**Surrey Manager Review meeting – 30th August 2017**

Attended by Phil Triggs, John Harrison and Anthony Fletcher (Allenbridge)

**Franklin Templeton**
*Stuart Lingard (Product Management), Chris Orr (Relationship Management)*

*Mandate summary*
This is a total return orientated capability seeking to deliver long-term returns from bond and currency markets. Although a bond benchmark is shown, the portfolio positions take very little notice of it – this is genuinely a non-benchmark driven approach. Surrey appointed Franklin Templeton in Feb 2013 and the mandate is currently valued at £73m.

*Performance*
The portfolio has very little alignment with a conventional bond index, in particular in relation to duration – the sensitivity to interest rate movements. In the 12 months to end June 2017 the portfolio delivered a return of 12.6%, with currency views accounting for 6.4% and yield curve positions 5.3%. Currency views were detrimental in 2014 and 2015 - over the three years to end June 2017 the overall fund return was +1.4% pa.

*Current Positioning*
The portfolio seeks to exploit three sources of return – curve, credit and currency. On curve, they believe inflation pressures in the US will push up interest rates, so they have a large negative duration position in US – the fund will make positive returns if US interest rates rise faster than consensus expectations. The portfolio overall has a duration of just 0.1 years compared with the 6.8 years' duration of the bond index.

On credit the portfolio continues to hold a broad spread of credit ratings, with over 30% below investment grade. This includes exposures to esoteric geographies, such as Ghana, Ukraine and Serbia. The average credit rating of the portfolio is BBB.

Currency is the return source that has seen the most volatility, which is why the large positions the portfolio maintains here are currently dominating relative performance. The fund has a combined negative 75% exposure to the Japanese Yen and the Euro, which make up about 40% of the global bond index.

*Adviser view*

Surrey appointed Franklin Templeton to take both 'long' and 'short' investment views based on long-term return potential without reference to the standard bond benchmark. They have done this consistently since appointment. The absolute returns have been variable, but in bond markets dominated by the large currency blocs of US dollars, Yen and Euro and distorted by monetary policy, this is hardly surprising. I have no immediate concerns, but we will need to be patient to see the full benefit of this investment approach.

**Ruffer**

*Alex Lennard (Investment Director), Trevor Bradley (Investment Director)*

*Mandate summary*

Ruffer seek to generate good long-term returns through a long-only portfolio with a strong emphasis on capital preservation. Surrey appointed Ruffer in Sept 2016 and the mandate is currently valued at £122m.

*Performance*

It is far too soon to judge the long-term success of a strategy that is designed to deliver over rolling 5 year periods or longer. The fund delivered a positive return late last year, but is slightly down in 2017, so the performance from Sept 2016 to July 2017 is +1.4%.

*Current positioning*

The managers are very cautious, believing that financial markets have been distorted by central bank intervention and are now displaying signs of 'yield mania' – investor willingness to overpay for risky assets in order to secure a high enough yield. They expect inflation to rise as a mechanism for deflating unsustainable levels of indebtedness. The current asset allocation is very different from any of Surrey's other managers and focused on index linked bonds (39%), developed market equities (41%) and gold (5%).

*Adviser view*

Ruffer may have very different views from the consensus, but they are well researched and consistently applied. They would probably be one of our better performing managers in a difficult market environment.

**Newton**

*Jeff Munroe (Head of Global Equities), David Moylett (Client Relationship)*

*Mandate summary*

A conventional active global equity mandate seeking to exceed the index by 2% pa. Surrey appointed Newton in 2008 as a growth style manage to complement the value style of UBS (see below). The current mandate is valued at £313m.

*Performance*
The last 12 months have been disappointing. The portfolio suffered poor relative returns during the financial crisis, but had improved markedly when Jeff Munroe took charge of the Global Equity team in 2012 (he had previously been the firm's CIO). However, after 4 years of good relative the portfolio return is 5.2% below benchmark in the 12 months to end June 2017.

