

SHINING A LIGHT ON..... SCHRODER GLOBAL PROPERTY FUND

At a glance

With a rising interest environment there is an argument that fixed income investments i.e. bonds will suffer. Another area which some argue will suffer is property. The reason is that many property funds have moved away from pure bricks and mortar to a basket of REITS (Real Estate Investment Trusts).

This is true where the REIT is heavily indebted and / or badly managed and therefore investors need to consider their options carefully. Of course investors could go for bricks and mortar but many investors remain raw about the closure of many of these funds in 2008 due to liquidity problems.

Of course investors could just ignore property, ignore bonds but that leaves them with cash or equities and therefore for a balanced portfolio a holding in property should be considered. The managers of the fund suggest this should be around 9% to 10%.

The fund which we have recently met the managers for is the Schroder Global Property Fund. Two things investors need to be aware of when looking at this fund – firstly it does invest REITS which we will cover further, and secondly performance has been patchy.

We will cover the second point in this introduction as this is important. The fund was previously outsourced to a third party. The management has now been brought in-house and is managed by Tom Walker and Hugo Machin. They only took over the management of the fund in July 2014 having previously worked at AMP Capital for over 8 years where they managed a property fund worth over \$6.5 billion.

More importantly is their performance over that period which was top quartile over 1, 3 and 5 years. Fundamentally Schroders recruited them to replicate the success they had had. We have stressed this many times and that is just because someone has done well before it doesn't guarantee success in the future and investors need to consider this if they consider this is a fund to invest in.

The managers have started to move the portfolio to what they consider is their unique style of management. Reducing or removing positions in the portfolio, adding in new holdings and increasing existing holdings. It may therefore take time for investors to see any change in performance as the fund is modelled towards their style of investing.

In this update the managers talked about what they feel is a unique approach to investing and why their fund is different to others currently being promoted.

Who are the team behind the fund?

The co-managers are Tom Walker and Hugo Machin who worked together at AMP Capital for over 8 years producing excellent returns (note this is not guaranteed in the future). They have both worked in Sydney focusing on the Asian Market, travelled extensively in the US and now are based in the UK focusing on the European market.

This knowledge of the global market is supported by 2 analysts in London, 3 analysts in the US and 9 analysts in Asia as well as the wider support of the Schroder Group.

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It is a team with a track record and support from a large organisation. Clearly from the update they have their supporters based on what they have done in the past and for Schroders to have brought them on board they must respect what they do.

To repeat, our concern is that the past is not the future.

Fund highlights?

Hugo and Tom started by discussing the asset class, covering performance, volatility and interest rates as all of this is part of the essence of the fund.

The asset class itself has returned 9.4% p.a. over the last 10 years which is comparable to global equities and in their view delivers an attractive return. The fund invests in companies which have direct real estate exposure so investors do have that exposure but the shares are liquid which means accessing money is no different to trading any listed share. Equally the focus is not on one market but a global market.

So effectively you have a liquid global asset class which has delivered solid returns over the last ten years (but of course this last bit is not guaranteed).

A rise in interest rates could impact performance because the cost of servicing debt increases but this is something that both Tom and Hugo explained was an important lesson of 2008. That is that to absorb this and deliver sustainable returns you need to pick companies which perform across the economic cycle, have a low level of debt, can sustain any increase in interest rates with minimal impact on the top line and have a management structure where their interests are aligned with shareholders. Utopia!!!

We keep saying in our reviews that we are looking for something that is different and the managers believe they have a unique style. Certainly listening to them it appears that what they offer is different to others. Their style is about investing on a horizontal basis with a quality bias.

So what does this mean? If they are considering a company in Hong Kong the factors for assessing that against one in the US are likely to be different; in particular the focus is more likely to be on the corporate governance as in the US transparency is much stronger. What this does is deliver a risk adjusted view of the company in Hong Kong vs a similar business in the US; at that point they can consider which one will give them the greater upside.

There is no bias to a region or sector it is a pure bottom up process looking at value and risk scoring. It is the experts on the ground who will give the managers advice and just because they are underweight or overweight a region or sector doesn't mean they favour it, there are just opportunities in those areas. They do check that they are not heavily overweight seeking advice across the company if this happens.

We talked about their two-step process comparing two UK companies – Big Yellow and British Land. With Big Yellow the two areas to assess the risk score were management and governance and this showed a risk score of 9. With British Land the focus was on the balance sheet and this showed a lower risk score of 5. The valuation for Big Yellow focused on dividend yield whereas with British Land it was NAV. Once these numbers were crunched Big Yellow showed the greatest upside and therefore it had the largest weighting. British Land is a quality company but the weighting was lower.

This demonstrates the search for quality, value and upside.

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The fund is currently playing four themes at the moment:

1. Strength of the tech, telecom and media market – this is fuelling the demand for properties in London and San Francisco. One of the holdings Boston Properties has just secured one of the largest deals with Sales Force.
2. Retail exposure in the UK – investing in shopping centres which can work in tandem with the internet, for example Bluewater
3. Energy independence in the US – in Texas the growing demand for industrial and office exposure
4. Age care – looking at the affluent elderly and looking for companies which are benefiting from these individuals

Against the sector the fund is underweight North America with 49.7% holding and the managers explained that there are some interesting areas to invest but others are expensive. The fund also has a 33.5% holding to Asia and 16% in Europe. But it is important to stress that the focus is on the companies and not countries and therefore this will change.

Clearly for investors looking for exposure to the property market this is an option to consider. The concept of comparing companies and looking for the best returns seems where they can add value and have done in the past. Lower debt and quality companies should soften any impact from interest rate rises. A concern would be whether they can replicate their success.

In summary a proven process but not at Schrodgers; investors may like their style but need to consider carefully whether success can be replicated.

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Fund performance

Performance since 2009 is shown below vs the index.

	2009	2010	2011	2012	2013	2014
Schroder Global Property Fund	27.81%	19.67%	-7.01%	21.33%	-1.01%	5.32%
iShares Developed Markets Property Yld	20.53%	21.13%	-4.65%	12.93%	-4.17%	9.54%

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 bottom up actively managed property fund with a team with a proven track record; the process is governed by risk and valuation using flexible inputs. By this they mean that different markets and businesses have different factors to consider when comparing to another business. As we have mentioned many times performance track record can only be based on the past.

The source of information in this note has been provided by Schrodgers 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.