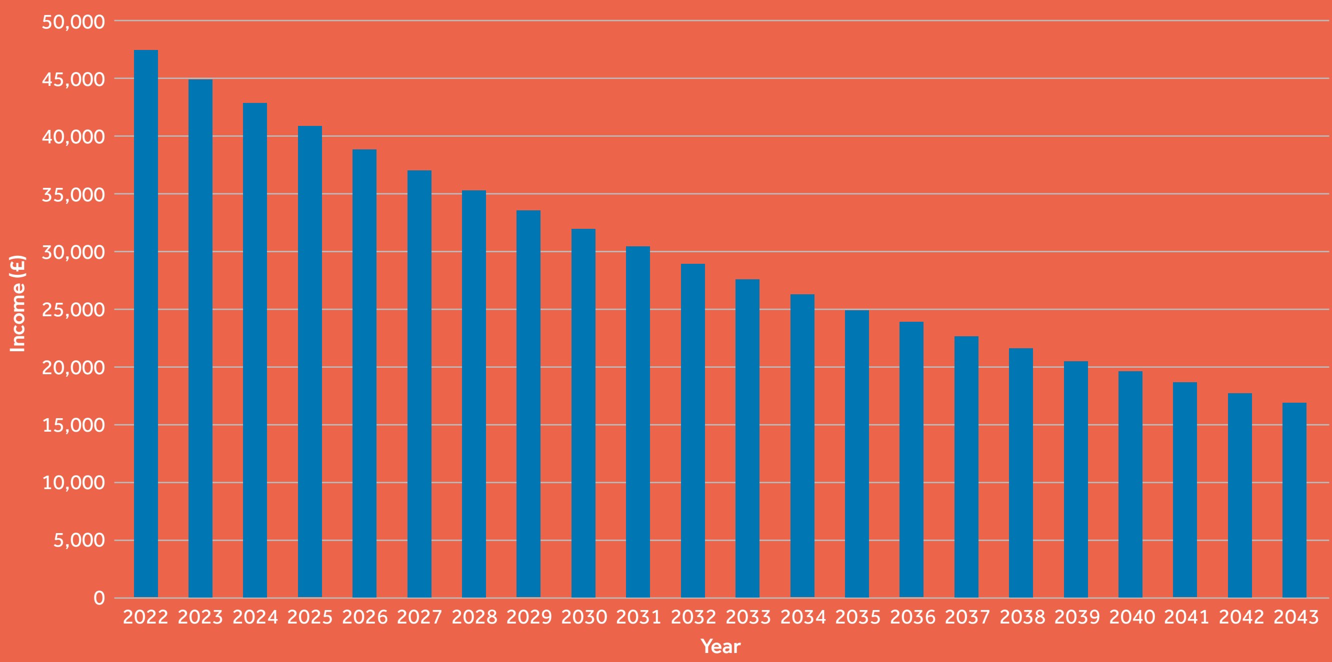
Inflation in the UK has climbed to 7% and looks set to remain there for the foreseeable future. Various factors will influence how long inflation is with us, but a long-drawn-out Russia/Ukraine conflict would be unlikely to help. How can we invest to get maximum pension returns despite persistent inflation?

Here we consider eight key questions you may need to answer if you are approaching retirement and want to ensure your portfolios are positioned as well as possible.

1. What impact could inflation have on your retirement plans?

On average, a 65-year-old man retiring today is expected to live for a further 19 years, while a 65-year-old woman retiring today would be expected to live for 22 years. For those on a fixed retirement income, high inflation can be very damaging. The following helps illustrate why: assuming inflation averages 5% per annum for 22 years and you have an annual fixed retirement income of £50,000, the effect would be to reduce this figure to marginally over £17,000 per annum.

Cash flow analysis
(£50k income in real terms assuming 5% inflation)



Source: Voyant (planwithvoyant.co.uk)

This means that ensuring retirement income keeps pace with inflation, or preferably grows in 'real' terms (i.e. factoring out the effect of inflation), is of utmost importance.

