SHINING A LIGHT ON……
SCHRODER RECOVERY FUND

At a glance

Strangely, although this is a well-known fund, with a good track record and a good management team we have never reviewed it!

The fund was established in 2004 and Nick Kirrage and Kevin Murphy became managers in 2006. It remains a fairly small fund with assets under management of £600 million and has delivered a consistently strong long term track record. (Although past performance is no guide to future performance).

The review was with Kevin Murphy, and he described the fund as something you are prepared to hold and almost forget about to get the best returns. Effectively this fund will be volatile and certainly won't appeal to all investors but it has an interesting style which has proven affective over time.

Who are the team behind the fund?

The fund is co-managed by Nick Kirrage and Kevin Murphy. Over a long track record, they have a track record of outperforming the peer group more often than not. They took over the management of the fund July 2006. In 2010 they took over the management of the Schroder Income Fund.

Nick joined Schroders in 2001. Previously he was a sector analyst responsible for a number of UK sectors including Transport and Metals & Mining. Kevin joined as a graduate in 2000 working on the UK team.

They also write blogs on the Value Perspective which is an extensive resource for providing information on 'value investing' in equities.

Fund highlights?

The fund is focused on 'value' investing. The argument is simple, you buy the market when it is cheap to get the most attractive returns. So if the average P/E (price to earnings) ratio is 0 – 7% then the likely annualised returns over 10 years is 10 – 11%. If you buy at 14 – 21% then the return is about 5%.

Currently the average is in the 14 – 21% bucket so it provides an idea as to what returns will be going forward. However, not all stocks and sectors are the same. In 2000, technology stocks were at 35% plus and tobacco was at 7 – 14%. Over the following decade average returns from technology was down 46% and Tobacco was up 763%.

Obviously this takes a total view of the market and different stocks will behave in different ways. Fast forward to today and those expensive companies include tobacco, financial services, food and beverage (i.e. restaurants / pubs) and technology. Those that are cheap are banks, food retail and oil and gas.

This overview gives an idea where the fund positions itself. It is looking to identify those out of favour sectors and invest in companies it believes can be beneficiaries of an upturn in the sector moving forward.

An example the fund has favoured for some time is banks. Banks are cheap for a reason – negative headlines keep investors away despite the fact that things are changing. Only when things are on the up do investors start to come in and then that is when it is time to sell! Banks have only been cheaper in 2009 and 2011 when the risk was at its highest point. These are now profitable businesses, building significant excess cash. What the market is missing is that these are stronger businesses, better run and can afford to pay the fines for past errors.

The capital surplus position for many of the banks is extremely strong and yet the valuations remain depressed. It is therefore not surprising that the fund holds RBS, Barclays and Lloyds.

Food retailers is another area of interest. The headlines are not dissimilar to 1991. The discount stores like Kwik Save were making significant progress and expected to double market share to 17% over 4 years. Aldi and Lidl were part of this drive. Share prices for Asda and Sainsbury's tumbled on profit warnings.

Fast forward to today, Lidl and Aldi are expected to significantly reduce the share of the big supermarkets. Sainsbury, Tesco and Morrisons have seen their share price crumble.

In 1991 the main supermarkets bounced back by launching their value range, and Tesco's increased its market share from 16% to 30% over the next 20 years!

If we take Tesco's today the share price has fallen 67% since 2007, it has suffered from profit warnings and is under threat from hard discounters. But what the market seems to have ignored is that it is cash generative, it is double the size of its nearest competitor and it has a new management team. It can bounce back as it did in 1991, other supermarkets they like include Morrisons and to a lesser extent Sainsburys.

Banks and retailers make up 20% of the fund.

They are currently reviewing the oil and mining sector which has seen significant falls. There are associated businesses they like, like Drax and Centrica but currently the risk / reward on pure oil stocks is harder to find. They have recently added Anglo American from the mining sector and are looking at one other company.

Kevin stressed for investors this is not a short term fund. This is something where an investor is happy to invest and hold. It will have periods of volatility and of underperformance but Kevin believes patience will be rewarded. Recovery in many of these businesses will not happen overnight and in many cases can take up to 5 years plus.

The style may not appeal to all investors but the managers have a proven track record and it might appeal as a blend to other funds. It is not a large fund with assets of around £680 million. It has less stocks as opportunities are harder to find, currently it is holding 47 stocks with 38% of the fund held by the top ten.

Fund performance

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

	2010	2011	2012	2013	2014	2015*
Schroder Recovery Fund	15.87%	-13.96%	34.41%	45.50%	1.67%	4.97%
FTSE All Share	14.51%	-3.46%	12.30%	20.81%	1.18%	6.44%

	1 year	3 years	5 years	6 years	Since launch**
Schroder Recovery Fund	3.67%	80.43%	110.46%	247.98%	227.48%
FTSE All Share	5.56%	36.40%	62.05%	138.76%	125.34%

***1 January to 28 February 2015**
*****26 November 2004**

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 well-managed fund with a staple team and good long term track record. By its very nature it will be more volatile than some other UK funds and therefore may not appeal to all investors. For a patient investor this may act as good exposure to undervalued shares within the UK.

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