Notes from Meetings with Fund Managers: 11 May 2015

Hosted by Franklin Templeton

Manager	Attending
Franklin Templeton	Chris Orr Stuart Lingard
Marathon	Graeme Neuff Neil Ostrer
CBRE	Max Johnson D.Dhananjai
UBS	Steve Magill Richard West

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Franklin Templeton

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

2. FT reported that the portfolio was directionally very similar in the last quarter of 14/15 in comparison with the preceding period, with changes in the portfolio constitution quite limited. However, the duration of the portfolio was further reduced to almost zero, leaving FT with very low exposure to interest rates.

3. The low portfolio duration was in response to perceived risk within the fixed income market arising from overvalued US Treasury bonds. The removal of the Federal Reserve Bank as the guaranteed buyer of US Treasuries, combined with the prospect of tightening of monetary policy through interest rate rises expected during 2015, was anticipated to lead to a selloff in US Treasuries.

4. FT claimed that, whilst inflation was dampened in the US, partly as a result of oil price weakness, the improving US economy, allied with recovering consumer spending and the prospect of wage rises in the future, has led the Fed Chairman, Janet Yellen, to hint that a decision on increasing interest rates may ignore short term factors to focus upon medium term expectations. As such, FT are positioned with a negative exposure to US Treasuries through interest rate swaps.

5. The performance during the previous quarter was driven largely by movements in foreign exchange markets. FT were and remain significantly overweight in US dollars and overweight peripheral Europe versus the Euro and Yen. Emerging market currencies were well below historical averages on an aggregate level, indicating there may be some value in emerging currency.

6. FT argued that China would avoid a hard landing or collapse in growth rates due to the presence of significant drivers for medium term growth. Urbanisation in China still has a long way to go, with increased infrastructure requirements associated with this. Also, recent wage growth in China should also allow for domestic demand to partially offset export issues.

7. FT hold a position in Portuguese government debt and are comfortable with the risk posed by Greece's potential exit from the Euro. The financial impact upon the rest of the Eurozone was deemed to be limited with sufficient firewalls in place.

Marathon

1. Met with Graeme Neuff and Neil Ostrer from Marathon.

2. There was a slight change to the allocation within of the investment team with an increase in the total allocated to the global sleeve of the portfolio from 27% to 31%.

3. The performance of the Marathon portfolio was significantly influenced by the large movements in the foreign exchange markets in key investment areas. Continued central bank action in Japan and in the Eurozone led to substantial declines in the currency values. In this climate, Marathon are contemplating implementing a currency hedge to limit the impact of a further divergence in monetary policy and economy cycle between the major economies.

4. Up until now Marathon have decided not to pursue a currency hedge, despite the period of recent volatility and divergence between major currencies being well above average. However, when combined with the additional cost of hedging, it has not been deemed appropriate.

5. Over the past year, returns in emerging markets acted as a detractor from the overall portfolio with selected stocks faring poorly in comparison to the benchmark. The portfolio was underweight China with very strong returns in the Chinese index over the last twelve months. The portfolio was overweight Korean financials which underperformed as well as investing in the African Bank which collapsed

6. Marathon was overweight in European equities. The margin between European earnings and US earnings was at record highs and European companies should be well placed to benefit from a more competitive exchange rate. The inability to form rapid policy within the European Union may lead to QE going on longer than necessary which should boost European equity. One company Marathon expected to benefit from the weaker Euro was Airbus, with the vast majority of costs in Euros and significant portion of revenues in USD.

7. Marathon was overweight Japanese equity to take advantage from the expected wide reaching fiscal, monetary and cultural reforms including changes in corporate behaviour to focus more on shareholder value.

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CBRE

1. Met with Max Johnson and D.Dhananjai from CBRE.

2. The election result was considered broadly positive by CBRE from a capital market viewpoint. The certainty provided by majority government was expected to increase capital inflows in UK property, providing another boost to returns from yield reductions. The forecast return for UK prime over the next 12 months was in the low double digits with some property funds estimating returns in the region of 15%.

3. The global property market was estimated to increase returns over the next two years with moderate growth forecasts in both the EU and USA. QE increased capital flows into the EU should compress yields but returns are expected to benefit from the declining vacancy rates.

4. The leverage within the UK portfolio remains low at 17% and reduced from 18% the previous year. The performance is planned to come from improvement in management of property assets rather than financial engineering.

5. CBRE were in the processes of committing and drawing down the final elements of the £25m allocated to the property portfolio, commitment to student accommodation, and an industrial property fund were expected in the next few weeks. The gradual drawing down of funds has resulted in a slight cash drag on the portfolio.

6. The shift to global property investment was discussed with the impact of currency movements and arrangements for hedging being a key consideration. CBRE did not offer to hedge the currency themselves but through a third party provider. The performance target for the global allocation is an unhedged 9-11% and the target allocation was provisionally proposed as 25% with a +/-10% margin. The method by which this 25% could be funded is either through additional capital, or through sale of UK assets and investment of income over a period of time.

UBS

1. Met with Steve Magill and Richard West from UBS.

2. Whilst UBS performance over the past three, five and seven years since the value team took over the portfolio management has surpassed that of the benchmark, performance over the last year has been weaker. There has been underperformance versus the benchmark in three out of the previous four quarters.

3. UBS argued that the recent dip was not a result of fundamental portfolio weaknesses but partly arising from profit taking in positions that had recently undergone substantial outperformance, e.g., cyclical holdings in Dixons. Another area of underperformance to the benchmark was the exclusion of pharmaceutical takeover targets Shore and AstraZeneca, as well as expensive consumer staple stocks acting as bond proxies that had benefited from recent reduction in gilt yields.

4. The largest transactions over the previous twelve months involved the sale of Standard Chartered as UBS believed the assets held by Standard Chartered to be inherently risky. The proceeds of the sale were used to purchase HSBC, which offered a more secure exposure, with a low valuation, returns below that of long term averages, and with any prospect of interest rate rises providing a fillip to the share price.

5. As well as HSBC, UBS were overweight in the banking sector with valuations much lower than historical averages with scope for further upside.

6. The second largest active stock position within the portfolio was 3i Group, the listed private equity investment company. The position in 3i began in 2008 and has been added to in recent years following cost cutting exercises and a turnaround in investment strategy. UBS stressed that the underlying investments that 3i made were vitally important to assessing the fair value of the stock. One such underlying investment the European discount chain, Action. This has the potential to be hugely successful for 3i.

7. The sector positioning was driven by bottom up stock selection as opposed to macro viewpoints. UBS were overweight sectors which are more economically sensitive, including oil and gas and industrials. This positioning was a view on the cheapness of stocks in these sectors and an additional margin of safety rather than a particular positive outlook on the economy.