2. What is your timeline to retirement?

As wealth advisers with many years of experience, we know that many people do not start considering whether they have sufficient funds to retire until around 18 months before they plan to stop work. That's human nature.

However, we believe that ideally, everyone should have a proper plan in place well before their desired retirement date, and that it's imperative to have a full understanding of their financial situation. This is the only way to identify future problems and, hopefully, rectify them.

The good news is that it's never too late for us to help you optimise your retirement financial planning, no matter how long you may have left it.

3. Could cash flow planning tools help you?

At CGWM, we believe cash flow planning tools can be very useful in making these assessments. They enable us to consider all your potential sources of income in retirement and how they can best be used to satisfy your expenditure needs. We will consider a number of factors such as your underlying investments, tax and, most importantly, how well your different income streams are protected against inflation.

Another benefit of using cash flow planning tools is that we can easily change those assumptions if your circumstances change; factoring in different investment returns, tax rates and inflation. This allows us to help you assess how much you need to have accumulated prior to retirement.

4. Would an annuity be beneficial?

A dwindling number of people have the luxury of a final salary pension – i.e. a guaranteed income from a pension that is fully indexed to keep pace with the rate of inflation – as they are now rarely offered by employers. We will always consider annuities (financial products that provide a guaranteed annual income for life) as an option for clients, but they are likely to be unsuitable in most cases. This is because annuity rates have fallen over a similar period to that of inflation, partly due to drops in interest rates but also because we are collectively living longer. As a result, purchasing a lifetime annuity with a pension lump sum is not typically an attractive proposition.

However, there are two circumstances where annuities may be well worth considering. Firstly, those who have no capacity for their income to fall in the future may have little choice but to purchase an annuity. Secondly, for those who are in less robust health, annuities may also be beneficial, as the rates paid out to policyholders may be high enough to warrant purchasing them.

5. Are you sitting on too much cash?

One of the best ways to protect against inflation in retirement is by investing in 'real assets' – i.e. any investment other than cash. Holding wealth in cash is typically not such a good idea during periods of high inflation because its value is eroded in real terms. With interest rates currently still comfortably below 1% and inflation high at 7% and increasing, the real value of cash is guaranteed to fall.

6. What is your attitude to risk?

A key factor in investment decisions is establishing the level of risk that is acceptable to each individual client, as this differs widely from one person to another. Your CGWM wealth adviser will spend time understanding your own concerns and help you to assess the most appropriate risk level.

Our investment managers then manage your discretionary portfolios, whether in pensions, ISAs or general investment accounts, to match your risk appetite. This will generally mean a different asset allocation between equities, bonds, property and other alternatives, with a view to ensuring that the income derived from that portfolio can at least keep pace with inflation.

7. Do you need to consider potential liability for inheritance tax (IHT)?

With inflation rates increasing, you may be worried about giving away assets to reduce the impact of inheritance tax on your estate. With inflation eating into the value of your assets, you may be concerned about striking the right balance between leaving yourself enough to live comfortably on, and giving away enough to avoid incurring IHT. In this situation, the use of cash flow modelling can again be a useful way to identify a comfortable level of assets that can be given away.

We can also assess the impact of IHT on your different funds.

8. Could your home be a retirement asset?

Property values in the UK have in general risen above inflation over the last 30 years. However, many clients heading towards retirement realise that while their main residence may be one of their most valuable assets, it provides them with no income. Some may look to downsize in order to free up additional funds to assist them in retirement. However, those who do not wish to move from their family home may consider a lifetime mortgage to assist with future cash flow.

In summary

With inflation raising its head for the first time in many years, advisers and clients are having to grapple with some new challenges. There is no 'one solution' to solve these problems, but forward planning and expert advice are imperative for a comfortable retirement in an inflationary world.

At CGWM, we offer retirement advice via our independent wealth planners. Contact us on +44 02 7523 4500 or email marketing@canaccord.com to book a free consultation.

The tax treatment of all investments depends upon individual circumstances and the levels and basis of taxation may change in the future. Investors should discuss their financial arrangements with their own tax adviser before investing.

