LWM Consultants Ltd
Meeting the Fund Manager

Fund manager meeting – Threadneedle UK Equity Team

We were recently invited to a lunch with Simon Brazier who is Head of UK Equities at Threadneedle and Richard Colwell who is the lead manager of the Threadneedle UK Equity Income Fund. Although we don't hold Threadneedle UK Funds in our portfolios we felt it was a good exercise to hear what other fund managers say and get a feel for their funds.

In previous briefing notes I have indicated that any UK fund really needs to stand out in the sector. This review remains, both fund managers are clearly talented and their funds good but against what we have already selected there is really little room to add these funds. However, certainly they would fall into our watch list.

Rather than outlining what the funds objectives are I have outlined some of the discussion points which I found interesting, and gives some idea to their style of investing.

Themes and investments

The start of the discussion was slightly depressing looking at the macro view of the UK, one thought shared by Richard was that the idea of shorter economic cycles is the new norm. The UK is still underwater because of the debt pile and hence austerity. The greatest fear of the government is that these pressures force the UK into a spiral of deflation and hence QE as a means of avoiding this. The general feeling was that the pain will continue as banks shrink balance sheets and this could continue for some time to come.

One message came from this which has been central to a lot of the discussions I have had recently, and that is that 75% of UK listed companies drive sales from outside of the UK so effectively however painful it is in the UK many companies look beyond to drive growth.

The two themes that Threadneedle are looking at are volatility and pricing. We went through a history lesson which, as I did history at A'level, I found interesting – in terms of market volatility the 80's and 90's were an anomaly. The eighties showed only positive returns on UK equities and in the nineties the positive far outweighed the negative i.e. there was very little volatility. The point is that we are just returning to a state that has always existed i.e. that we can expect to see returns such as 25% one year and then suffer losses of 20% the next. So we could expect to receive say 5% p.a. returns but there will be swings each year to achieve that.

This means that the market will open up opportunities. Paul often talks about Price to Earnings ratio as a good indicator of value, Threadneedle believe below 10 x earnings has the potential to deliver at least 10% p.a. real returns. When we consider that in 1998 / 99 the average PE Ratio was nearer 30 times you can start to see how returns would struggle.

But volatility delivers opportunities. A couple of examples we looked at were BP and Tesco. BP was crippled after the disaster and the bottom drop from the share price. At £3.20 the valuation for the company was mad. If all the assets of the company were sold even at a fire sale they would reach more than £3.20 a share.

Another example is Tesco's – they have not owned this for eight years but recently this has come onto the buy list. At £3.15 a share and paying a dividend around 8% this stock is now very cheap and a good 3 to 5 year hold.

The point from this reflects their style which is to buy stocks when people don't want to own them. The rules really are to look for strong financials, global reach and the ability to grow.

In summary although the outlook for the UK is bleak the potential for UK companies with a global reach is good.

Conclusion

We already use a number of Threadneedle Funds both Simon and Richard painted a really interesting picture and we will certainly add the funds to a watch list but as the market is crowded unless there are fundamental reasons for change we probably wouldn't make these.

The source of information in this note has been provided by Threadneedle and is correct to mid May 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.