

# Investing in UK companies webchat transcript

On Wednesday 2 March 2011, we hosted a live webchat with investment experts, Andy Parsons, advice team manager at The Share Centre, and Alastair Mundy, who manages the UK Special Situations and Cautious Managed fund at Investec.

Thank you to everyone who joined in and asked questions. Here are the responses.

**Q:** With the recent publicity around boardroom excesses what steps are taken by fund managers generally to curb these excessive salaries and bonuses?

**Alastair:** I think you need to have a certain emotion to be a short-term investor, and if you can't handle the short-term volatility of the market, you're holding the wrong portfolio. I would suggest a buy and hold strategy is better.

**Andy:** I concur with what Alastair has said. When investing, you have to understand what it is you are looking to achieve, the risk you are prepared to take and, as investment in collected investments is seen for the medium to long term, you will undoubtedly experience periods of volatility in the short term.

**Q:** Can you explain the accounting system in place and therefore earnings per share - which allows banks to be funded by the public purse via elected "toxic assets" that are excluded from company accounts or how and where did governments and controlling central banks and the individual bank losses on the toxic assets go?

**Alastair:** No I can't explain that. I'm sure this will go down as one of the great three card tricks of modern times. The banks lost the money and the public stepped in to save them without holders of bank debt needing to flinch. Extraordinary. I think we can be pretty confident that this won't be repeated when the next banking crisis happens (50 years time?)

**Q:** Is there a particular sector or industry in the UK that you feel is poised for a take off and hence currently undervalued? And then on the contrary, is there a particular sector or industry in the UK that is currently overvalued and might see a major correction over the future year?

**Alastair:** Our focus is typically much more on individual companies than on sectors or industries. Having said that we wonder if investors' big expectations for emerging markets will be met.

**Q:** I want to invest in all the companies you invest in but not in your fund. I am not a fund man, but trade in separate companies. Would it be possible to do so?

**Alastair:** No. As we don't publish all our buys and sells you would not be able to keep your portfolio aligned with ours. If that is the way you want to go it's probably best just to stick with your own ideas!

**Andy:** Retail investors are able to invest in all individual listed companies, however to create an equity portfolio which replicates a portfolio run by a fund manager would be expensive and require regular attention and review.

**Q:** How many funds does Alastair manage and are they all on a contrarian approach? How contrarian is he? i.e. does he hold any of the top FTSE 100 companies and if so, what percentage of them are in his Funds?

**Alastair:** We manage 6 funds on the desk in a contrarian style of which the highest profile are UK Special Situations, Global Special Situations, Cautious Managed and the Temple Bar Investment Trust. You do not have to go too off piste to show your contrarian colours so yes we are happy to invest in the FTSE100 and hold about 20 FTSE100 stocks across the funds.

**Q:** If there is a fall in a share price you are monitoring with a view to invest, how do you judge the ideal time to buy? And what research do you do to exclude unknown factors/causes? Do you ever go as far as asking sellers "why are you getting out?"

**Alastair:** Judging the ideal time to buy is impossible! Instead we aim to buy when we can see a margin of safety. This leads nicely into the second question. There are always lots of unknown factors some of which will be small and some big, but by their nature are unknowable. However, we are able to take a view on a typical size of the unknowns. For example, a supermarket chain is far less likely to be affected by a large unknowable event than a bank. If the shares have been purchased cheaply enough, this will allow for these unknowns. While we cannot ask the sellers why they are selling (and they probably wouldn't tell us!) our due diligence process does involve trying to understand why they might be selling. This ensures we are going into the shares with our eyes wide open and not with blinkers on.

**Q:** I notice that the top 10 holdings are mainly 'blue chip' companies. Approximately what percentage of total fund value is currently held in large, mid and small cap categories? Are these governed by any pre-set limits?

**Alastair:** Currently in the UK Special Situations fund, 62% of the equities are from the FTSE 100. 24% are mid-cap companies, 3% are smaller companies and 10% are international companies. We do have some limits but typically they allow some flexibility.

**Andy:** Alastair's fund is an example of where an investor can utilise the skills of a fund manager to identify those companies further down the market cap scale, thereby looking to find the opportunities with FTSE 250 and small cap. Investors should always be aware that not all UK funds can have the flexibility of moving around the market cap scale.

**Q:** What's your best pick for 2011 and will it continue its Growth

**Andy:** In terms of best stock ideas for 2011 investors can visit our website: [www.share.com](http://www.share.com) and view our six top tips for 2011, which are: Rio Tinto, Centrica, Prudential, Enquest, Booker Group and Dominion Petroleum. Please note however, that these may not be suitable for all investors and we would recommend investors review our comments and if in doubt speak to an advisor.