Patrick Thomas, Head of ESG Portfolio Management

Chips with everything

One item links the US/China trade war and post-pandemic supply chain woes. We all use them every day, and you have likely never seen one. It's the semiconductor chip.

This invention is right up there with humanity's greatest achievements. These tiny items, made of silicon, cobalt, and copper, are central to all modern technology and sit inside almost every electronic device, including your car, phone and computer. Nearly everything we do today is based on this minuscule construct of metal and metalloid.

Recently, the problem has been not having enough of them. Last year many car manufacturers, including GM and Ford, either shut down or slowed down production because they couldn't get enough chips. For example, Ford's F-150, the best-selling truck in America, was held hostage to a semiconductor with a price of just US$0.25.

Here we cover the key issues and look at the opportunities they create for investors, including:

- The semiconductor supply chain and the current shortage
- The impact of demand and supply
- Geopolitical questions, such as competition with China.

What is causing the current shortage?

Let's start with the demand side.

The percentage of a car made up of electronics has been steadily increasing, to about 40% of the total cost of a car today. In 2000, it was around 18%. This seems obvious when you think of safety features like adaptive cruise control, or automated stopping if there's a pedestrian in front of you.

Secondly, when COVID-19 hit, many car manufacturers assumed car demand was going to fall sharply. So they cut back orders. At the same time demand went through the roof for consumer electronics: Chromebooks, other laptops, webcams, and everything that makes Zoom (and other video call platforms) possible. When it later emerged that car sales weren't going to be as dramatically impacted by COVID-19 as initially thought, the manufacturers went back to the suppliers, and discovered the chips were not available.

Unfortunately, it takes dozens of weeks to make a new semiconductor, and you can't turn production off and on quickly. When orders get cancelled, lines are retooled to build other chips. To restore the production line for your chip could take a year.

The biggest customers for chips are mobile phone makers. If Apple places an order, that's billions of components, and it's a reliable customer, so would be prioritised ahead of automotive companies. Car chips can also be harder to make. Their temperature range, operating lifetime, and failure rates have to be better. While your Chromebook's light sensor can go bad without endangering lives, your car's adaptive cruise control can't.

Cars need two kinds of chips: cheaper, older-generation ones (e.g. for anti-lock brakes), and newer ones (e.g. for advanced driver assistance systems); the latter kind are more profitable, so companies prioritise producing them. They are also basically the same chips that are used in smartphones, so they bring car manufacturers directly into competiton with phone companies for the already limited supply.

Understanding the semiconductor supply chain

Integrated device companies (e.g. Samsung) manufacture their own chips.

'Fabless' chip companies (e.g. Qualcomm) design chips, but use other companies to manufacture them (e.g. TSMC).

Other firms design and manufacture chips (e.g. NVIDIA).

Chips are sold to businesses (e.g. Siemens AG) who make electronic systems for vehicles (e.g. entertainment, adaptive cruise control or anti-brake lock systems).

Car manufacturers (e.g. GM, Ford) incorporate electronic systems with component chips into their vehicle assembly.

Boom in electronic systems is driving demand for chips

In 2000, electronics were about **18%** of the overall cost of a car.

Today, electronics are about **40%** of the overall cost of a car.

