SHINING A LIGHT ON……
AXA FRAMLINGTON UK SMALLER COMPANIES FUND

At a glance

The UK Sector has many very talented fund managers and excellent funds. Choosing between them can be difficult. Even scratching beneath the surface uncovers things that many don't expect.

In this update we talk to the manager behind the AXA Framlington UK Smaller Companies. The manager has been at the helm for three years and the fund has an excellent track record.

In this update we talked about his track record, the number of holdings and his approach to investing.

Who are the team behind the fund?

The fund is managed by Henry Lowson who took on the management of the fund in May 2012. From 2008 the fund was managed by Chris St John who now acts as a deputy on the fund. All decisions are made by Henry but Chris acts as his replacement when he is away.

Although Henry makes all the day-to-day decisions he works closely with the UK team. He joined AXA Framlington from university 11 years ago as a trainee fund manager under the tutorship of Nigel Thomas. Before taking on this fund he managed their AIM Inheritance Tax Fund for just over three years.

Fund highlights?

We started the discussion by talking about some of the specifics around the fund.

Henry explained that he aims to invest in growth companies where not all the good news is factored in. I asked whether there were periods when this strategy doesn't work. Henry said that when there is a sharp rally in the market whether in value or high risk equities then the fund can lag. He used the example of 2012 where stocks like Thomas Cook went from 34p to £1.60 in a very short period of time and it is in these periods the fund suffers.

This is a smaller companies fund and I asked whether the fund holds any mid / large cap stocks. Henry explained that the holding period for the stocks is 3 to 5 years and it is natural for stocks to move from small to mid-cap. At present the fund is about 80% small and Aim listed shares and about 20% mid-cap.

I asked him about the number of holdings which seems high at 80. He explained this is important as it removes any stock specific risk. His view is that smaller companies can be more volatile and by spreading the risk the performance is repeatable. If a company halves in one day, it won't break the year. This therefore may appeal to investors looking to invest in smaller companies but worried about the volatility.

With so many holdings I asked whether he truly knows all the companies. He explained that these are his best eighty companies. If he no longer likes the companies, or he feels it is right to sell then he will. He also added that by their nature small companies are more illiquid and he doesn't want to hold a large portion of one company which then makes it difficult to sell.

The whole strategy is about having a "sleep easy at night" philosophy. If he can pick the best companies with a three to five-year timeframe which deliver solid returns then this is what he is looking to do. He also added that 95% of the performance is driven through stock picking with his aim very much on being risk averse. He looks to avoid loss making stocks and those companies hyped by investor sentiment (and not sound fundamentals).

Turning to the market he hunts in he explained this is under researched with companies being less well known. He feels this gives him an advantage in finding the good companies which can offer excellent long term opportunities.

I asked him to expand on the types of companies he likes and he added that the aim is to find good companies at an attractive price. By this he means where not all the good news is priced in and there is upside potential.

The types of companies vary; proven track record is important as are attractive economic tailwinds. I asked whether it is becoming harder to find companies and he added it is always difficult to find companies. His approach is to meet companies and he said it is rarely black and white. One of the tests is a gut feel when meeting management but also looking at tangible things like whether the management team invest in the companies and how they are incentivised.

The companies are not exciting but they reflect his approach of finding good long term investments. Some examples include:

GB Group – he has held this stock for 3 ½ years. They are an ID verification and fraud detection company. They have a contract with the DWP and they have a high return on investment. Since investing the company has gone from 12 x earnings to 25 x earnings and he believes there are still significant opportunities to grow.

Avon Rubber – this is another long term holding. It has a contract with the US army to supply gas masks and also has a diary line with contracts in China, US and Europe.

4 Imprint – produces promotional products in the US and spends about $70 million on advertising and marketing. This makes it very hard for anyone to compete with them

In conclusion although the number of holdings is high this provides some downside protection but at the same gives investors access to smaller companies. This is a long term hold strategy and therefore companies will move into the mid-cap space but over 80% is small with AIM listed companies included in this. It is well managed and has delivered consistently strong returns although this is not guaranteed. Therefore, it may be an opportunity for investors to consider when looking in this space.

Fund performance

Performance from 2010 to 31 October 2015 vs L&G UK Alpha Fund, Standard Life UK Smaller Companies Fund and iShares UK Smaller Co Ord:

	2010	2011	2012	2013	2014	2015
AXA Framlington UK Smaller Companies Fund	32.33%	-0.89%	23.64%	43.20%	5.78%	19.05%
L&G UK Alpha Fund	35.73%	-14.43%	6.18%	42.11%	-1.75%	-6.22%
Standard Life UK Smaller Companies Fund	70.47%	-12.41%	32.64%	41.28%	-15.10%	25.38%
iShares MSCI UK Smaller Companies ETF	30.19%	-12.18%	27.51%	35.71%	-0.19%	10.96%

1, 3 and 5-year performance and since launch.

	1 Year	3 Years	5 Years	Since Launch (27/04/2001)
AXA Framlington UK Smaller Companies Fund	25.97%	86.05%	142.67%	360.29%
L&G UK Alpha Fund	-7.20%	29.03%	28.56%	N/A
Standard Life UK Smaller Companies Fund	23.60%	51.35%	97.02%	214.56%
iShares MSCI UK Smaller Companies ETF	15.02%	52.96%	79.04%	N/A

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.

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