

Client: Chi Med
Source: New Model Adviser (Main)
Date: 14 May 2012
Page: 36
Reach: 6090
Size: 797cm2
Value: 4853.73

Citigate
Dewe Rogerson

Top performing funds acclaim importance of firms that export

Top quartile funds in the UK equities sector tend to steer clear of firms with domestic bias

JENNIFER HILL

Variation in performance is huge among UK equity funds. The best performer, MFM Slater Growth run by Slater Investments, the boutique funds house, has returned almost 170% over three years.

At the other end, Jayesh Manek's Manek Growth has lost almost 34%, largely due to poor stock selection. Its largest holding, internet stock Blinkx, has plummeted in value following a placing, while Heritage Oil, another big holding, has struggled, not helped by a recent tax dispute with the Ugandan government.

For Mark Slater, chief investment officer at Slater Investments, valuation is king.

'[Economic] growth should accelerate in the second half and we should see modest growth over the next few years, but we're

'We're going to
feel like we're
bumping along
the bottom for
some time'

Mark Slater
Slater Investments

going to feel like we're bumping along the bottom for some time,' he says. 'That said, there's no correlation between stock market returns and economic growth. Growth by itself is meaningless. Valuation is what's important. You pay a great premium for everybody agreeing that the economic outlook is wonderful.'

Acceptable valuation

The valuation of the UK market is 'within an acceptable range' in relation to economic prospects at present. So how does Slater fish out undervalued stocks for the MFM Slater Growth fund?

First, he avoids problematic sectors including banks, companies exposed to consumer spending and those with exposure to Greece, Spain and Portugal. 'We're in an extremely unforgiving

Client: Chi Med
Source: New Model Adviser (Main)
Date: 14 May 2012
Page: 36
Reach: 6090
Size: 797cm2
Value: 4853.73

Citigate
Dewe Rogerson



environment,' says Slater. 'In a tough economic environment, it's difficult to solve problems that arise in businesses.'

Second, he looks for businesses with a 'good tail wind' and visible earnings potential, often niche companies operating globally. 'The UK is a good way to get global exposure without some of the global risks,' he says.

The fund holds Dialight, the LED lighting and technology business that supplies products for US traffic lights, refineries and large industrial plants; Oxford Instruments, the first commercial spin-out company from Oxford University, which sells scientific instruments for use in nanotechnology and is growing rapidly in Asia; and Hutchison China MediTech, the AIM-listed holding company of a pharmaceutical and healthcare group based primarily in China.

'The driver here is massive government spending, focused on improving the healthcare of urban workers in China,' says Slater, a Citywire AA-rated manager. 'It's the equivalent of the NHS in the 1940s; the numbers are off the charts.'

MFM Slater Growth is up 74.1% over five years. It has returned 169.9% over three years, compared with the FTSE All-Share's 67.9%.

International exposure

International focus is one of the big attractions of the UK market, according to Julian Fosh, co-manager of the Liontrust Special Situations fund, a Citywire Selection pick. 'The UK has one of the most stable legal frameworks, but gives access to earnings from around the world. We're pretty upbeat about the prospects for the right companies.'

The 'right' companies come in all shapes and sizes. Of the fund's 48 holdings, 64.3% of sales are derived from overseas, versus 68.5% for the FTSE All-Share.

Last year, the fund made 32% on plant hire firm Aggreko, and almost 19% on both drinks giant Diageo and pharmaceutical firm GlaxoSmithKline – a trio of international businesses. It also made 55% on PayPoint, which facilitates local payment of household bills and mobile top-ups, and 60% on Rightmove, the property portal.

Were it not for Liontrust's focus on business models – and eschewal of sector-based views – the latter might have been excluded. However, Fosh says: 'We have no top-down

investments at all. Rightmove might be in the property sector, but it's the number one site for online advertising for estate agents. It's riding a structural wave of change. In the past properties had to be advertised in newspapers, now it's online.'

Liontrust's investment strategy focuses on 'three killer intangible advantages': intellectual property (Glaxo's patents on drugs are an example); strong distribution networks (Diageo's 'worldwide and world-class distribution network running across all continents'); and high contracted recurring revenues (multi-year contracts signed by the likes of engineering consultancy Amec, for example, give shelter from any economic downturn in the interim).

