Allenbridge
Part of MJ Hudson

13

# Surrey Manager Review Meeting

18TH OCTOBER 2017

# Attendees:

Phil Triggs, Neil Mason, Chris Duke (first two items), John Harrison

# CBRE

*Max Johnson (Client Relationship), Dhananjai (Fund Manager)*

*Property Fund-of-Funds mandate (£233m) seeking to achieve benchmark +0.5% pa over rolling 3 year periods*

Performance

- Delays in property valuations mean we only had end June data available; these delays mean it is also better to measure performance on a 'Business Day 10' basis
- For the quarter to June 2017 the portfolio return was +2.2% (benchmark +2.3%); over a rolling three year period the portfolio return of +9.1% pa compares with a benchmark of +9.5% pa
- In the last quarter, the biggest detractor (-0.6%) was currency movements reflecting a strengthening of sterling

Activity

- The overseas exposure is now at 15% and will rise to 17% when the outstanding commitment to the Global Alpha fund is drawn down.
- Other commitments in draw down include the M&G Real Estate Debt funds (£4.1m), Palmer Capital Development (£1.6m) and the Leisure Fund (£5.2m) – these should fully invested by end December 2017
- The portfolio comprises 27 holdings, but 7 of these are less than 1% of the portfolio and are being sold
- They are also reducing the holding in Curlew Student Trust following good performance; current interest suggests sales may achieve a 10% premium to NAV

Positioning

- The key themes remain prime logistics (16%), defensive alternatives (student, healthcare and leisure – 24%), secure income (19%) and regional diversification (12%)
- The UK market has been surprisingly strong post-Brexit, in part due to overseas interest following the fall in sterling; industrial units have seen strong tenant demand, particularly in the South East
- Consensus forecasts indicate a lacklustre outlook for capital growth in the UK, so yield will be the main source of return; CBRE are more cautious than consensus about returns from 2019
- CBRE expect total returns to average about 4% pa over the next 3 and 5 years; they believe London office will provide poor returns, with leisure and industrials the strongest performers
- The fund is overweight in shopping centres (+4%), industrials (+2%) and 'other' (+18%) and underweight in retail units/warehouses (-15%) and offices (-10%); leverage is at 20% and the yield is 3.5%
- They are considering new investments in healthcare and social housing

**Adviser View**

- No issues. This is a well-diversified portfolio with sensible positions. Performance has not been exciting, but CBRE has been restructuring the portfolio to have a higher allocation to overseas assets without incurring too much cost. To be close to benchmark through this change is satisfactory.

# Marathon

*Graeme Neuff (Client Relationship), Charlotte Bostock (Client Executive)*

*Global equity mandate seeking to achieve index +2% pa*

Performance

- A poor last 12 months (14.2% versus 14.9%) but achieving target over rolling 3 years (16.4% pa versus 14.4% pa); for Surrey, returns since inception (April 2004) are above target (12.6% pa versus 9.6% pa)
- Marathon has an excellent 30-year track record and very stable client base; half its clients have been with them over 10 years and a third over 20 years

Activity

- The big change has been to remove the previous asset allocation biases to Europe and Japan relative to the US; they have decided that their bottom-up process of stock selection has not been helpful in taking asset allocation views - the weighting to Japan has nearly halved to 9% (versus 7.6% index)
- One consequence of this change has been to free up $3bn capacity in Japan for new investors – Japan had been the most significant capacity 'pinch point'; they envisage adding about $1bn in new Japanese mandates, with an additional $1bn available for new global mandates (meaning they could take on an additional $10bn); this would enable Border to Coast to make a meaningful allocation if it chooses

Positioning

- The multi-manager process, with two or three managers for each regional 'sleeve', results in over 500 individual holdings; the multi-manager approach improves accountability and provides a succession planning
- The portfolio is overweight in consumer staples (+9%) and cash (+4%) and underweight in healthcare (-4%), energy (-5%) and utilities (-3%)
- Although the portfolio has a number of contrarian positions, such as Japan insurance and agriculture suppliers, it does not demonstrate value characteristics; relative to the index, the average P/E is higher (20.3x versus 20.0x) and the yield lower (2.1% versus 2.4%)
- The portfolio takes large active positions, particularly in not owning expensive stocks – current nil positions include Apple, Microsoft, Exxon, JP Morgan and Bank of America

**Adviser view**

- No issues. Marathon remains a core active manager for the fund. Their consistent approach based on the capital cycle has a proven long-term track record and the strength and depth of the ream is impressive.

