

SHINING A LIGHT ON..... L&G UK ALPHA TRUST

At a glance

In a crowded market finding hidden gems can be tricky. The UK sector is one of those that has a vast amount of funds and in most cases the performance of the top funds is fairly similar over the long term. For the more volatile funds, to identify the good ones is much harder because they will have perhaps 2 or 3 outstanding years and then 2 or 3 poor years but overall over a 5 to 10 year period the performance is strong.

It is therefore about navigating this market to find the right fund. The L&G UK Alpha Trust is one fund which might not stick out but could be worthy of consideration. Established in May 2005 it has been managed by the same manager since launch. Its performance since launch is excellent but its shorter term performance is less strong and this might deter investors.

The fund does have a point of difference which is reflective in the performance and although the short term volatility of the fund might not appeal to all investors it may have a place with other investors. In this update with the manager we focus mainly on our concerns around the short term performance and whether there is potential to turn this around.

Who are the team behind the fund?

The fund is managed by Richard Penny.

Richard joined LGIM in 2003 and is a Senior Fund Manager within the High Alpha Team and the Manager of the L&G UK Alpha Trust as well as a number of segregated portfolios. Previously he worked for five years as a Fund Manager for M&G Investment Management and prior to this, for four years as a Fund Manager at Scottish Amicable Investment Management.

Over 3, 5, 7 and 10 years he has outperformed his peer group composite.

Fund highlights?

This fund invests primarily in the micro and small cap market. By the very nature of its holdings it will have periods where it will significantly underperform and periods where it significantly outperform. So 2009, 2010 and 2013 were stand out years for the fund, however 2012, 2014 and the start of 2015 have not. If we take performance from 1 October 2010 to date then the fund has marginally outperformed the All Share Index but since launch in 2005 it has significantly outperformed the index.

Drilling down further the top ten holdings make up 45% of the fund, there are currently 45 holdings. This means any negative move in any of those holdings will be negative for the fund. An example he gave was an Indian Company listed in the UK. This is one of the largest holdings. It is benefiting from the reforms in India and is growing strongly (15 to 20% p.a.), the manager added the holding at 160p with an expectation that the shares should be worth significantly more. Independent analysts have estimated the shares are worth 300p plus, although his expectations are less.

Because this is a micro-cap stock any sudden sell-off impacts the share price irrespective of how well the company is performing. Some institutions sold their holding pushing the price down to 105p, it has since recovered to 117p but remains significantly below the entry point for the fund. Richard

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continues to believe in the stock and believes this will correct. He has used this short term volatility in the share price to add to his holding but it shows the impact negativity on one or two stocks can have on the performance.

An example of how his patience works is Smart Meters which he purchased at 60p and the stock is now 330p. The stock has fallen back from highs in December of 400p but he believes there remains value in the stock and although this has been a negative contributor to the fund in the short term, long term it has significantly benefited the overall performance of the fund.

The nature of the holdings also means that it doesn't behave in the same way as the market. So 2012 was positive for the market but initially the main beneficiaries of this were the large cap stocks and it took time for this to filter through to the micro and small-cap funds. This meant 2012 was weak for the fund but 2013 was strong.

Richard remains of the view that this fund is not for those who are looking for a short term win. This is a fund where investors are prepared to be patient and wait. It is volatile and its performance over 5 years is questionable but performance since launch and six years is much stronger. It is a relatively small fund (£197 million) and this helps it operate in the markets it aims to drive value.

It is a fund that Richard supports, investing three times in 2005, 2009 and 2014 and a display of his belief in the strategy and he feels puts him closer to those who invest in the fund. He doesn't see this as a core holding for people, but perhaps a blend with a less volatile fund (or funds). It certainly won't appeal to all investors, and the recent underperformance does beg the question can it reverse.

In summary this is a fund positioned to drive returns from the small and micro-cap market. Investors should be prepared to accept short term volatility and periods of underperformance but in theory over the long term the fund should deliver considerable upside. Potential investors need to consider whether what he has achieved in the past is capable of being achieved in the future.

Fund performance

Performance for the past five year's vs the benchmark.

	2010	2011	2012	2013	2014	2015*
L&G UK Alpha Trust	35.73%	-14.43%	6.18%	42.11%	-1.75%	-3.11%
Lyxor ETF FTSE All Share	15.40%	-4.61%	11.67%	20.16%	0.93%	2.70%

	1 year	3 years	5 years	6 years	Since launch**
L&G UK Alpha Trust	-8.32%	36.92%	68.22%	196.80%	193.01%
Lyxor ETF FTSE All Share	6.92%	35.69%	58.15%	108.63%	N/A

***1 January to 31 January 2015**

****27 May 2005**

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

This is a fund which over 6 years and since launch has significantly outperformed the FTSE All Share Index. Although the ETF does not go back to 2005, the All Share Index over that period returned 102.67% vs the fund 193.01%. The challenge for investors is the short term volatility and whether the recent poor performance will be reversed. This may not appeal to all investors and may be seen as a blend with other funds.

The source of information in this note has been provided by L&G and is correct as at February 2015. 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.