SHINING A LIGHT ON……
SLI EUROPEAN EQUITY INCOME FUND

At a glance

2013 was a fantastic time for European Equities, however much of that was momentum driven with poor peripheral stocks driving the returns. This meant that funds tracking the index tended to outperform active managers. The optimism of 2013 drove many investors back into European markets on the assumption that it would continue into 2014. So far in 2014 the market has been flat.

With so many funds in the sector it is very hard for an investor to choose. One fund which we have followed is the SLI European Equity Income Fund. Since launch it has significantly outperformed the benchmark but over the last 20 months it has only tracked the index.

We like the approach of the manager which attracted us to the fund, but our concern is around recent performance and whether the outperformance will start to narrow. It is a large fund with over £2 billion under management but with just 60 holdings. No one stock dominates the fund.

This is the second time we have met the manager and in this update we wanted to explore some of the management style and some of the positioning so potential investors can consider whether this is a fund they should include in their portfolios.

Who are the team behind the fund?

The fund is managed by Will James. He has a track record of outperformance against his peer group and tends to perform well both in a down market as well as an up market. He joined Standard Life Investments (SLI) in 2007 and has managed the fund since its launch on 3 April 2009.

Fund highlights?

When we review funds, we like to find something that makes the manager stand out from the crowd. The harsh reality is that although many managers can outperform the index, the style doesn't deliver anything significantly different to the market.

This may sound negative, but the reality is that it can be easier to compare against other funds because for similar funds it is less about style but more about performance. Alternatively where you know a fund does something different and the performance is significantly better, an investor can decide whether the increased risk is worth taking for any potential reward.

Talking to the manager, what we like about him is the disciplined approach with a focus on capital protection and yield. However, looking at the process and style there isn't anything that really makes him stand out. The process might be different but the outcome is the same.

So how should investors look at this fund? For growth investors, returns will be made up of capital growth and income. The income also provides 'protection' in down markets and it is clear from speaking to the manager that capital protection is important. It doesn't mean investors won't lose money. In 2011 the index was down over 17% whereas this fund was down just over 10%.

This isn't a quick 'in and out' of Europe Fund. This should be seen as a long term 'hold' fund and performance indicates that taking this approach has delivered significant outperformance for investors. Investors therefore need to test this performance against other similar funds before deciding if this is right for them.

The style of management follows some of the other income funds managed by Standard Life. Holdings are split into three categories:

1. Premium and sustainable dividend yield – this makes up around 50% of the fund. These are companies where the dividend growth is limited (circa 0 to 10%) but they are paying healthy dividends (currently circa 3.9 to 9%)
2. Dividend growth at a premium to the market – this group makes up around 35% of the fund. These companies are paying lower dividends (currently circa 2 to 3.8%) but the dividend growth is expected to be in the region of 10 to 30%
3. Dividend paying capacity significantly mispriced – less than 15% of the fund, these are the highest turnover stocks with quick profit taking offering dividends around 1.5 to 8%

This is not a true conviction led fund i.e. the top holdings make up only around 2 to 3% of the fund. This reduces volatility as no one stock dominates the returns (or losses). Its approach is not to chase short term momentum which reflects the poor performance in 2013 and 2014. 2013 was driven by momentum whereby poor stocks like Italian Banks drove the index higher.

So the message for potential investors is that they shouldn't suffer any nasty shocks by investing long term and this is a steady eddy. There is also stability in the management in that the manager has been at the helm since launch and this is important as the style hasn't changed since launch in 2009.

As to the types of stocks, these are mainly large cap stocks. For example Ryanair has been held three times since the fund was launched. Will has recently purchased the stock again on the back of profit warnings. The reason is that the company is embarking on a new strategy to move away from low cost travel, it continues to generate cash and it is growing market share.

Another couple of stocks he has purchased are Nokia 5% 2017 convertible which he hopes to benefit from equity upside and yield enhancement and Danske Bank to participate in the recovery of the Danish economy.

In summary this is a large fund (circa £2 billion) with a track record of significant outperformance. Short term performance has lagged but this reflects the style of management which is not driven by momentum. There is nothing that makes the fund stand out and therefore risk / reward will be the key reason for investors to consider, so volatility isn't as high as some funds but the returns might be compromised as a result.

Fund performance

The table below shows performance since 2009 and going into 2014:

	2009 *	2010	2011	2012	2013	2014	Since launch
SLI European Equity Income Fund	27.29%	11.81%	-10.41%	21.98%	23.20%	-1.15%	12.53% p.a.
iShares MSCI Europe Ex UK	31.47%	1.95%	-17.85%	14.00%	21.74%	-1.11%	7.93% p.a.

**launch 3rd April 2009*

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

A steady eddy fund with a good long term track record and a stable investment team at the helm. It has nothing that particularly stands out and should potentially be seen as a long term holding.

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