Part of the reason for the shortfall has been a marked change in market sentiment, particularly in respect of the 'reflation bounce' following the election of Donald Trump. Their sector positioning has been cautious, favouring consumer staples and healthcare over financials and materials. This worked well up to mid-2016 but has worked badly since then. More worryingly, part of the shortfall has also been individual security selection mistakes, such as Teva Pharmaceutical and TripAdvisor.

Despite the latest 12 months, performance remains above benchmark over 3 years (by 0.2% pa) and 5 years (by 0.7% pa). While below target, this does suggest the process is not wholly broken.

*Current positioning*
There has been no change in philosophy or approach and therefore no material change in their views. They believe the economic and profit environment will become more challenging as monetary stimulus wanes, with the overhang of indebtedness constraining growth. They are also wary of the credit cycle in China. The portfolio is therefore focused on defensive sectors and underweight in cyclical sectors. The portfolio has 68 holdings.

*Key personnel*
Newton announced in August the appointment of Curt Custard in a newly created role as CIO. Curt was previously Head of Global Investment Solutions at UBS. His role will be to oversee the investment teams, including Global Equities. He will not be managing money, but will be monitoring risk disciplines.

*Adviser view*
I do not regard the appointment of Curt Custard as a positive. The key individuals driving investment thinking at Newton are Jeff Munroe and Iain Stewart, Head of Multi-Asset. Given they have previously had considerable autonomy, any attempt to constrain their ability to take the investment risks they judge sensible could prompt staff instability.

Having said that, there is no evidence as yet that this is happening. The poor recent returns have been in the context of a very strong market environment. Should the current investor euphoria subside, the portfolio positioning would be beneficial. Newton is currently on watch and I suggest it should remain so.

**UBS**
*Steve Magill (Head of UK Value), Guy Walker (Fund Manager), Digby Armstrong (Client Relationship)*

*Mandate summary*
An active UK equity mandate with a strong value style bias seeking to outperform the UK index by 2% pa. Surrey has been with UBS for many years, but this mandate was created from the previous balanced mandate in March 2004.

*Performance*
The last 12 months have seen exceptionally strong relative returns, with the portfolio return of 28.0% against an index return of 18.1%. All the factors that weighed against Newton were beneficial for UBS. The value bias favoured financials, materials and industrials, all of which performed extremely well in the reflation bounce. Longer term performance has also been strong, with relative returns 1.8% pa ahead of index over 3 years and 3.3% pa ahead over 5 years.

*Current positioning*
The portfolio remains more than 4% overweight in both industrials and basic materials. The other notable overweight sector is oil & gas, at close to 4%. The major underweight sector is consumer stocks, where the fund is close to 10% below index. This reflects their belief that defensive consumer stocks are too highly rated following strong performance over recent years.

*Corporate change*
The UK Value team has recently taken on the management of the European equity mandates at the specific request of one of their largest LGPS clients. The team does have experience of European equities – both Steve and Guy were previously European analysts. The UK index also derives well over 70% of its earnings outside the UK, so they have always had to consider European and global issues.

The extension of the team's responsibilities does make the capability less vulnerable to the LGPS pooling process. There have been very few UK equity mandates awarded in recent years and the team's client base is heavily skewed to LGPS clients. The consolidation of mandates may have threatened the viability of the product had the business base not been expanded in this way.

Having said that, there is a risk that the team will be overstretched in the coming months. They will have to place emphasis on deepening their knowledge of European companies, so they will have less time to focus on UK stocks. This is probably manageable, but is an issue to monitor.

*Adviser view*
The relative performance of UBS will always be highly correlated with the value style, which has a long-term record of delivering above index returns but with sometimes prolonged period of underperformance. The extension of the team's responsibilities to cover Europe is worth noting, but is not an immediate cause of concern.

**John Harrison – Managing Director, Allenbridge**