



LWM Consultants Ltd

Meeting the Fund Manager

Threadneedle European Funds (*Select and Smaller Companies*)

Often when we consider the economic woes we think about Europe and because we look at the macro picture we often overlook the opportunities of the asset class. In some of our portfolios we hold Threadneedle European Smaller Companies Fund, although we have carried out a lot of research on the fund we haven't met the manager before.

David Dudding, the manager of the fund, joined Threadneedle as an analyst in 1999 and started managing the Threadneedle Smaller Companies Fund in 2002, and then in 2008 he took over the European Select Fund as well. There were a number of things which came out of the discussion which reflects the importance of having an experienced fund manager.

The most important aspect is that of patience, David is in his early forties and considers investing as a get rich slowly strategy. That is he has possibly twenty years before he retires, and then perhaps another twenty years in retirement. He is therefore looking to identify companies which can deliver over the long term, rather than seeking short term winners.

This conviction is backed by David investing his own money in the fund. In the discussion we looked at brands like ABInBev and Handelsbanken as well as investing in Europe and the potential challenges.

Overview

The first discussion was around Europe, whether there was value in Europe and whether there were countries that David avoided. The first point is to understand David's approach which is "bottom up", by this he is looking for good companies first and foremost rather than regions or sectors to invest in and then finding companies. A good company has a number of characteristics like, for example, brand, competitive advantage and / or pricing power.

These companies have the ability to compound growth over time whether this is through pure growth, dividends or a combination of the two. His approach also means he doesn't own 'timing' stocks, so pure cyclical stocks which can fall in and out on fashion. He pointed out that he doesn't hold many European banks because of the limited opportunities they offer. For example in Germany 400 banks applied for EU funding.

He feels with banks they have limited ability to cross sell and expand out of the country they operate in. So although they are cheap in valuation terms, he believes there are better

opportunities in the market. Of course in doing this he has missed the rally in bombed out stocks over the last few weeks but this goes against his philosophy. So how does this apply to Europe?

The problem is that people look at the bigger picture and believe European companies reflect that picture. So although the European economies are not healthy the companies are good and there are certainly pockets of excellence, for example in the luxury brand market. So David is looking to identify those companies that are globally competitive, and effectively exporters.

So, for example, Nestle is a globally recognised brand both with pet food and confectionary. It has a sustainable dividend which has not dropped in fifty years. So it has a sustainable franchise and price. So taking this to the street level we want a Kit Kat we don't go looking for the cheapest price we just buy it.

Taking this into other Sectors, Fresenius Medical Care has 70% of the US Kidney Dialysis market. It has a low cost base and there are significant barriers to entry.

We then discussed another company ABInBev – this company plays in a mature market where there are fewer players and therefore better pricing. It fully owns Mexico's biggest brewer which accounts for 54% of the market. There are only two players and therefore it has a strong hold of the market. Two factors that play in its favour, firstly young men drink the beer and there are plenty of them and secondly the market is growing. So this is a mature, established market with little competitive opposition.

Of course ABInBev is the world's largest brewer, with brands like Budweiser, Becks and Stella Artois and has strong market share in the US and Brazil. The management also own a significant stake of the business. So combining these factors you have a good European company.

I wanted to discuss Handelsbanken which is a bank they hold. This is a popular holding of many European Funds so I wanted to understand his reason for holding a company that doesn't really have a global reach. To some extent his description of the business came into the get rich slowly category. They hold a dominant position in Sweden and have now started to spread out into the UK and Holland. They have not looked to buy branches but grow slowly.

The approach goes back to the old banking days of knowing your branch manager and the branch manager knowing you. Effectively the branch has freedom to lend to who it wants to. There are no growth targets but a single goal to be in the top quartile in terms of capital return. This approach has seen them survive two banking crisis without the need to turn to government support.

So not necessarily a global company but it has a good franchise. Another key aspect is that the employees' pension scheme holds shares in the company, i.e. there is a link between shareholder value and employee interests.

It has not been the fastest growing company over the last four years returning around 20% but it has provided dividends of 20% as well so net net, the return is around 40%.

Before concluding the discussion I want to touch on the difference between the Select and Smaller Companies Fund. The Select Fund invests in around 48 stocks and the Small Cap Fund has around 78 funds. Around 25% of the Select Companies appear in the Small Cap Fund. The Small Cap Fund

is more volatile because of the companies it invests in and turnover is higher. But fundamentally with both funds you are benefiting from David's experience with investing in Europe.

Conclusion

David is clearly an experienced fund manager who believes in steady long term investing, this means he won't chase short fixes but will focus on companies which can deliver long term performance. He may go underweight in a particular country but this not because of the political situation but more that he is unable to identify good opportunities.

The philosophy of get rich slowly appeals to us and using the smaller companies fund works well alongside the other funds we use. We will review the Select fund as this may provide a good balance to the portfolios.

The source of information in this note has been provided by Threadneedle and is correct as at 18 October. 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 note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.