

# Fund Bites

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## *F&C US Smaller Companies Fund*

The F&C US Smaller Companies Fund was added to the portfolios in 2012 as part of our review of North American Equity Funds. This “fund bites” is a summary of the recent meeting we had with the fund manager, Robert Siddles.

## Introduction

When we are looking for funds sometimes we select funds on the performance, the process and the management team. Often I call this bland, there is nothing exciting but you cannot deny them being part of the package.

Sometimes you find a gem, and the gems are the ones we are constantly looking for. In our view the F&C US Smaller Companies Fund is a gem.

The fund has been managed by Robert Siddles for 12 years and prior to that he was head of the US team at Gartmore.

We have tended to pigeon hole the fund in the more high risk strategies but his approach demonstrates that out performance has been achieved without forcing additional risk onto the fund.

His approach is very much about achieving long term capital growth but at the same time avoiding capital loss. He does this by what he calls having a margin of safety approach – he is long term in his thinking and value orientated. He explained that through this approach it means he doesn't focus on short term noise which can often force early selling.

This is a low turn over portfolio and focuses on a few good businesses. In this review we will talk about the good company test he uses, his approach and some stock examples.

## The Fund

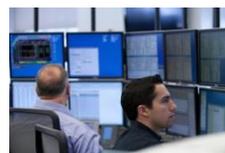


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At the heart of the portfolio construction is what Robert calls the good company concept. Every company they hold must pass this. So this

1. Strong franchise – a clear edge over the competition
2. Free cash flow – how capital is used over the competition
3. Insider ownership – the right incentive for management. Robert likes family ownership but is worried if for example a son is placed on the board with no management experience
4. Customer concentration – so for example Pool Corp is a distributor of swimming pool supplies and this is sold to people who maintain pools, lots of small businesses effectively. Someone who solely distributes to one business would be too concentrated for the portfolio
5. Inexpensive valuation – Robert is looking for at least a 50% upside

The portfolio is made up of Buffett Compounders, these are stocks you could hold forever, and Graham Cigar Butts or Recovery Stocks, these are stocks which are more likely to be held over the short term and really cheap in absolute returns.



An example of a compounder is INTL FCStone. This is a small financial services company which offers a comprehensive hedging strategy. They are upfront about what they charge and nothing is hidden.

The business has a good philosophy about compounding the book value of shares by avoiding trading losses. At a recent meeting with the CEO the CEO was about to meet a trader who had gone over their limit, this is not tolerated within the business and that trader would be fired immediately.

With some high profile failures it was felt customers would go to bigger names. So

effectively the stock was out of favour and trading just above book value. Robert's view was that the business could compound value and that it was a compelling business model.

What is important for Robert is that he knows where he thinks a stock should be and prefers a straight line to growth, this means he may trim if the share rises too quickly and buy when it dips.



An example of a recover stock is Alere. This provides point of care diagnostics. It is a healthcare company based in Boston. Effectively if testing is done at home it is a lot cheaper.

The problem with the business is that it is run by entrepreneurs who have badly managed the business; they have too many non-integrated businesses and debts. This is compounded by problems with testing.

Roberts view is that they are either getting on top of the problem or have a plan to deal with it. They have started to sell non-core business.

The stock has increased significantly since the investment was made.

For Robert this is about managing risk in the portfolio through both compounders and recovery stories.

We talked about the macro picture in the US – there has been a steady improvement in labour conditions and manufacturing output and this shows a slowly growing economy. Shale gas is important and this will lead to cheaper energy.

Auto industry is another interesting area with an aging fleet of cars which will need replacing. Housing is starting to pick up a little as well.

Before concluding the meeting I wanted to see the types of stocks Robert looks at to benefit from some of the changes in the US. This is important when in the past I have said how important these smaller funds are.



So for example if we look at Shale Gas there are many opportunities. So transportation you have the likes of Kirby that do coastal trade using inland tank barges.

Railcars develop tanks which can shift oil and gas. Hub Group offer an intermodal transport service which moves goods from the ports across country by train and truck.

Robert doesn't tend to hold technology stocks as he feels they put additional risk into the portfolio and are expensive.

In summary this is a conviction portfolio which looks at long term investing. It is not restricted to one sector but is ideally placed to benefit from the changes in the US economy.

## **Conclusion**

We believe this a gem; the manager has been at the helm for over 10 years and has consistently outperformed the benchmark. His style of management means he doesn't track the benchmark but favours looking for good quality companies which can deliver long term out performance.

*The source of information in this note has been provided by F&C and is correct as at 25 April. These are notes from meeting the fund manager or representative 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.*