

# LWM Consultants

*“An investment in knowledge always pays the best interest”*

## Fund Manager Meeting Notes – Standard Life Fund Manager Meetings



Standard Life Investments would normally fall into the big fund house mentality but somehow they continue to have a boutique feel. They also have a stable of excellent fund managers outside of their key fund. In the UK there is Harry Nimmo, Ed Leggett and Thomas Moore and on the global side Alan Rowsell.

We have recently met the manager on the emerging equity income side and we know the emerging debt manager from his management days at Threadneedle.

Obviously there are areas which we feel are not as strong but very few fund houses can offer a total spread across all asset classes.

We recently met Tom for an update on his income fund and this time we had a chance to meet Ed and Alan and also have an update on the GARS Fund.

The questions really were the same for the equity funds – both the UK Unconstrained Fund and Global Smaller Companies Fund have delivered amazing performance and whether this can continue. With the GARS Fund we wanted to know where now, (with its size) can it continue to deliver and what went wrong earlier in the year.

## OVERVIEW OF FUNDS

### UK Unconstrained Fund

#### Overview

The fund takes an unconstrained approach to investing in the UK focusing purely on best ideas and using conviction based positions to deliver long term returns.

Fund Manager			Fund Size		
Ed Leggett			£897 m		
Performance					
YTD	2012	2011	2010	2009	2008
41.37%	44.30%	-20.44%	38.53%	99.36%	-40.92%

*Source: Morningstar, on a bid to bid basis with net income reinvested. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. See note at end of document.*

#### Key discussion points

With the exception of 2011 since 2009 the fund has delivered fantastic performance, the question to Ed was whether this could continue.

Ed's view is that people are starting to accept the world is ok, the US economy could be stronger next year and the UK could move forward. China is unlikely to implode (although some still seem to think this will happen) and Japan could potentially turn around.

The point is that what we had was a generational opportunity to buy into good companies cheaply and

achieve significant upside. Howden Joinery was trading around 170p a share in 2007, with the collapse in the market the shares dropped as low as 15p. Nothing had really changed, it was a good and well run business but in an unloved sector. Now the share price is 332p with a P/E ratio of 19 times. It is still a good company but there is little upside left and therefore Ed has been reducing his exposure to this stock.

He has also started to take profits from Lloyds which was trading as low as 20p and is now nearing 80p.

Many stocks are moving to fair value and we need to accept that rather than 100% return type stocks this may be around 30 to 50%. The market for these types of stocks is shrinking and therefore if the market continues in an upward curve the fund could underperform.

The danger that Ed sees is that people are basing decisions on the past and as he articulated probably the best is coming to an end. It may be there for another 12 months but after that we should move to more normalised returns.

With this in mind we talked about short term opportunities and long term opportunities. Short term Ed is playing the European recovery story, long term he is looking at emerging markets. Emerging markets have gone from the darling of the stock market to the villain, but Ed thinks long term this will come back and therefore he has been adding exposure to unloved stocks like Standard Chartered and Burberry.

In summary we have seen fantastic numbers since 2009, clearly there are stocks in the portfolio which haven't yet shone; for example Barclays; and these could help deliver strong performance in 2014 but realistically we need to accept that the types of returns we have seen will slow. We believe that in a fair valued market Ed can continue to perform but the danger will always be if the fund gets too big and that is something we will need to watch.

## Global Absolute Return Strategy Fund

### Overview

This is a multi-asset fund targeting returns of cash plus 5% gross of charges over a rolling three year period. This is not a guaranteed return.

Fund Manager		Fund Size			
Multi Asset Team		£18,180 m			
Performance					
YTD	2012	2011	2010	2009	2008
4.23%	7.02%	2.19%	9.90%	18.67%	N/A

*Source: Morningstar, on a bid to bid basis with net income reinvested. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. See note at end of document.*

### Key discussion points

There were two questions firstly performance which suffered significantly this year and the size of the strategy which is over £30 billion pounds. Success has brought a lot of negative comments on the fund.

