

SHINING A LIGHT ON.....
SCHRODERS EUROPEAN ALPHA INCOME FUND
(PREVIOUSLY CAZENOVE EUROPEAN INCOME FUND)

At a glance

Since Draghi's 'do whatever it takes' speech in 2012 the markets have become less worried about the collapse of the Euro and peripheral economies. There is a greater confidence around political stability in Europe.

However, investors continue to be wary of Europe which is reflected in negative inflows over the last five years. Towards the end of 2013 the outflows reduced and although still negative in aggregate it continues to narrow. As a consequence we are seeing more European fund managers on the road explaining why now is the time to invest.

We have met managers from JPM and BlackRock recently and although the funds are good we haven't had a sense of anything special.

Cazenove, a boutique investment house, was recently purchased by Schroders and one of the funds which came across was the Cazenove European Income Fund managed by James Sym.

The fund was established in May 2012 to take advantage of opportunities in Europe and has an unconstrained, conviction led philosophy making it stand out from the crowd.

In our meeting with James there were two areas we wanted to explore; firstly there is an argument that stocks in Europe have been so beaten up that anyone can make money and therefore can James continue to deliver in a recovering market, and secondly the culture at Cazenove is very different to Schroders and will they continue to support him in periods of underperformance.

Who are the team behind the fund?

The fund is managed by James Sym. James joined Cazenove Capital in 2007. He moved to the European desk in January 2012 with a primary focus to work with Chris Rice on the Cazenove European Income Fund. James was appointed co-manager of this fund on 1st November 2012, and when Schroders took over Cazenove Chris Rice left and James took the lead manager position.

What is the story behind the investment?

Some commentators argue that the US has had a strong run and there is not much more that can be gained from this market whereas the opposite is true for Europe. Although the European market was one of the strongest in 2013 much of it was through re-rating rather than growth.

The lead indicators (PMI and Consumer Confidence) indicate that this growth can come through in 2014 (although the economies are very fragile). The Q1 and Q2 corporate earnings news will be a crucial to how 2014 will behave.

Additionally companies in Europe are sitting on over €1 trillion on balance sheets. As companies feel more confident on the outlook the markets would expect this money to be put to use. This could be through M&A activity, buy-backs and special dividends.

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If the news is positive the belief is that the second half of the year could be strong for European equities.

Fund highlights?

We are always looking for hidden gems and this has the potential to be.

A key question for us is whether James has been lucky, European stocks have been so beaten up that anyone can make money. As the market recovers this will identify the managers who have been lucky, and those that have the ability to perform whatever the cycle.

The answer to this question lies in the style of management for the fund. James argues that there are four cycles – slowdown, recession, recovery and expansion. Within each of these stages there will always be stocks where an investor can make money. The fund itself looks to call the point of the cycle and find stocks which have the potential to outperform during that point of the cycle.

Atresmedia is a Spanish Media Company. This market has been crushed with revenues down 50% from the peak. As a result the market has consolidated from 8 players to the top two players controlling 90% of the market.

At its lowest the stock was trading at 3 x earnings and although it is not making money it is assumed that as the recovery comes into Spain so too will profit margins increase; as a result the stock is now trading on 10 x earnings.

This is an example of buying in at the recession and moving out in the recovery phase (James has now sold the stock to search out other opportunities in the market).

Examples of recovery cycle stocks are Wienerberger and Renault.

Wienerberger are the world's largest brick manufacturer, and are starting to see a pick-up in key markets in the UK and Germany. As the recovery bites and more houses are built this stock provides the potential for considerable upside (currently trading at 3.9 x peak earnings).

Renault has seen European car sales are at an all-time low; over the last five years it has significantly reduced its debt, moved away from state influence and set up a joint venture with Nissan. It also has its own bank which provides the finance for individuals buying their cars. James believes although there has already been upside to the stock there is more to come as the recovery cycle works through.

There is a risk with the strategy and that is that he calls the cycle wrong. We can see that since launch he has got it right and we do not believe this down to luck however it will be interesting to see how he works through each cycle.

The second discussion with James was around culture. The lead manager of the fund left when Schroders purchased Cazenove; clearly he felt the culture was not the same. James explained that the fund should be seen as a 3 to 5 year investment and that there will be periods when it underperforms however he believes Schroders understand this approach and are supportive of it. Certainly he has been able to continue with his investment style however we haven't seen any underperformance so we won't know until this is tested as to the level of support he actually receives.

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In summary we believe this fund does stand out from the crowd. There remains a perception that anything with income in its title is dull and certainly this fund has demonstrated its ability to outperform pure growth funds. The calling of the cycle is a challenge and a risk for the fund and therefore we would suggest this is blended with other European Funds.

Fund performance

The table below shows performance since launch (1 May 2012) and going into 2014:

	2012	2013	2014	Since launch
Schroders European Alpha Income fund	14.98%	39.47%	9.05%	74.88%
iShares MSCI Europe Ex UK	8.26%	21.74%	1.34%	33.57%

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.

Conclusion

The fund is a hidden gem with strong outperformance driven by a contrarian approach to investing. We don't believe James takes undue risk in achieving these returns however the risk is in calling the cycle wrong. We would consider adding it to our portfolios because of this approach and the fact that it offers a different approach to investing in Europe.

The source of information in this note has been provided by Schroders and is correct as at March 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.