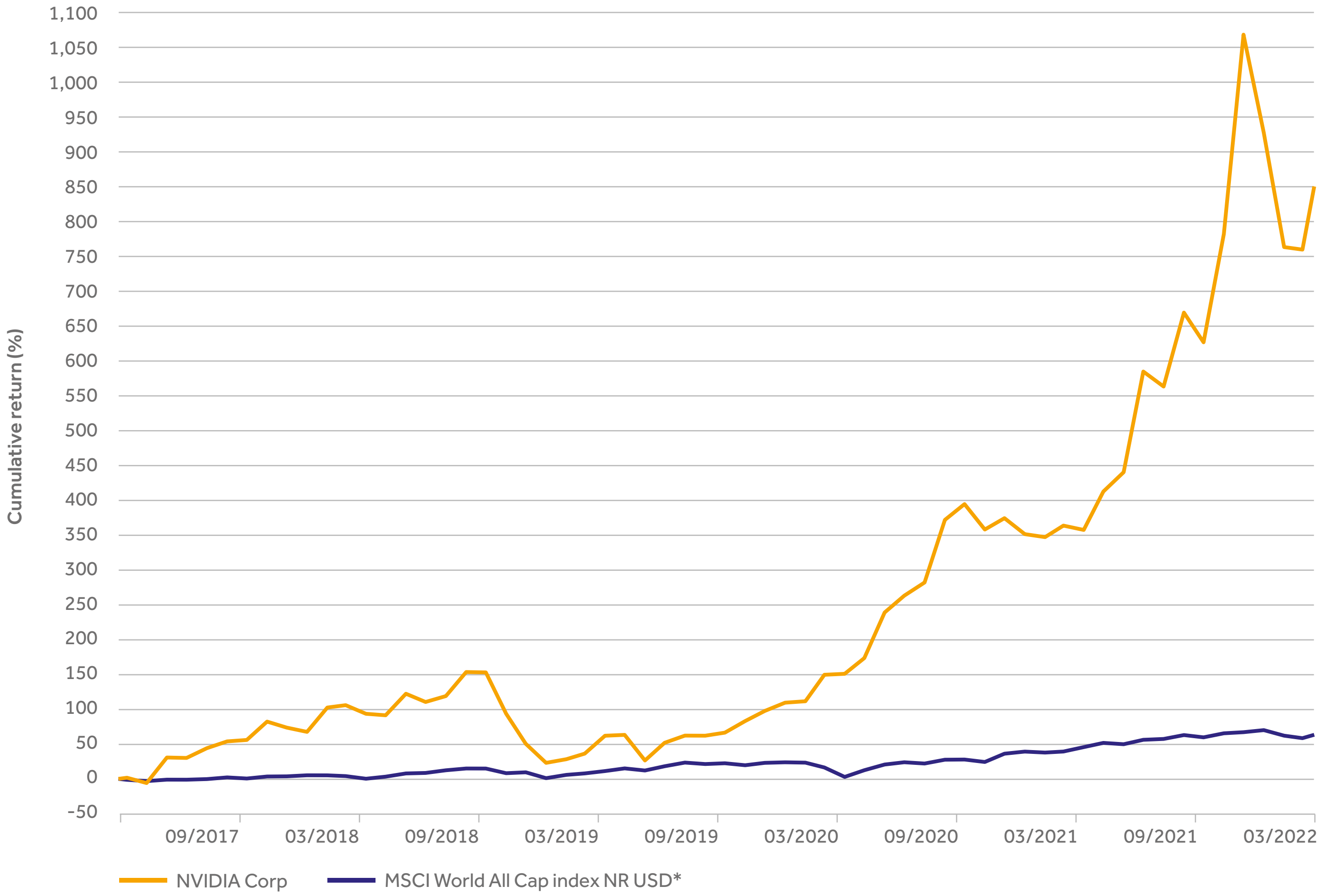
Source: Electronics now account for 40% of a vehicle's cost | Carscoops

Fighting over a fixed supply

The world has a fixed semiconductor manufacturing capability, but infinite demand. Semiconductor factories are incredibly expensive (say US$10bn) and relatively low margin to build, and might be obsolete in five years. So they depreciate quickly, contributing to chip supply problems.

In turn, the investment industry has rewarded companies that design chips, but don't actually make them, like Qualcomm, as they provide higher profit margins. Companies like NVIDIA, that both design and manufacture, have also performed extremely well in terms of investment growth compared with the global market as a whole.

NVIDIA Corp cumulative return % vs MSCI World All Cap index



Source: Morningstar, Inc

*The MSCI World All Cap is a stock market index covering over 1500 large, mid, small and micro-cap companies in 23 developed countries.

Past performance is not a reliable indicator of future performance.

The US is rightly worried that China will buy semiconductor manufacturing equipment, reverse engineer it, infringe on the intellectual property, and then make their own semiconductors.