# Majedie

*Chris Field (Fund Manager), Sarah Maynard (Client Relationship)*

*UK equity mandate (£390m) seeking to achieve index +2.5% pa over rolling 3 years*

Performance

- The fund outperformed the index in the latest quarter (3.0% versus 2.1%) but has lagged in calendar 2017 to date (4.4% versus 7.8%)
- Longer term performance remains excellent; since inception in Sept 2004 the fund is 3.7% pa ahead (11.9% pa versus 8.3% pa)
- The latest quarter benefitted from underweight positions in consumer staples (BAT, Reckitt Benckiser, Imperial) and overweight positions in mining (KAZ Minerals, Anglo American) and food retailers (Tesco)

Activity

- There has been very little change to key themes since May; they remain cautious and are wary of perceived defensive stocks on high valuations
- They did buy a small (<0.5%) position in BAT because its index weight rose above 4%; they have since reviewed the internal +/- 4% limit on individual positions and decided to amend this to +4% only; the holding in BAT will therefore be sold

Positioning

- There is a high risk of policy mistakes as central banks seek to unwind QE in an uncertain economic environment
- They believe that UK domestic exposure is attractive, with the largest active positions being food retailers (+7%) and telecoms (+6%); the main underweights are tobacco (-5%) and pharmaceuticals (-5%)
- The 1.6% in Ryanair is entirely in the sleeve managed by Chris (neither James nor Matthew own it); Chris believes the core business case is intact and that Ryanair will take market share from EasyJet

**Adviser view**

- No issues. A very strong long-term track record from a very strong investment team. There have been similar periods of underperformance in the past, but they have usually proved short lived. The first half of 2017 may also fall into that category.

# Aviva

*Peter Fitzgerald (Fund Manager), John Andrews (Client Relationship)*

*DGF mandate seeking cash +5% pa over rolling 3 year periods*

Performance

- It is still early days, but returns have been modest since inception in September 2016 at +1.6%
- This was another lacklustre quarter, with a return of -0.5%; equity markets were mildly positive, but offset by currency and duration positions

Activity

- The portfolio makes regular changes to its investment positions
- The most notable this quarter were an increase in their negative view on long dated US bonds and new positions in equities (emerging versus developed, short European cyclicals) and credit (long Mexican bonds)

Positions

- Aviva expects US inflation to pick up further and were surprised when US bond yields fell over the summer

- They expect UK inflation to drift lower; they have short positions on both UK inflation and duration; they believe LDI demand for long gilts may be waning given the higher than expected transfers out of corporate schemes
- There is a dislocate between equity markets (discounting reflation) and bond markets (discounting deflation); they expect the return to net government bond issuance in 2017/18 after a prolonged period of QE driven excess central bank buying
- Equity risk is broadly mid-range at about 40% of overall risk; this is consistent with about a 30% equity weighting
- Long term concerns/risks include debt deleveraging, illiquid fixed interest instruments and increased market automation (algorithmic trading, passive, factor investing, etc.)

**Adviser view**

- The rationale for having DGFs (to diversify equity market risk) through three differentiated funds (to diversify manager risk) remains valid. This has not been a good period for the Aviva approach, which is similar to a macro hedge fund, but the mandate has only been in place for a year and should be judged over longer time periods.

# Baillie Gifford

*David McIntyre (Fund Manager), Paul Morrison (Client Relationship)*

*DGF mandates (£148m) seeking to achieve base rates +3.5% pa net of fees over rolling 5 year periods*

Performance

- In contrast to Aviva, the Baillie Gifford approach has worked well in the last year, with a return of +7.6% net of fees; the rolling five-year return at 5.7% pa net of fees compares to the benchmark target of 3.9% pa
- Since inception in May 2012, the return of 6.0% pa net is well ahead of the target of 4.0% pa (base rates +3.5% pa); volatility has also been very low at 4.0%
- In the year to September 2017, the main positives were listed equities (+4.1%), emerging market bonds (+1.0%), high yield (+0.8%), currency (+0.7%) and property (+0.6%); the only detractors were commodities (-0.2%) and absolute return hedges (-0.5%)

Activity

- They added modestly to listed equities, high yield and emerging bonds; they also added to absolute return hedge exposures (e.g. CTAs and VIX) to mitigate tail risk; a short Korean won currency position was taken out, which is also a hedge against global economic growth weakening
- The positions in platinum and palladium were removed; the palladium view had worked well, but the platinum market had not moved as expected due to over production by South Africa

Positioning

- The fund remains broadly diversified strategically, with just 22% in equities; the other exposures are to credit (36%), real assets (16%), government bonds (8%), absolute return hedges (7%), insurance linked securities (3%) and cash (11%)
- The high cash position reflects the balance between a benign central expectation (good for risk assets) and a range of potential geo-political, economic and valuation shocks any of which could prompt very poor returns from risk assets; cash is the defensive buffer that provides liquidity to buy cheap assets if and when opportunities arise
- Having been closed to new investors for a while, there is some additional capacity for existing investors; the overall capacity of this capability is judged to be £9bn, so up to £2bn more could be invested; so far existing investors have indicated demand for about £200m

**Adviser view**



- No issues. This remains a core DGF holding and has delivered very consistent returns from the outset. The team has grown steadily, but the main managers (Patrick, James and David) continue to be the drivers of key views.

8 Old Jewry, London EC2R 8DN, United Kingdom | +44 20 7079 1000 | info@allenbridge.com | mjhudson.com | allenbridge.com