SHINING A LIGHT ON……
SCHRODER GLOBAL RECOVERY FUND

At a glance

This fund is for patient investors who are comfortable with riding out short term volatility for above average long term rewards. It invests in global companies (which will include the UK) which for reasons have suffered a setback in either profits or price but where prospects are believed to be good. We will touch on this further in the review when we look at the fund highlights.

It is a concentrated portfolio of between 30 and 60 stocks with a low turnover. Speaking to the team the typical investor will be someone who has a hard hat and an open mind, meaning they are prepared to focus on the micro whilst being conscious of (but not swayed by) the macro and have a long term horizon.

However, investors who like the fund may find it hard to invest in. It is domiciled offshore and as yet not available on many platforms. The fund was launched in 2013 however the team have a track record of 7 years running the Schroder Recovery Fund in the UK which has the ability to invest up to 20% in overseas recovery stocks. It therefore is a natural progression to open a global version to increase the opportunity set further.

In summary for long term value investors (see story behind the investment) this offers them the opportunity to invest globally in undervalued stocks. The downside is finding a platform which offers it currently.

Who are the team behind the fund?

The fund is very much about the team and the input across Schroder’s as a whole. There are three lead managers. The key managers are Kevin Murphy and Nick Kirrage.

Kevin’s investment career spans more than 13 years, having joined Schroder’s as an equity analyst in 2000. He has managed the Schroder Recovery Fund alongside Nick Kirrage since 2006. Nick Kirrage has more than 12 years’ investment experience at Schroder’s and has co-managed the Schroder Recovery Fund since 2006.

Nick and Kevin have consistently outperformed their peer group over 1, 3, 5 and 7 years.

The newest member is Andrew Lyddon who joined Schroder’s in 2005 as an Equity Analyst. Previously a sector analyst responsible for telecoms, construction and support services, Andrew has relinquished responsibly for this analytical coverage to become a full-time named manager on the Global Recovery Fund.

They have access to over 80 global analysts who provide on the ground reports for companies they are looking at.

The story behind the investment

The managers are seeking globally unloved companies; good companies fallen on hard times and with the potential for recovery.

The managers seek out the companies which have had a setback but where long term prospects are believed to be intact. These companies can be out of favour for many reasons including weak short term profitability, economic concerns or under strength balance sheets.

One of the holdings which falls into this category and has been in the news recently is Barclays. The stock has not recovered as other banking stocks such as Lloyds and continues to be hit by bad news. Over 12 months the share price is down nearly 20% and analysts continue to cut forecasts on bad profit results.

The argument from the managers is that the market underestimates the ability of a business to improve their situation over time. The process is highly disciplined which they summarise as an 'unemotional valuation driven philosophy'. By this they mean that they look to exploit short term bad news, and investor anxiety. Again using Barclays as an example the negative headlines mean investors sell and this gives a long term investor the opportunity to buy at bargain prices.

However the managers stressed that by going global although it gives an opportunity set of 10,000 companies, the expression of needing a hard hat and open mind is crucial. Many of these companies will take time to recover and there is no crystal ball to predict exactly how long it will take. This means investors must be prepared to take short term pain for the potential of long term gain.

This is a low turnover fund which means the managers are prepared to hold as they wait out the various recovery stories.

In summary companies will at times go through difficult periods, investors will become disillusioned and prices become low. By looking out further than the next few quarterly earnings updates this scenario presents excellent opportunities if patience is practiced.

Fund highlights?

The managers highlighted the Apollo Group as a story to focus on. We also picked up holdings in Saab and Barclays. (We have touched on Barclays.)

Saab is a company probably better known in the UK for cars but is an aerospace and defence company with Saab cars being a subsidiary which went into liquidation. It has recently been sold and new cars are being produced for the Swedish and Chinese markets.

Looking at its latest shareholder reports one can see that the company is going through an ongoing period of restructuring. It continues to sell non-core assets which have generated SEK 1.8 billion. Further into the report the management talk about further efficiency measures to drive growth. The share price has increased by nearly 150% over five years and clearly the managers feel that focusing on core assets will make the company more profitable and this will show through into the share price.

Saab is winning global contracts and surprised the market with a $4.5 billion contract to supply Brazil with 36 new jets as well as supply and service contracts expected to be worth billions of dollars. It is these stories that are sometimes missed by the market and are when companies stage recoveries.

Another highlighted example was the Apollo Group. This is not a company I know much about; it is a global education supplier with its roots in the US. Over five years the share price has fallen over 60% although in the last year it has risen 63%. The group faces a number of short term issues including:

- Government subsidised tuition led to excessive growth and industry-wide bad behaviour
- Cyclical downturn limiting ability of new students to afford further education
- Excess admissions working their way through system – profits likely to decline

However the managers outlined the long-term rewards:

- Education provides enhanced job prospects – for profit companies required to deliver teaching capacity
- Size gives marketing resources that competition cannot match
- Industry leading on-line tuition technology
- Net cash balance sheet
- Capacity likely to leave industry

The stock is currently trading on a P/E of 6x earnings. Half its market cap is in cash, none of it is trapped overseas and the current cash flow yield of 13%.

In summary we covered the top twenty holdings which include Barclays, Saab, Apollo as well as the likes of AstraZeneca, Nokia and Hewlett-Packard. However, the key message is that the managers are not wedded to a particular sector or country but on the fundamentals identifying sustainable long term businesses which have the potential to make a full recovery which when they invest is still unappreciated by the market.

Fund performance

Performance since launch is shown below.

	Launch (9/10/13) – 31/12/2013	**2014**	**Since Launch**
Schroder ISF Global Recovery Fund	6.99%	-0.30%	6.67% p.a.
DB X-Trackers FTSE All World Ex UK ETF	4.52%	-3.25%	1.12% p.a.

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. 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. Returns are based on the US share class.

Conclusion

In summary this fund is ideal for investors looking to benefit from global recovery stories with a long-term investment time frame. There will be short term volatility and investors must be prepared to accept this. The performance on the UK version has been strong and the track record on this is very short and therefore difficult to judge. Investors may be limited on how they can access the fund particularly as this has only been available since the end of 2013.

The source of information in this note has been provided by Schroder's and is correct as at January 2014. 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 rise.