LWM Consultants Ltd

Meeting the Fund Manager

M&G Recovery Fund

Some fund managers are harder to meet so we were delighted to get the opportunity to meet Tom Dobell who is the manager of the M&G Recovery Fund. If I am honest the meeting was a bit like going to watch Queen and then Freddie Mercury not turning up. As a group Queen was brilliant but it was Freddie Mercury who was the showman. As you can guess from the analogy Tom Dobell didn't appear and we met one of the deputy fund managers Michael Stiasny.

The fund itself is the Manchester United of the Fund world with an impressive track record over a period of 40 plus years and only three fund managers over that time. To some extent the fund has become a victim of its own success with assets under management of over £7 billion.

We have supported this fund for a number of years and we have started to see that the performance is starting to stagnate. This isn't a negative for the portfolios because the volatility of the fund is low and therefore it acts as a good counter balance to some of the other funds we have but we have to consider whether it has run its course and whether there are better opportunities in the market.

One meeting will not confirm the route we take but it will help us in making the final decision. Below are some of the notes I made as a result of the meeting.

Overview

A number of the aspects around the fund appeal to our style of fund selection. Firstly Tom Dobell has been in control of the fund since 2000 so brings stability to the fund, secondly the fund has two deputy fund managers who only act as deputies providing good succession planning to the fore and thirdly they are effectively buy and hold managers.

Interestingly when we discussed the underperformance of the fund one key point was that they believe in the companies they invest in and they believe in the strategy they have adopted and therefore they see no reason to change course to chase short term performance figures. If we apply the same theory to fund selection, nothing has changed so should we change tack.

Holding onto the point of underperformance Michael noted that the markets are not reflecting the re-rating of companies, so by this he means many companies have good management in place and have started the recovery phase but because of short term horizons and risk aversion the companies continue to struggle in this market. For the recovery fund holding stocks for 7 to 8 years is not unusual but it needs to be considered against the average holding which is now around 8 months.

The strategy for the fund as quoted by Michael is very simple:

1. What they do:
    a. Only invest in companies they understand
    b. Only invest in companies they trust
    c. Seek companies that influence their own fate
    d. Back the underdog with special potential

2. What they don't do:
    a. Invest in companies with BOTH financial and operational problems
    b. Invest in IPOs
    c. Change their investment principles if they're out of fashion
    d. Use derivatives or engage in stock lending

The process follows a four stage process. Stage 1 is unloved stocks and Stage 2 is stabilising, around 2/3rds of the portfolio sits in this area, Stage 3 is recovering well and Stage 4 is Mature. Around a third sits in Recovering Well and Stage 4 is when they are looking to sell.

An example of an unloved stock is BP, they do expect this to move to Stage 2 but market sentiment is against BP. The key point is around a settlement in the US Court Case. However Michael doesn't see a quick resolve to this and actually the company is already planning for the future and this was reflected in the recent dividend payment. The point Michael was making is that this is classic unloved stock which could produce good long term value.

I wanted to explore whether companies fail and he admitted that around 1 company a year goes into receivership and 1 company tends to drop out because it hasn't delivered. With holdings up to 100 this is only a small percentage so should not have a material impact on the fund.

The fund does benefit from mergers and acquisitions and this activity has been muted over the last couple of years, there was no activity in 2011 and little this year. However, they do believe this will change.

One interesting point of discussion was around size and selling stocks, Michael didn't see this as a problem and in fact citied a company they had held for eight years and then sold towards the end of last year when they felt it had started to turn sour. They owned 17% of the company and were able to sell the shares in one day. Interestingly the company has now gone into receivership. With other companies they might reduce their position to zero over a six month period.

Clearly the message is this, this is a recovery message and size doesn't matter, although the performance has been poor they are sticking to the process and plan and we could see some upturn over the coming months.

From our side there a couple of concerns that we feel were not addressed, firstly some of the holdings go back to 2000 (a period of 12 years) and it begs the question as to whether these are really recovering stocks or whether they are holding for the potential strong performance they could offer. So they hold them in stage 3 rather than forcing a sell at stage 4. The second point is size, they say that size suits the fund however all it does is reduce the volatility, this then begs the question are there similar funds with regards to volatility which deliver better returns.

Conclusion

Clearly this is an exceptional fund with an exceptional team; the question is whether there are better opportunities out there. Perhaps smaller funds, identifying good long term opportunities, might be better suited to the portfolios. As we start the process of reviewing the portfolios we will consider this fund and look at alternative options.

On the flip side it could be that by holding the return comes through and it would be wrong to miss that, and equally with low volatility this acts as a good counterbalance to the more volatile funds.

Going back to the analogy at the beginning perhaps if Tom had appeared we might have been able to get a little more conviction in the fund but that is the problem when your lead singer doesn't make an appearance!