SHINING A LIGHT ON……
NEPTUNE UK OPPORTUNITIES FUND

At a glance

There are over 400 UK Equity Growth and Income Funds; providing investors with access to many different investment styles. So choosing the right fund depends upon understanding their methods and aims.

Performance is part of the equation but equally the management team is crucial. We have met a number of talented Fund Managers, the likes of Standard Life Investments, Neptune, Schroders, Legal and General, Threadneedle and Liontrust (not all of these are in our portfolios).

Until 12 months ago we held the Neptune Special Situations Fund in our portfolio. Primarily we liked the manager and therefore the fund. The manager moved to Schroders and was replaced by a relatively inexperienced manager. Although he had managed a fund himself and was deputy on the fund we felt his track record was limited.

Twelve months on we had a follow up meeting with the manager to see how he has settled in and what the fund is doing.

Who are the team behind the fund?

Scott MacLennan took over the management of the fund in April 2013 and acts as assistant manager on the UK Mid Cap Fund. He joined Neptune in January 2012 as an investment analysis and has support from the 5 strong Neptune UK equity team.

Fund highlights?

A lot of the meeting was trying to understand more about Scott and how this would feed into the fund.

In November 2013 the Neptune UK Equity Fund and Special Situations Fund were merged creating assets under management of just over £50 million and the new fund was called the UK Opportunities Fund. Since then it has gained from growth in the portfolio and positive inflows to £63 million.

Scott explained that little has changed since Alex left, he continues to search out special situations and targets undervalued stocks. It is a multi-cap fund with around 50% in small and mid-cap and the balance in large and mega cap stocks.

The fund has around 50 stocks and there is greater conviction in the top ten holdings.

One of the main characteristics behind the fund is to identify the worst case scenario, so looking at limiting downside risk but also combing that with upside potential. He believes by adopting this approach he won’t necessarily be the top fund but he will consistently outperform through thick and thin.

He has adopted the style of the previous manager and many of the holdings still reflect choices made by the previous manager; although he has made some changes.

We talked about some stock examples, Kenetic is a business which spun out of the government. On paper it is not a good business to buy – its market is shrinking and it has a lot of fat to cut. To Scott this is an example of a misunderstood situation where under the surface you discover that earnings growth will come from internal restructuring.

Another example is Entertainment 1 which is the largest non US independent producer and distributor. It has a library of content of $650 m. It is a play on the value of content and how the thirst for content grows so these businesses will benefit. When he entered the position it was at 11 x P/E, now it is 14.8 x P/E. (P/E is price to earnings ratio, a lower ratio can be a positive time to invest).

We talked about how it has been easy to make money and now this is changing. He admitted that there are fewer opportunities and therefore it will be harder to drive returns but he believes the opportunities are there.

Since he took on the fund he has significantly outperformed the market. The concern is his experience which is less than 3 years and managing a fund for just over a year. He has come in at a time when everything was in his favour and now we are moving to much more volatile period and it is unclear how he will respond in this market.

On paper and listening to him clearly risk / reward are key and protecting on the downside is crucial, but it is difficult to test this. Also although he has started to feed in his stocks the portfolio in the main is that of the old manager and perhaps it will be 3 years before we will see whether Scott can deliver.

For investors looking to invest in special situations then this fund certainly gives that exposure and the aim to reduce on the downside is important. It has a long term track record of outperformance but investors need to consider whether they trust such a young manager to take this fund on. On the flip side Scott has demonstrated strong performance since he took the helm and is well supported within Neptune. It sometimes pays dividends to invest with someone at the start of their career because if they are good then you will get in early and perhaps capture more of the growth before others follow.

Fund performance

Performance over the last five years is shown below, and year to date.

	2009	**2010**	**2011**	**2012**	**2013**	**2014**
Neptune UK Opportunities Fund	29.11%	19.36%	-5.36%	19.14%	34.06%	0.77%
Lyxor ETF FTSE All Share	29.16%	15.40%	-4.61%	11.67%	20.16%	3.08%

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

We liked the previous manager and the style. The style has been carried on by the existing manager and performance has remained strong. Our concern remains around experience of the manager and any investor will have to come to their own conclusion around this.

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