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Legal & General fund manager Richard Penny talks to Jenny Lowe about his strategy for investing in stocks

The art of picking and choosing the right stocks

In a sector comprising more than 300 funds, it can be quite difficult to maintain a consistent top decile performance, particularly when the manager has a strong small-cap bias.

The investment style of the Legal & General UK Alpha Trust fund is split between deep value and strong growth investments and can vary its allocation to these accordingly – between 40 and 60 per cent in each style at any given time.

It is this barbell approach, which aims to allow the fund to perform at different stages of the economic cycle, that has helped it maintain its position near the top of the 300 plus funds in the Investment Management Association's (IMA) UK All Companies Sector over one, three and five years, in terms of total return.

Manager Richard Penny, who has been at the helm of the fund since its launch in 2005, defines these strong growth investments as companies that aggressively grow sales and profits by at least 15 per cent, while more deep value ideas are stable, out-of-favour companies where emerging catalysts, such as a management change or refinancing, may restore value.

However, Mr Penny attributes the funds performance over the last 12 months to his overweight position in overseas companies.

He explains: "Every single holding

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in the fund is UK-listed, so all are traded on the UK exchange, be it Aim or London Stock Exchange. On the FTSE 100 index, between 60 per cent and 70 per cent of profits come from abroad, and I would say roughly 50 per cent of the earnings of the holdings I own come from abroad.

"You could look at this and think you should just buy an emerging market fund, but I don't see it like that. I see good price and real value potential."

Mr Penny believes companies such as Hutchison China Meditech, which was the best performer in the fund in both 2009 and 2010, will experience continued growth throughout this year.

"Hutchison China Meditech provide traditional Chinese medicines into the Chinese medicine list – a huge growth area with the Chinese government spending more on this and growing prosperity," he explains.

"As this grows so too do sales. In the last six to seven years, it has seen 27 per cent per annum sales growth.

"I run the fund on a conviction and contrarian stock picking basis. This allows me to see the upside in stocks that perhaps others miss"

Profits have gone from $2.5m to north of $9m.

"It's grown really strongly and there are visible drivers of growth; China, the emerging markets and increasing provision of healthcare."

Preferring to invest in UK companies, Mr Penny has taken positions in some businesses that are based here, but have operations overseas. Immunodiagnostics, for example, has a number of subsidiaries in America, Germany, France, Denmark, Finland and Belgium and added high single-digit gains to the funds performance over the last year.

"I run the fund on a conviction and contrarian stock picking basis. This allows me to see the upside in stocks that perhaps others miss.

"To be a good stock picker, you need to know the company inside out," he states.

"I would rather buy a business in the UK than abroad, but they're growing fast abroad and we have to step out of our comfort zone."

He adds: "When building a portfolio I produce robust shortlists of potential stocks.

"I then take the time to really get to know the management and the company before deciding if it's right to invest in the stock or not."

Using his strategy of identifying stocks he believes will double in around three years or less, Mr Penny has seen his UK Alpha Trust fund gain 70.18 per cent over three years, compared to a sector average return of 10.23 per cent, and over five years it is up 124.06 per cent compared to a UK All Companies peer group average of 23.72 per cent.

The manager does, however, warn that in spite of a positive macroeconomic outlook, growth in the UK will not rapidly improve.

"The UK outlook is less good than its been for the last six to nine months so I think we will see positive, but not

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exceptional growth," he forecasts.

"This isn't necessarily a problem because shares and equities are cheap in the UK market. The prospect of rising tax and interest rates and reduced government spending has to be a bit of a drag, but at the moment trading is holding up fine and valuations look quite cheap."

Chris Mayo, investment director at Fund Intelligence, gives his verdict:
Richard Penny has managed this fund since launch, and over this time, performance has been strong relative to his peers. Given the managers background in smaller companies, it comes as little surprise to find the fund has a pronounced bias to small cap names. However, while the current size of the fund allows investment into these illiquid issues, as the fund continues to attract assets, the allocation to more liquid names will have to increase, possibly to the detriment of performance."

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