As with every other manufacturing facility, COVID-19 hit the semiconductor industry. However, the good news is that South Korea and Taiwan, the biggest manufacturers, were much less exposed to COVID-19. The bad news is that Taiwan went through a drought and you need a lot of water to make chips. Taiwanese Semiconductor Manufacturing Company Limited (TSMC)'s daily water consumption is 156,000 tons a day. In the northern part of Taiwan where these factories sit, that's equivalent to 10% of the region's daily supply of water.

East is east, and west is west

If there were no politics, China would be the obvious choice for manufacturing semiconductors.

However, companies in the semiconductor tool chain in the United States have to apply for licences to sell to Chinese companies. The US is rightly worried that China will buy semiconductor manufacturing equipment, reverse engineer it, infringe on the intellectual property, and then make their own semiconductors. China's explicit goal is to have the number one semiconductor design and manufacturing industry in the world by 2030.

Can China get there? They don't want to stop at just chips. They want the entire technology supply chain. In the next 10 years, will there be a Chinese operating system running on a Chinese chip, designed by China? If so, we will really have two competing world ecosystems.

We have some soul searching to do about how much our supply chains should reflect geopolitics. How much technology should be country-independent? Should the best ideas (meritocracy) win the day or will we be in a world where US-led and Chinese-led tech industries don't cooperate to achieve the best technological advancement possible, but instead view each other with mutual suspicion?

Reasons to be optimistic

We will not be at COVID-19 highs on webcam orders forever. We have always had component shocks in the tech ecosystem, but this was a particularly bad one because we have so many car factories making very expensive products, stymied by the shortage of semiconductors. And since software is now inherent in everything, these shocks ripple beyond technology.

The implications for investors can be seen in two ways. Firstly, a technology supply chain affects plenty of businesses outside the technology sector. Secondly, this presents a great opportunity to invest in companies that can innovate to make this process more efficient or resilient. One well known electric company has vertically integrated its supply chain. As ever, whenever there is a problem, creative companies will find a solution.

Stuart Dickson, Senior Investment Director, Adam & Company

Across the metaverse

Mark Zuckerberg is the emperor of a digital country with 2.8bn citizens across its four regions – Facebook, Messenger, WhatsApp and Instagram. He is a dictator who controls most of the voting rights. However, he is a benign one as he lets us live there for free. Although his empire is often called a social media company, 99% of Zuckerberg's revenue comes from targeted digital ads – he simply wants all our data in order to target these ads more precisely.

But all is not well – the population has started to fall as the younger citizens move to more exciting destinations. TikTok, a Chinese platform which allows users to share short videos, has seen a surge in new users in the past couple of years and now has over one billion users spending an average 14 hours a month there. 'Massive Multi-player' games such as Call of Duty and Roblox have also benefitted from COVID-19 lockdowns as people engage with each other in virtual worlds.

News of the fall in engagement – and Apple's crackdown on data collection on their platforms – caused the Facebook share price to halve from September 2021 to March 2022 and has hastened Facebook's re-invention of itself.

A metabolic shift

Having been founded with the aim to 'Move fast and break things' and the noble goal of 'Connecting the world', the company is now driven by the slogans 'Build awesome things' and 'Live in the future'. To emphasise this, it has changed its name to Meta Platforms Inc., and is spending over US$10bn[1] a year to build its vision of the future (approximately 9% of its total US$117bn total revenue in 2021[2]) – a seismic shift to the metaverse.

The metaverse, a portmanteau word meaning 'beyond the universe', is a vision for the future direction of the internet. It is a virtual world where you can connect with people via your avatar in a digital environment akin to the real world. It represents the immersive third iteration of the internet following Web 1.0 (often defined as browsing centrally created content) and Web 2.0 (user-generated content).

In this vision of virtual socialising and virtual meeting places, Meta is hoping to tread on the toes of Microsoft. Microsoft has a similar vision for immersive workspaces in the future office and should also benefit from the continued increase in demands for cloud computing and storage which result from this.

