LWM Consultants Ltd

Meeting the Fund Manager

Liontrust Special Situations Fund

We are always looking out for talented fund managers. These can be young talent like for example Alex Breese of Neptune or, experienced talent like Harry Nimmo of Standard Life. The Liontrust Special Special Situations Fund is one of those funds where the fund manager clearly has both experience and talent and this is recognised in the various awards that have been received as well as the consistent long term performance.

The fund has been run using the same style and process since 2005 (although this process has been in place since 1998 when the UK Smaller Companies Fund was launched) and therefore the fund manager has run money through some of the most difficult periods over the last decade and more. The fund manager we met was Anthony Frost, who co-manages the fund with Julian Fosh.

This fund is more about being a long term value play (although Anthony would not want to be shoehorned into a particular style) with between 40 to 50 holdings. Below we will talk more about some of the points discussed but fundamentally Anthony and Julian are looking for companies which have barriers to entry, strong financial output and provide the opportunity for compounded growth over a long period of time. The last point is important, they look to hold for as Anthony quoted “ever”, and I will expand on this later.

Overview

The selection process is a good starting point for this fund – the key message is the hunt for companies that have company strengths that competitors struggle to reproduce, i.e. barriers to competition.

There are three areas that they look at to quantify this – the first is intellectual property. By this they mean they are looking for companies that have patents and pricing power, this could be companies in engineering, media, software etc.

A secondary area is distribution – this could be data embedded, i.e. the likes of Rightmove, or where there are strong networks to distribution therefore creating hurdles to people coming.

And finally they look at repeat business; so where around 70% of business is repeat business and this is then used to develop the business, this is seen as a sustainable long term business.

Once businesses have come through these checks then they look at other factors like brand, franchises, licenses etc. An interesting example of a stock they hold is Domino’s Pizza, it is not just about dough and calories! It is the UK's largest pizza delivery business with over 750 outlets. It has a massive distribution network which confers significant advantage over competitors. It makes the most of ecommerce with 50% of orders coming online and finally because of the different factors it has high franchise profitability which attracts new franchises.

Anthony explained that they first bought into Dominos through the Growth Fund in 2008 when the share price was just over 200p and through the Special Situations Fund in 2010 where the price was just over 300p. The share price today is over 550p.

Digging into the companies Anthony talked about looking at returns on capital for companies over a ten year period. What he is looking to identify is how they employ capital, so for example British Airways would be seen as a value destroying business.

Then he will look at price, what he is looking for is a good price, this doesn't necessarily mean cheap but he wants to avoid a bubble type price. This touched on target prices and Anthony explained that they don't have target prices, they are happy to sit and hold. This may mean holding when the price goes up, or down, or remains flat. During this time they may shave, trim or add holdings as they look to hold a maximum of 3% in a company.

Touching on the reasons to sell – if a company is no longer seen to be delivering then they will look into the reasons for this i.e. is it cyclical or something more fundamental, if the company has lost its intellectual capital and if there is a potential risk to the business.

One other reason to sell is around direct shareholder holdings. One important aspect of investing is director ownership as Anthony believes this provides strength to the business and aligns the directors directly with the business. They look for directors holding a minimum of 3%, and should this fall then this might be a trigger to sell.

This point was interesting as I wanted to know if Liontrust adopted a similar approach, Anthony does have shares in Liontrust as well as options and he does invest his own money in the fund. So effectively his investments are aligned to his client's investments.

So going back to the initial point on holding periods for stocks this could be in Anthony's words "forever".

Finally we touched on sectors, currently the fund holds around 25% in small cap, 35% mid cap and the balance in FTSE 100 companies. He believes this combined with the diversity of companies ensures that the fund is not reliant one sector. This is best demonstrated by the performance in 2011, 2010, 2009, 2008 and 2007 which shows its performance against the FTSE all share index which is what we use to measure our UK funds:

	2011	2010	2009	2008	2007
Liontrust Special Situations Fund	7.54%	36.14%	41.20%	-25.90%	0.17%
FTSE All Share Index	-3.46%	14.51%	30.12%	-29.85%	5.32%

Since launch the fund in 2005 the fund has returned 13.6% p.a. The volatility is relatively low over three years at 12.41%.

Special note to performance data: You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

It was excellent to meet Anthony Cross and we have added the fund to our watch list. As we have hinted before there are are few very talented UK fund managers and therefore it is always difficult to add new funds. However, when we build portfolios we will look at many factors which includes volatility against return and if we feel there is a place for this fund then we would look to add this.

The source of information in this note has been provided by Liontrust and is correct to the end of August 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.