SHINING A LIGHT ON……
FRANKLIN UK MID CAP 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).

We recently reviewed the Franklin UK Managers Focus Fund. This was an interesting fund because it brought together the best ideas from across the UK team into one fund. Effectively it was their shop window to the world. One of the managers which stood out was Paul Spencer who manages the UK Mid Cap Fund.

We highlighted his excellent track record but with negative sentiment towards mid cap stocks the question is whether now is the time to invest and if so whether this fund can respond to this evolving environment.

Who are the team behind the fund?

Paul Spencer is the lead manager. He started his investment career at Rensburg in 1987 before leaving in 1995 and then re-joining in 2006 to manage the Mid Cap Fund. When Rensburg were acquired by Franklin Templeton in 2011 he joined them.

Over an eight year period he has 100% record of outperformance against his peer group.

He is supported by Richard Bullas and Mark Hall. Richard has a small cap bias and manages the UK Smaller Companies Fund. Like Paul he has a 100% record of outperformance. Mark Hall previously managed the UK Select Growth Fund.

It is a close knit team who have worked closely together for many years.

Fund highlights?

We have seen mid and small cap stocks fall out of favour in recent months as investors turn to large cap defensive stocks and this update gave us an opportunity to understand how this might impact on future returns for the fund.

There are number of aspects of the fund which make it stand out from the crowd and in theory these should enable it to respond to the changing environment.

Firstly this is a high conviction and concentrated portfolio of currently 36 stocks. It can go up to 45 holdings and currently the top holding is 4.7% of the portfolio and the bottom 1.65%.

This is important because Paul believes the recent weakness is the mid cap space and switch to large cap is more about sectors than the market cap. Money is flowing to Pharmaceuticals, Tobacco and Integrated Oils all of which are not heavily represented in the mid cap space.

The fund itself currently favours engineering, electronics, housing related (builders merchants, buy to let and residential lenders), retailers and leisure and has zero exposure to insurers, oil and mining, food producers, telecoms, gaming and transport.

So effectively the concentrated and conviction based approach should enable the fund to perform even if the market in places is patchy.

Secondly the sell-off in the mid cap space has delivered opportunities to buy quality companies which offer robust balance sheets, attractive business models and shareholder friendly management teams.

Additionally the focus on good companies in the particularly fields they operate in offers other opportunities. Many possess strategically valuable intellectual property and hold very strong market positions. In turn this means they are potential bid targets for larger companies particularly in defence, media, electronics and engineering sectors.

On stocks the fund has benefited from good performance from holdings like Carphone Warehouse, Bodycote, Rathbones and Thomas Cook but suffered with Just Retirement (1.43% of the fund) after the Government's decision to end compulsory annuities in the budget, Cairn Energy (zeo weighting) over retrospective tax changes in India and Drax following a Government U-turn on support to biomass power plant conversion.

The fund has added holdings in Euromoney Institutional Investor, Rotork, Croda, Restaurant Group and International Personal Finance. It has sold Spirent and Premier Oil on the back of operational disappointments and Premier Farnell and Esure on full valuations.

A more concentrated list of holdings means that every holding has to work for the fund and we can see that the manager is active in buying and selling holdings. There are also events which any manager will face which they cannot predict and this has gone against the fund with the likes of Just Retirement.

There is little to be negative about on the fund it is a mid-cap fund and it will sell holdings when they enter the FTSE 100 our only concern would be on size. The fund is now over £1 billion and if it continues to grow then it may be harder for the manager to run a concentrated portfolio and we have seen as funds get larger the performance can start to lag.

In summary this is a well-managed fund with a track record of outperformance. Although mid-cap appears out of favour the manager believes the fund has the capacity to deliver. Investors will need to decide whether they believe mid-cap can outperform over the long term and whether this fund is the best option to achieve this.

Fund performance

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

	2009	2010	2011	2012	2013	2014
Franklin UK Mid Cap Fund	45.02%	32.72%	-5.98%	27.18%	36.77%	-4.57%
Lyxor ETF FTSE All Share	29.16%	15.40%	-4.61%	11.67%	20.16%	0.87%

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 believe this to be a well-managed mid-cap fund delivering consistent out-performance. The management team is strong and there is little to be negative about. Potential investors would need to compare to other mid-cap funds before deciding whether this is the right fund and would need to consider whether if there is a downturn in mid-cap this fund can deliver positively in this environment.

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