Up to 22 May the fund was up over 7%, when Bernanke made his speech the fund dropped significantly and over the next month was down nearly 5%. Its biggest drop since it was launched in 2008. When we flagged this in the summer the managers were keen to emphasise patience and not short term panic selling. The reason is that GAR strategies take time to work through and the focus is over the three year period. By the end of October the fund had returned over 4% and to the end of November over 5%.

Credit has boosted performance for the fund but now the fund is more cautious about credit although they see some opportunities around high yield. There is some emerging market exposure but they feel they need to choose their battles carefully.

On the size of the fund we found this really interesting. The argument has been that as the fund grows there is less that the fund can do, and that liquidity squeezes the markets it can operate in. It was explained that from the

day the fund was launched the managers operated it like a £40 billion fund. This meant that they weren't placing trades which caused liquidity problems. This has meant there are trades that perhaps they would have liked to have placed but haven't because of this constraint.

This is important because most funds operate the reverse so they work within the size they are at the start and as the fund grows they find they can't deliver the same returns. The other aspect that many forget is that this is not a single asset fund; it could go across multiple assets which means £40 billion is fairly small when you consider access across all asset classes.

They are looking to launch a SICAV GARS Fund targeting a higher return which will have limited capacity and take advantage of some of the smaller trades that they can't use in GARS.

In summary the fund did suffer in the sell-off in May, however we have started to see this recover with over 5% return this year. We are less concerned about the size of the fund as clearly it has always been managed at this level, the new fund is interesting and may appeal to the higher risk portfolios.

### Global Smaller Companies Fund

#### Overview

The fund aims to deliver long term outperformance by investing in a basket of global smaller companies.

Fund Manager		Fund Size			
Harry Nimmo, Alan Rowsell and Kirsty Desson		£178 m			
Performance					
YTD	2012	2011	2010	2009	2008
33.45%	N/A	N/A	N/A	N/A	N/A

*Source: Morningstar, on an bid to bid basis with net income reinvested. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. See note at end of document.*

#### Key discussion points

The fund was launched in 2012 using the same process as the UK Smaller Companies Fund. We added it to the portfolios in 2012 and it has achieved fantastic performance. We also feel that it blends well with Scottish Mortgage as a global fund.

There is some crossover with the UK smaller companies fund, around 15% is allocated to the UK but the fund can cherry pick the best ideas for the global fund. It has around 16% allocated to emerging markets and 46% to the US.

The process uses a matrix system which scores companies around quality, growth, momentum and valuation. This is then filtered down to buy ideas and then the portfolio which is around 50 names. These are high conviction stocks.

We are asked whether the performance could continue and Alan doesn't feel valuations are stretched in the space they are working in. As an example he referred to a recent UBS report which demonstrated that European Smaller Company stocks are trading below their average P/E ratio.

The fund also is working on a global basis and if valuations become stretched in say the US or UK there are plenty of opportunities in emerging markets and Asia.

In summary this is a great little fund and blends well with the Scottish Mortgage Trust. We like Alan who is co-manager on the fund and clearly as a team they focus on the fundamentals of searching out quality companies with sustainable growth prospects. We believe that small and mid-cap focus can continue to deliver in this challenging environment however it is clear that the spectacular returns we have seen will slow to a more normalised level going forward.

#### Special note to performance data

*The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted*

*for sales charges and the effects of taxation, the performance quoted would be reduced.*

## **Conclusion**

We continue to be comfortable with the SLI approach to investing and clients have benefited across all the funds we use. Ed's fund has delivered fantastic performance and this may slow to more normalized returns as could the Global Smaller Companies Fund. However, we believe being in these funds we have the opportunity to deliver higher returns than other funds in the sectors they operate in.

Although the GARS Fund suffered significant underperformance in May / June clearly the strategies are starting to work through and we continue to believe this is the right place to be instead of bonds.

*The source of information in this note has been provided by SLI and is correct as at November 2013. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.*