

## **Liontrust Investment Conference – an overview**

In February, we attended an Investment Conference hosted by Liontrust Investment Managers. The speakers covered a variety of topics; in this brief, we want to highlight some of the key discussion points.

This doesn't cover everything that was said, and is not a recommendation to invest in any fund or strategy mentioned. We would also add these the comments below represent the views of Liontrust and do not necessarily reflect our personal views.

### **Europe – Olly Russ (Manager of the European Income Fund)**

There were two areas of interest which we will share; firstly, looking at European Income vs UK Income, and secondly looking at whether Europe is structurally broken.

Touching on dividends, the average yield in the UK is 4.1% compared to 3.9% in Europe. The big difference is the source of that yield; in the UK, there are 144 companies paying dividends above 3.5% whereas in Europe it is 426 companies. This means there is greater sector and geographic diversification in Europe.

Additionally, in the UK, there are 83 funds covering the income sector, whereas there are just 10 covering Europe. This means that there can be significant overlap between funds in the UK. The message being that moving forward, Europe could be a better hunting ground for income with greater diversification and less overlap in holdings between funds.

Of course, to counter this is that some think that Europe is structurally broken. When comparing it to the US there is a big difference; with US earnings at all-time highs whereas European earnings sit at about a third of its peak. Clearly investors are nervous at the state of the Eurozone, with more money coming out of European funds than going in.

Olly feels that investors are perhaps missing three important signs which would point to a change in fortunes for the Eurozone. Firstly, although unemployment is high it is falling and has been for three years, secondly EPS growth has been coming through since July after years of falling data and thirdly loan growth is slightly positive which is pointing in the right direction.

In summary, Olly feels that there are signs of positive changes in the Eurozone and although investors remain nervous he believes there is greater value available in Europe compared to the US. Where income is added into the equation, he feels there are significant opportunities where perhaps they are limited in the UK.

### **Macro - Stephen Bailey and Jamie Clark (Managers of the Macro Equity Income Fund and Macro UK Growth Fund)**

The area of interest in this discussion was around Oil and Gas. They explained that this sector makes up 15.7% of the FTSE All Share Index, and holding some of these stocks carries significant risk.

There are two factors which are likely to keep the price of oil around the \$45 to \$60 a barrel mark. The first is electric cars. At present these make for a tiny amount of market share but in the same ways smart phones, computers etc represented small market share there is a real possibility that demand could suddenly accelerate to a point where 50% of all cars within the next 20 years could be electric.

Mix this with the fact that OPEC is no longer the powerhouse it once was. The recent agreement didn't include Libya and Nigeria and they could at any point increase supply which forces down prices. More importantly is that the US no longer needs to look outside of the US for supplies, and can be self-sufficient within the next twelve months. This makes them totally independent of the likes of OPEC and any other nation which is hostile to their interests.

Added to this if electric cars become the norm then we are likely to see prices remain within the \$45 to \$60 range.

This in turn has an impact on companies like Royal Dutch Shell, where dividends per share are significantly higher than earnings per share. They have significant debt and need to sell assets to reduce debt. The problem with this is that it stifles growth and is at a time when they cannot necessarily get the best prices for the asset they are selling. If the price of oil stagnates, this again is not good for the company. One easy way to reduce debt would be to cut dividends. The argument from everyone is that this will never happen because they have only ever grown the dividend.

The argument from Liontrust is that just because the dividend has always grown it doesn't mean that it will continue. Oil prices are not going to rise any time soon and Royal Dutch Shell needs to cut its debt burden; dividend cuts are one way to achieve this. BP is perhaps more fortunate because it is further down the road; by having to sell assets a few years ago, but it still has a falling revenue challenge to face.

In summary, the main point was that it is very easy to assume that what is happening now will continue forever but the reality is that there are significant challenges in the sector which could have a detrimental impact over the coming years.

#### **Asia – Mark Williams (Manager Asia Income Fund)**

In this discussion, the two areas of interest were China's trade dependency and the impact of infrastructure spend.

In 2005 Asia ex-Japan made up 20.3% of Global GDP, this is now 52.3% of which China makes up 35.9%. The big question is around trade to the US; in 2006 exports to the US were nearly 22%, this has since fallen to below 7% and simultaneously it has fallen from over 20% to below 4% (as a percentage of GDP).

This shows that China is making the transition to being more domestically focused, and clearly other countries are more reliant on US trade. Asia exports ex-China are nearly 5% and as a percentage of GDP just over 4%. Interestingly on a trade basis the top three exports to China from the US are, planes, helicopters and spacecraft (\$14 billion), soy beans (\$14 billion) and cars (\$12 billion). The first two make up nearly 20% of all exports and cars 9%.

China exports computers (\$60 billion), broadcasting equipment (\$40 billion) and telephones (\$15 billion) and these make up 14%, 9% and 3% of all exports. So, there is little overlap between the two but they both need each other when it comes to trade. A trade war would hurt but it would also impact US industries, therefore how much is this pushed?

It is clear that economies are moving towards being more domestically focused, in terms of rankings on quality of infrastructure the US sits at 11<sup>th</sup> and Hong Kong 1<sup>st</sup>. But China is 42<sup>nd</sup>, Thailand 49<sup>th</sup> and India 68<sup>th</sup>. It shows that although economies need exports there are also significant opportunities internally for countries to grow and develop.

Just touching on India where infrastructure is vital to free up the economy; the biggest risk is that Modi is assassinated. Assuming this doesn't happen, there are significant opportunities to grow the economy in the same way as China has done over the last ten or twenty years.

In summary, we shouldn't play down a trade war but there is mutual reliance from both economies and we are seeing China move to being more domestically focused. Infrastructure can be a big part of growing and developing economies in Asia.

### **Global Equity – Hugo Rogers (Co-Manager Global Water and Agriculture Fund) and Kristof Bulkai (Co-Manager Global Strategic Fund)**

In this section, there were two areas of interest; the first focusing on the US and the second on emerging markets.

In the US, most drinking water infrastructure is over 50 years old and the total replacement cost is estimated to \$2.1 trn. It is estimated that \$500bn replacement spend needs to be made up to 2035. With the new Trump administration (or even without) there is a growing realisation that money needs to be invested in this area. There is therefore an expectation of double digit growth in water infrastructure over the coming years.

Water services are also a big part of the US shale gas industry and with a move to self-sufficiency it is expected that spend in this area will grow rapidly. As highlighted as rig count recovers, water demand has grown to new highs as water per well is up three times in the last five years.

Water infrastructure is a small part of the many opportunities within the US, but it shows where potential spends will be focused and how investors might be able to benefit.

Turning to emerging markets there are opportunities including stronger US nominal GDP growth, attractive valuations and commodity price reflection but there are significant risks. A collapse in Turkey could pull down other economies like South Africa. So, areas to watch are foreign direct investment as these are a life blood to the economies and help build infrastructure and grow the economy. If it stops or declines, there is a problem. Another example would be Mexico where we have started to see car manufacturers stop building factories.

In summary, water infrastructure in the US is something to watch. With emerging markets, although there are opportunities there are also underlying risks especially if foreign investment slows or stops.

### **Summary**

This is a brief snapshot of some of the discussion points from the conference, and does not include all the speakers and points raised. As with most conferences they will highlight the opportunities rather than focusing on the potential risks. However, what is clear is that to look beyond the noise and dig beneath the surface there does appear to remain significant opportunities.