

SHINING A LIGHT ON..... GLG UNDERVALUED ASSETS 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).

The Matterley Undervalued Assets Fund was established in August 2008 and delivered strong out-performance compared to the benchmark. In 2013 the manager left Matterley and joined GLG where they replicated the fund and launched the GLG Undervalued Assets Fund. He also continues to manage the old Matterley Fund.

The fund has attracted nearly £150 million since its launch and therefore reflects the faith many investors have in the manager's style. The name of the fund seems to imply its style is more akin to the M&G Recovery Fund or the JOHCM UK Dynamic Fund. In both cases these funds look for undervalued businesses and back them through to recovery. By their very nature the holdings tend to be long term and in particular with the M&G Recovery Fund the holdings can be up to 10 years.

This fund does seek out undervalued stocks which might be classed as recovery but the time frame is much shorter with a two year time frame. In fact a proportion of holdings achieve their target price within six months of the investment being made. So effectively this fund is about exploiting market weakness in shares and selling when the upside comes.

This to some extent makes it closer to the SLI UK Equity Unconstrained Fund which looks to invest in good businesses which are undervalued. Comparing the performance SLI has significantly outperformed but the big difference is volatility; the SLI Fund has volatility at around 18% whereas the GLG Fund is around 13%.

Effectively to achieve this level of outperformance investors have to accept a higher degree of volatility as can be seen in the falls in 2011 where the SLI down 10% more than the Matterley Fund, even going into 2014 the SLI fund has not responded well to the more volatility markets. It doesn't make one fund better than the other but it gives investors an idea where to place the fund.

In this update with the manager we cover his thoughts on where the opportunities are and talk about some of the areas he sees value.

LWM Consultants Ltd

Who are the team behind the fund?

Henry Dixon is the lead manager of the fund and his co-manager is Jack Barrat.

Henry co-founded Matterley with George Godber back in 2008 and it was acquired by Charles Stanley in August 2009, at which stage Undervalued Assets had just £2 million under management.

Henry and George jointly managed the fund from launch in August 2008 until George left to join MAM Funds in 2012, taking analyst Georgina Hamilton with him. They had built up a loyal following with assets under management of £75 million,

Henry is well regarded in the industry and moved to GLG in 2013 with his co-manager Jack Barrett and analyst Alice Sharp. Previously he worked for New Star and Family Charities Ethical Trust.

Fund highlights?

Much of Henry's thinking and choice of investments is centred on his view of the economy over a two year horizon and what opportunities are presented.

So the first part of the discussion we had was around whether there was still value in UK market. His feeling is that based on a pure P/E ratio equities are close to the 30 year average and above the 95 year average. However, on another side the dividend yield is running below the 30 and 90 year average.

Going further Henry explained that in 2009 38% of shares were below the 95 year average, today it is around 19%. So the squeeze on value is getting tighter and the opportunity set smaller but there are still opportunities if you look.

So what does this all mean?

Henry went onto explain this further using a scatter graph which identifies where the potential opportunities are. This graph showed that the percentage of stocks which are overvalued is around the 52% mark, although this has dropped below 50% in the recent sell off. These are the types of stocks he will avoid preferring to focus on stocks with undervalued returns or assets. It sounds such an easy process but the skill lies in identifying those businesses which fall above and below the line.

An example of an undervalued return stock is Admiral which has a cheap cost base and drives exceptional returns but the market is not pricing that in. But just because he sees opportunities it doesn't mean he will invest. In this he prefers eSure where he sees greater opportunities.

So effectively he is taking a view on the UK market and then identifies pockets of weakness and therefore opportunities. The current number of holdings is 70 and the top 5 holdings make up nearly 20% of the portfolio so the question is where he finds value.

There are three areas where he sees potential value – mining, oil and supermarkets.

Talking Supermarkets and Oil as examples; he feels that supermarkets are tricky because he doesn't know where this could lead so they could be value traps, and therefore he is prepared to wait to see how the market plays out. In oil the fund has holdings in BP and Shell, BP remains unloved despite all the changes in the business since 2012.

LWM Consultants Ltd

Other areas of interest and value include banking, he currently has a holding in Lloyds in the top ten holdings, house buildings (or companies associated with the housing sector) – an example he gave was Howden's where the share has fallen significantly but for no reason associated with the business. He also likes airlines but is holding back because he fears that Ebola may impact on prices if an outbreak occurs in the UK.

Other areas are financials (excluding banks) and Postal Services. These last two show that the fund can and does invest in Europe. Currently around 11% is in Europe and it can go up to 20%. Two financials he likes are Allianz and AXA. He also invested in Belgian Post and Dutch Post as opposed to Royal Mail. He has now sold these holdings as the target price was achieved.

Constantly you get a feel that Henry is looking for value and where companies are undervalued by the market and how he can make money.

So how do they avoid value traps? They target companies which are trading below their estimation of their replacement cost but they must be cash generative with a strong balance sheet. The focus is very much on the company's assets, cash and cash flow (he hates debt). When we talked about airlines BA was an example where the business is very cash generative and it is trading below the replacement cost but he doesn't want to invest because of the risk of Ebola impacting on the share price.

The point is that returned is measured against risk. Not only to avoid value traps but also consider other potential risks.

The fund is about Henry's view but he has demonstrated his ability to deliver significant outperformance. Every stock is priced one year forward and the sell discipline is crucial, around 58% of sells is based on the price target being met. The balance is due to downgrades or a reduction in cash generation.

The whole style means that the fund is a large turnover fund, this can generate greater costs and therefore potentially be a drag on performance particularly on the downside. So the average turnover is around 50%, this fund is sitting at around 120% and there is one fund we are aware of that has a turnover of over 1000%!

In conclusion it is a stock picker's fund which looks to exploit short term weaknesses in share prices. This is not a buy and hold strategy and therefore may not appeal to every investor. It currently has around 75% of the holdings in mid to large cap with the bias to large cap. Henry has demonstrated his ability to out-perform the market without undue volatility based on the UK sector. Although there is risk with the strategy clearly the focus on cash generative businesses with little debt helps to reduce that risk.

LWM Consultants Ltd

Fund performance

Performance over of the Matterley Fund since launch to the end of September vs the SLI Fund and Index is shown below. We have also included an additional table showing the new GLG Fund vs the Matterley Fund, SLI and Index since its launch on 15th November 2013.

	2009	2010	2011	2012	2013	2014	Since launch
Matterley Undervalued Assets Fund	39.33%	29.31%	-9.54%	23.89%	37.09%	3.02%	114.63%
SLI UK Equity Unconstrained Fund	99.36%	38.53%	-20.44%	44.30%	43.41%	-3.44%	172.29%
Lyxor ETF FTSE All Share	29.16%	15.40%	-4.61%	11.67%	20.16%	0.53%	52.07%

	2013	2014	Since launch of GLG Fund
GLG Undervalued Assets Fund	5.00%	2.88%	8.02%
Matterley Undervalued Assets Fund	6.28%	3.22%	9.49%
SLI UK Equity Unconstrained Fund	4.50%	-3.44%	0.91%
Lyxor ETF FTSE All Share	1.75%	0.53%	2.29%

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

A well respected fund manager delivering excellent long term outperformance; it is a high turnover fund and relies on Henry's stock picking skills to deliver on the performance.

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