'It's different to being a retailer, where you have to start again every day,' says Fosh. 'Companies with one, two or all three of these intangible asset strengths should have a real competitive advantage.'

These three criteria mean certain industries are excluded, such as banks, mining companies and house builders.

Liontrust Special Situations is up 118.7% over three years, compared with a benchmark 70.1%, and 56.6% over five years.

Global interest

BlackRock UK Special Situations has returned 79.8% over three years and 23.2% over five, placing it 17th over three years in the UK All Companies sector.

In recent years, the fund's manager, Richard Plackett, has had a strategy of mainly owning companies with global interests.



Client: Chi Med
Source: New Model Adviser (Main)
Date: 14 May 2012
Page: 36
Reach: 6090
Size: 797cm2
Value: 4853.73

Citigate
Dewe Rogerson



'We've had a big emphasis on international exposure for quite some time, and tend to buy domestic exposure only in special circumstances,' he says.

'The world economy is growing, but there's a clear divergence between [those] contending with the credit crunch – highly leveraged western consumers and governments – and those unaffected, such as firms with strong balance sheets and the developing world. It's important to own stocks exposed to the right parts.'

The fund is structurally overweight in small and mid caps, which make up at least 50% of holdings due to their greater growth potential.

'Good stock-picking can have a disproportionate benefit in this part of the market,' says Plackett, who is also head of the UK small/mid cap team at BlackRock. 'More small and mid caps are exposed to the UK consumer and have a domestic bias in general, which could be a drag on their performance, so we avoid these companies and focus more on international shares.'

The fund is overweight industrials and high tech firms, particularly those with 'unique and fast-growing products'. Holdings include Spirax Sarco, which manufactures boiler and pipeline control valves for the handling of steam and industrial fluids, Rotork, a manufacturer of electronic valve actuators, and Aveva, which produces software for process plant design.

The fund also owns Asia-exposed banks HSBC and Standard Chartered as well as house builder Bovis and Bellway. 'The house building market has consolidated in recent years and the survivors have shown they can do well,' says Plackett.

Large cap bias

SVM UK Growth has returned 75.7% and 29.2% over three and five years respectively. It is placed 10th over five years in the UK All Companies sector.

The fund has a bias towards large caps, which account for around 80% of the portfolio. It adopts a three-pronged approach, with a core portfolio of almost 50% in large-cap growth stocks, and the remainder evenly split between aggressive tactical plays and special situations – small and mid-cap ideas from managers across SVM's fund range.

Colin McLean, founder of SVM Asset Management and co-manager of SVM UK Growth alongside Margaret Lawson, says: 'Our core portfolio focuses on growth stocks that we tend to stay with through the economic cycle.'

'They're fairly cash generative, liquid stocks and that's helped us stay pretty much fully invested and not suffer as much as other funds in 2007-08. They tend to be quite big international businesses that aren't overleveraged.'

'Our more sensitive holdings tend to vary through the cycle – we've held miners and financials at times.'

At present, the fund is slightly overweight mining and has a

material overweight position in industrials. It holds Fresnillo, the silver mining company, Ashtead, the industrial equipment rental firm, and Wolseley, the global supplier of heating, plumbing and building products. 'We [believe] the US construction and housing sectors are starting to recover,' says McLean.

He also likes oil and gas exploration firms Cove Energy, which has recently been subject to a bid from Royal Dutch Shell following a successful gas discovery in Tanzania, and Ophir Energy, with its portfolio of interests across Africa.

'They're less liquid than some of the other stocks we've got but Ophir has the potential to more than double if it's successful with its drilling, so could be a great alpha kicker,' says McLean.

Only 3% of the portfolio is in financials, with holdings in Derwent London, the property investment and development business, financial adviser Hargreaves Lansdown and insurer Prudential.



**'The UK has
one of the most
stable legal
frameworks, but
gives access to
earnings from
around the
world'**

Julian Fosh
Liontrust Special Situations