However, Microsoft's Xbox gaming franchise gives it a further route into our homes. It recently purchased Activision Blizzard for US$69bn[3] (the biggest takeover of financial year 2021-22 globally) to capture the hearts, minds, and wallets of consumers through the acquisition of some of the world's most famous online gaming franchises.

Preparing for new horizons

This new frontier is likely to expand well beyond these environments, and a broad swathe of businesses are preparing. Success will partly be to do with technology and partly to do with the experience consumers will enjoy.

Retailers from Amazon to Tesco envisage us browsing virtual shopping aisles. Your avatar will need clothing and accessories, so Gucci and Louis Vuitton have announced plans to sell 'non-fungible tokens' or NFTs (unique digital assets which only you can own) to allow you to dress your digital self in their latest fashions and handbags.

Similarly, you may need art for the walls of your virtual house and office, so artists are selling NFTs of their work; Bloomberg Intelligence reports that there were US$54bn in sales of virtual goods in 2021 alone. And this virtual economy will need a way of conducting transactions, leading to further growth in digital currencies and other decentralised technologies.

Education and healthcare are other possible applications which business and governments are keen to explore, as well as the art world – from gallery tours to immersive pop concerts.

> *Microsoft's US$69bn purchase of Activision Blizzard[3] is the largest investment in the metaverse aside from Meta Platforms'; yet this represents a mere 4% of the company's value, significantly lower than Meta's annual investment of 9% of its total revenue[4].*

Facebook, Inc. has changed its name to Meta Platforms, Inc. and is spending over US$10bn[1] a year to build its vision of the future (approximately 9% of its total US$117bn total revenue in 2021[2]) – a seismic shift to the metaverse.

Living in a virtual world

Technology consultant Gartner now believes 25% of us will spend at least an hour a day in these virtual environments. Given that we already spend an average of almost four hours a day interacting with our phones, this might be a conservative estimate.

For most of the companies mentioned, these are relatively small investments in a possible future. Microsoft's US$69bn purchase of Activision Blizzard is the largest and most visible investment in the metaverse aside from Meta Platforms'. Yet Microsoft is now so big that this represents a mere 4% of the company's current value[4], significantly lower than Meta's annual investment of 9% of its total revenue in the metaverse[3].

On the dark side

We should not overlook potential problems for society in this digital land grab. Recent whistle-blowers have revealed the damage to teenagers' mental health caused by Instagram, while the World Health Organisation now recognises video game addiction as an illness.

As often happens, governments, regulators and law enforcement are far behind the emergence of new threats and opportunities that these new worlds offer. At the extreme, there is also the science fiction-style threat explored in the Matrix films – that artificial intelligence becomes so powerful that we can no longer tell our virtual world apart from reality. And we may not even care.

In conclusion

For now, the attitude of many businesses is perhaps summed up best by the boss of Gucci, French billionaire François-Henri Pinault: "We are in an extremely early stage of what could happen. Nothing is certain; it might fizzle out. But the philosophy of the group, rather than wait and see, is to test and learn."

This immersive third generation of the internet could provide fascinating and exciting opportunities for investors – and not just in technology companies. All kinds of companies are already adopting technology platforms and content.

However, the first two iterations saw huge disruption to incumbent business models and the emergence of giant new businesses which now dominate our lives. Rest assured, at Canaccord Genuity Wealth Management we will continue to research and monitor developments to try to take advantage of the potential opportunities, and avoid the possible disturbances.

If you would like to look into the possibilities inherent in this new meta world, get in touch with your investment manager, who will be happy to discuss this with you.

[1]Facebook spending $10 billion this year on its metaverse division – The Verge Top 25 Players of the Metaverse – TechRound
[2]Meta – Facebook reports third quarter 2021 results (fb.com)
[3]Microsoft/Activision Blizzard website (Microsoft to acquire Activision Blizzard to bring the joy and community of gaming to everyone, across every device – Stories)
[4]Microsoft Annual Report 2021.

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T: +44 20 7523 4500

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