LWM Consultants Ltd
Meeting the Fund Manager

Fund manager meeting – Schroder Income Fund

We do not directly invest in the Schroder Income Fund but its strategy underpins the Schroder Income Maximiser Fund. The fund is co-managed by Nick Kirrage. Nick joined Schroders in 2001, and is a UK equity research analyst responsible for covering various sectors including transport, aerospace and defence and metals and mining. He also co-manages the Schroder Recovery Fund and Schroder Specialist Value UK Equity Fund.

It was excellent to have the opportunity to meet Nick and talk through his strategy. One area of focus was around the holding of banking stocks which don't yield anything and why the fund adopts this strategy. The other area of interest with Nick is his belief in value investing and it was therefore interesting to see how this strategy plays through.

Investment objective and profile

The fund's investment objective is to provide a growing income, predominantly from investment in UK equities. In seeking a yield higher than that offered by the major UK equity indices, the fund will invest primarily in above-average yielding equities rather than fixed interest securities. Investment will be in directly held transferable securities. The fund may also invest in collective investment schemes, warrants and money market instruments.

Themes and investments

We started by having an interesting discussion around the importance of experience, and clearly this is an important aspect of the fund and the holdings. Nick uses the Graham and Dodd theory of investing. Effectively without going into a great deal of detail the theory encourages investors to take an entirely different approach by gauging the rough value of the operating business that lies behind the security. It is seen as the foundation stone for value investing.

The fund currently holds banking stocks, these don't produce a yield and actually are seen as high risk stocks. The point which Nick articulated was that in 2005 banking stocks were seen as low risk. Effectively hurricanes happen, which overnight change perception, banking stocks are now seen as high risk. The question that has to be asked is, is there a misprice in share price. When you consider a number of these banks have been around for 300 years, will they be around for another 300 years? What are the barriers to entry, could more competitors come into the market, barrier to entry in the banking sector is huge. So then you look at the price, at between 25 and 30p is this a fair value? The price should be higher possible between 80p and £1.

Are there downsides? Currently the stocks are not paying dividends but they have in the past and could in the future. RBS have recently announced they will be paying dividends again. So effectively one downside risk is that may never pay dividends and therefore this could be a drag on yield. The second is that as they part owned by the state they could become nationalised however they only make up around 6% of the fund. So because the fund is diversified it lessens the risk should the worst case scenario play out.

As a long term investment Banks are therefore a good value play. Other examples are BP, once a darling stock there was always a risk that something could go wrong and it did, does that change the company and how we perceive the risk?

Another example we looked at was Legal and General, at one point the shares were trading at 25p. Now they are trading at £1.15 and the dividend is up 25%.

So the key is about finding hidden gems – in the UK 2/3rds of the top twenty provide the bulk of income and most income funds following a similar style analysis with the exception of Schroders. The fund also takes advantage of investing overseas in the likes of Pfizer and Merck.

A message that we have heard a number of times is that at the moment there are a number of very cheap good companies out there. Clearly this plays well into a value orientated fund.

Conclusion

Although we don't directly hold this within the portfolios it is the underlying part of the Income Maximiser Fund. We were impressed by Nick's enthusiasm for the fund and the style he adopts to manage the fund.

The source of information in this note has been provided by Schroders and is correct to the end of April 2012. These are notes from meeting the fund manager and should not be seen as a recommendation to purchase this fund. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should also note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.