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Notes from Meetings with Fund Managers: 7 November 2013

Hosted by Baillie Gifford.

Manager	Attending
Majedie	Simon Hazlitt
UBS	Digby Armstrong Steve Magill Richard West
Western	Marian George Paul Shuttleworth
Baillie Gifford	Anthony Dickson David McIntyre

Majedie

1. Met with Simon Hazlitt (SH) from Majedie.

2. Majedie presented another quarter of strong results with gross return of 9.0% versus the benchmark of 5.6%.

3. Majedie acknowledged that, whilst they had been able judge past economic environments well, they were less successful in their timing of the changes to the portfolio. There was a desire to move ahead of market changes and potentially miss some upside than have to move in a downward market.

4. The relatively small size of the fund does allow for rapid portfolio transitions without significant market distortion.

5. Majedie reported a slight shift into a more defensive stock allocation, although SH pointed that the move was not into what are often classed as defensive stocks, e.g., utilities and consumer staples.

6. In response to questioning as to whether the adjustment was down to valuations or due to an opinion regarding market sentiment, SH reported that the main driver of the change was due to valuations but as managers they could not rely solely on valuations and that sentiment was important but not an overriding factor. Resilience to a normalisation of QE was a primary feature of stock and sector choices rather than traditional ‘defensive’ characteristics.

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7. Majedie were overweight telecommunications in UK and in Europe. The lack of infrastructure investment in the sector throughout Europe has resulted in a significant gap between US and European capacity and high speed coverage. In order to redress that gap the EU regulator is showing signs of softening the approach to price controls and may allow price increases to encourage investment. The level of consumer demand for electronics should be secure in the face of price increases.

8. Majedie holds a large overweight position in BAE Systems which, along with other defence suppliers such as Lockheed Martin, have held up well with decent results given poor fiscal positions in the UK and US and is well placed for future returns.

9. Majedie also reported a recent increase in the holdings of Shell following positive communication with management about the potential for cutting back on ambitious and expensive capital expenditure. In response to questions about the potential decline in the oil price impacting upon both Shell and BP, SH responded by saying that the oil majors were not overly correlated to the price of oil.

10. Majedie presented a view that the potential for declining commodity prices would lead into a better environment for consumer spending. This would be beneficial for a key portfolio holding, Marks and Spencer. Majedie were also positive for the potential upside for M&S. Interestingly, because the existing management systems were very limited, M&S are unable to ascertain the profitability for each item sold.

UBS

1. Digby Armstrong, Steve Magill and Richard West presented.

2. In response to questions about the performance fee, UBS mentioned that 70% of their value clients were also on performance fees.

3. UBS reported strong results for the quarter with positive returns from a large holding in Lloyds Banking Group.

4. The main drag on performance was from a large overweight position in BP, which remained flat against a rising market. UBS is still overweight BP which has recently reported decent results following the end of the quarter.

5. Strong performance for a number of equities had pushed them above perceived fair value and UBS had begun selling down stakes in ITV, the house builder Taylor Wimpey and Daily Mail General Trust.

6. UBS reported recent positions within a number of large cap stocks that have underperformed the market. UBS had bought an increased stake in Shell, arising from a belief in the new management's commitment to more frugal capital expenditure.

7. UBS had also bought back into Rio Tinto and Standard Chartered.

8. UBS was underweight consumer staples: as defensive stocks with high yields, they have similar qualities to bonds and could suffer from interest rate rises. In contrast UBS was overweight consumer discretionary stocks, poised to benefit from a recovering economy and were attractively valued.

9. UBS were evaluating the potential for investing in support services companies, such as G4S and Serco. Both have recently changed management and UBS were positive about the appointments but the valuations were still considered reasonably high.

2 **Western**

1. Marian George and Paul Shuttleworth from Western presented.

2. Western reported the portfolio was well positioned in the face of significant volatility. The first six months of the new year was characterised by central bank activity, especially the decision by the Federal Reserve not to taper the asset purchasing programme in September.

3. The Federal Reserve surprised the markets leading to a dramatic sell off in more secure assets as investors sought yield again. This volatility led to aggravated price movements in more illiquid emerging market positions. Western believed that there was significant opportunity for good value in illiquid emerging markets areas, especially in sovereign debt, following future tapering decisions. Brazilian government debt was yielding around 12% but substantial currency fluctuations were a cause for concern.

4. Western had taken a position in Russian sovereign debt denominated in Euros.

5. The portfolio is positioned underweight to UK and supranational government debt as well as financials with overweight positions in UK asset back securities, high yield and investment grade bonds.

6. A drag on performance during the quarter was an underweight position in utilities which performed strongly.

7. The quarter was marked by huge corporate issuance in the US, with Apple bringing £17bn and Verizon £10bn to the market, in contrast to low UK and European bond issuances. The margin between the corporate bond spread for UK and US has grown significantly throughout the year.

8. Western was positive on the long term strength of Verizon and participated in the issuance with market spreads reducing from over 200bps at the time of issuance in late August to 160 in mid October.

9. Western were cautious about the lack of growth in corporate revenues, with significant pressure from shareholders to continue dividend growth or share buybacks, resulting in declining dividend cover. Siemens had recently announced a significant share buyback programme from cash reserves.

Baillie Gifford

1. Met with Anthony Dickson and David McIntyre.

2. Baillie Gifford (BG) reported that recent scenario analysis was focused entirely on the potential market conditions arising from different QE outcomes.

3. As a result of this analysis, BG have become more selective on which emerging market bonds are included within the portfolio, avoiding countries that, in the short term, are more dependent upon external capital flows. BG are negative on Brazilian sovereign debt due to a sizable current account deficit. In contrast, BG are overweight on Peru with a much stronger current account position.

4. BG outlined recent changes to the portfolio asset allocation, including a reduction in the weighting for insurance linked bonds by 2%. This asset class returned 11% during the previous 12 months, partly as a result of the absence of significant natural catastrophes and partly from an increased capital inflow into the asset class. Whilst this provided a capital value boost, it has reduced the yield from new issuance.

5. There will still be opportunities within the asset class for certain perils due to instances of supplier demand imbalance.

6. BG increased the portfolio exposure to bonds with an increase in high yield and investment grade as well as a doubling of the size of the exposure to government bonds to 6%. BG believed that the recent increases in gilts implied a more rapid increase in interest rates than the UK economy would sustain. Government bonds would also act as a safe haven in the event of market uncertainty. The allocation to cash was reduced in order to fund the bond increase.

7. BG reported a recent investment in German residential property in the form of listed equities. The rationale was that with a significant contrast between economic growth in Germany with that of other EU countries, low interest rates and higher national inflation would push German savers to invest in property. Mortgage affordability and other metrics point to an increasing demand for German housing, whilst rent price controls significantly limit demand for construction.

8. BG have added an exposure to platinum and palladium, a belief that a number of mines and factories are processing the metals at a loss and as a result of worker unrest in South Africa, wage inflation is estimated to rise, with the likely outcome of significant drops in output.

9. BG argued that in general most asset classes were fair value whilst some were overvalued, but that an economic recovery was priced in. BG were concerned that if economic conditions become less favourable there could be a sharp contraction in asset values.

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