Notes from Meetings with Fund Managers: 12 February 2015

Hosted by Western Asset Management

Manager	Attending
Western	Marian George Andrew Belshaw
Baillie Gifford	Anthony Dickson Patrick Edwardson
Franklin Templeton	Chris Orr Stuart Lingard
CBRE	Max Johnson Ivo de Wit D.Dhananjai

Western

1. Met with Marian George and Andrew Belshaw from Western.

2. Western discussed the continued global accommodative monetary policy. In their view, despite the ceasing of the US Federal Reserve's Quantitative Easing (QE) stimulus, monetary policy will remain loose with no expected rate rise until late 2015, despite strong economic growth and recent employment statistics.

3. Despite slightly contradictory pronouncements from Mark Carney during 2014, there will likely be no change to the Bank of England record low rates until 2016. The European Central Bank surprised markets by the scale of the recently announced QE program and recent sluggishness in the Japanese economy will likely lead to further central bank action.

4. Western's relative performance over the last year, and especially in the most recent quarter, suffered from the underweight position in long dated gilts, the yields on which have fallen dramatically. It was argued that the UK economy still retains the key problems which came into focus during the credit crisis: overly dependent upon consumer and domestic demand, which is in turn overly dependent upon credit. There was substantial growth in unsecured credit over the preceding 12 months.

5. The UK has reported consistently large current account deficits and, on a national level, failed to properly apply the fiscal reforms needed. This has led to a twin current account and fiscal deficit and given the prospect for higher medium term inflation. The depressed yield on longer dated UK Gilts was considered unjustified. The outlook for the UK is further complicated by the upcoming general election in which the prospect of a majority government appears unlikely.

6. Western were overweight long dated US credit and high yield which is considered cheap relative to EU and UK equivalent yields. This sector should perform well if the US economy experiences higher than expected economic growth.

7. In response to questioning on individual selections within US credit, Western were previously underweight in the energy sector, but were now looking to move overweight following recent price weaknesses.

8. Western are also positioned in certain emerging market debt bonds, notably index-linked Brazilian and Mexican debt.

9. Western anticipates European QE to continue beyond the current deadline of 2016 with the expectation of further yield compression.

Baillie Gifford

1. Met with Anthony Dickson and Patrick Edwardson from Baillie Gifford.

2. The main focus of the meeting was the departure of Mike Brooks from the multi-asset team at Baillie Gifford. Mike was one of four portfolio managers and one of seven investors within the multi-asset team, although the multi-asset team is supported by the other specialised areas of the firm.

3. Baillie Gifford were keen to stress that this was not considered a significantly damaging departure. Mike Brooks had played a very important part in the creation of the multi-asset team but the organisational structure and investment processes were now very well established.

4. In response to questioning on areas of specialist knowledge or individual ideas that would be lost from Mike Brook's departure, Baillie Gifford highlighted the fact that, whilst individuals within the multi-asset team were given individual areas of focus, the responsibility and accountability for any investment decision making was taken at a team level and the source of a particular investment idea was often the surrounding specialist team, e.g., fixed income.

5. Baillie Gifford is in the process of developing a diversified growth fund in the same vein as the existing fund but excluding the most capacity constrained investments, e.g., insurance bonds, to allow for a larger fund size. This expansion to managing two funds would likely involve external recruitment to cover the increased workload.

6. Looking forward, Baillie Gifford had made further investments into high yield and senior loans following recent volatility and a widening of spreads. In contrast, the fund now has no developed market bond exposure following the recent sale of Australian government bonds. Baillie Gifford were also planning to increase the exposure to global property

Franklin Templeton

1. Met with Chris Orr and Stuart Lingard from Franklin Templeton.

2. The performance benchmark for Franklin Templeton was raised as an issue during the meeting, given the wide disparity between the reported benchmark and performance.

3. The Franklin Templeton absolute return fund is a USD denominated fund, hedged back to Sterling and, as such, Franklin Templeton maintained that the appropriate benchmark is the USD benchmark rather than the Sterling benchmark as has been previously reported in the board reports.

4. The performance for Franklin Templeton updated for comparison against the USD global bond benchmark is as follows.

	Return %	Benchmark %	Difference %
Quarter 3	-1.7	-1.2	-0.5
12 Months	0.6	0.5	0.1
Inception (Feb 2013)	1.7	-0.1	1.8

5. The fund portfolio was positioned very defensively in terms of duration with an average duration of just over one year, which has decreased over the past six months. Franklin Templeton were not convinced that estimates of global deflation would materialise beyond short term oil related dips. There was considered to be a fundamental mismatch in the pricing of developed market bonds.

6. Franklin Templeton were very positive on the US economy with the potential for the economy to surprise on the upside of market expectations. Given the strength of the US economy, it was likely that there would be a rise in US treasuries in 2015 regardless of an actual movement in the US Federal Reserve rate.

7. The portfolio was positioned to take advantage of US growth with investments closely linked to the US economy. The fund has a large exposure to short dated South Korean and Mexican government debt. In currency terms, the fund is long the USD versus the Yen and the Euro.

8. The fund has two small holdings in Ukrainian and Russian government debt as well as a bond holding in a Russian government backed bank. The portfolio is required by US law to be 100% liquid within 7 days and this is assessed on a regular basis by an independent provider. The portfolio is still considered to be 100% liquid and the market has sufficiently priced in the risk for Ukraine. Franklin Templeton were confident that Internal Monetary Fund (IMF) support for Ukraine would continue. Russia was considered to be more at risk in the long term but the investment was of short duration and was currently affordable.

CBRE

1. Met with Max Johnson Ivo de Wit and D.Dhananjai from CBRE to discuss the current UK focused mandate and the potential to invest in global property through CBRE's Global Alpha Fund.

2. The Global Alpha Fund is a perpetual open ended fund which launched in November 2010 with a focus upon a developed market and sustainable high income strategies. The target is a total return of 9-11% per annum of which 50% is distributable dividend income.

3. The leverage ratio is currently 33% and is likely to vary between 30-35%. This is broadly higher than in the UK strategy as other geographic regions are typically exposed to higher levels of leverage.

4. There is a three-year lock in period once funds are committed. The entry price is at net asset value but the exit price is at net asset value minus trading costs.

5. The fund does not target an equal weighting in all geographic markets and sectors but focuses upon areas of strong rental income and capital growth driven by fundamentals rather than capital flows.

6. The CBRE fee would be 50 bps if over £20m is committed, with other fund and operating costs expected to comprise about 110bps.

7. The fund's performance is measured in local currency with the decision to hedge currency movements the decision of the client. CBRE suggested that if a decision was taken to invest in the global fund, a currency hedge be utilised as well.

8. CBRE recommended that, given the impressive recent rally in UK property, it would be sensible to diversify some part of the portfolio to the global fund. A target of 75% UK to 25% global was suggested.

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