**Alastair:** I think it's hard enough to find cheap shares, let alone to know when they are going to go up. We simply buy them when they're cheap, and sell them when they get to fair value, irrespective of the length of the holding period.

**Q:** Obvious question: what are the best UK companies to buy for short-term growth and long-term growth, when both categories are partially insulated from fluctuations in the UK economy?

**Alastair:** We do not buy for the short term. Our average holding period is 3-5 years. We think the most attractive stocks currently are the largest blue chip names in the market as we believe they have cheap valuations, attractive yields and strong balance sheets.

**Q:** What is your view on the effect that events in the Middle East may have on UK oil and gas companies, which are often core holdings in UK portfolios?

**Andy:** This is still extremely hard to call, as the tensions in the Middle East continue to intensify. The obvious effect currently is that the price of oil is rising and this will no doubt filter through regrettably even greater short-term inflationary pressures.

**Q:** In this current climate, is it best to look for growth or yield when researching UK companies for potential investment?

**Alastair:** We find that growth stories are typically very expensive. Investors love dreams and narratives and overpay for these fantasies. We prefer stocks with no stories and accompanying disappointments as they are much cheaper.

**Andy:** This all depends on an individual investors' personal circumstances. For those wishing to supplement income, the search would obviously centre on companies or funds that pay a reasonable yield or dividend, whilst those looking for capital appreciation, will look for growth.

**Q:** What are the signs you look for in undervalued CO's? Share price? Poor management? Contracts?

**Alastair:** We look for shares that are horribly out of favour and have significantly under-performed the markets. We believe investors will sell these shares through a mixture of disinterest, embarrassment, and humiliation, and provide rational investors an opportunity to find some jewels in the dustbin.

**Andy:** It's Alastair's investment principles that make him stand out as a contrarian investor, which naturally filters through to the way he manages the UK Special Situations Fund.

Q: Is ITV a classic example of a company with low share price that can bounce back?

**Alastair:** ITV has certainly lost its way over the years living on its former glories of dreadful programmes like Emmerdale!! Extraordinarily, it has recovered its poise with equally shocking programmes (!) such as X Factor. There are also opportunities for them to have even more advertising during programmes, increase the price of these adverts and place products during programmes. However, we think the shares currently discount a lot of this potential good news, so we do not hold them on the portfolio currently.

Q: Should I invest my ISA in small cap or large cap companies for the best returns this year?

**Alastair:** Small caps have significantly out-performed larger caps over the last ten years, however, trees do not grow to the sky, and the increased interest in small caps worries me greatly. I would prefer large caps from here.

**Andy:** If you are investing for the first time, it may be worthwhile considering selecting a fund that offers a blend between small and large cap, with the reassurance being that the large cap, to a degree, should remove some of the volatility, whereas the small cap holdings will provide the excitement and potential for greater reward, albeit it may be a rollercoaster of a ride. Again, funds such as Alastair's provide a blend across the market cap spectrum.

Q: What can UK companies offer me as an investor that's better than investing in US companies?

**Alastair:** The main attraction of UK companies is their cheaper valuation. It's important for investors not to be too concerned with where a share is listed, where it makes its profits and the valuation of the shares are far more important.

**Andy:** I would concur again, as investors will now find that many of the leading equity markets around the world all contain prominent global brands and names.

Q: Are you to provide any definition of "undervalued" - presumably a company's P/E comes into the equation but what do you compare it against?

**Alastair:** We use EV/EBIT that is Enterprise Value to Earnings before Interest and Tax. This compares the profits a company makes to the amount that an investor has to pay for the shares, plus the debt of the company. We look for this ratio to be above 10%.

Q: With the market around 6000 it is getting harder to get further growth in my portfolio. I would like to transfer cash held in banks into shares that provide good income (better than the 3% top in the high street). How do I find the shares to invest in without too much risk in the long term to my capital?

**Alastair:** The best way to minimise risk is to invest when markets are cheap and to hold on until they reach fair value or get a bit expensive. Obviously this does not protect you from day to day volatility but that is no measure of risk. And, yes almost by definition as the market goes higher there are fewer good opportunities around.

**Andy:** If you are not prepared to accept a potential loss on an investment then investing in asset backed arrangements should not be considered. Unless an investor is particularly looking for very short term price growth in a share, we would point out that investments should be considered for the medium and long term. To that end the level of a stock market can be fairly irrelevant when considered against all the other key personal financial considerations. It is highly unlikely that an investor can ever invest at a low point in a market cycle.

Q: What Sectors/Companies should we stay clear of in 2011?

**Alastair:** We have got no exposure to UK listed resource stocks, like mining stocks. This is not a view for 2011, but a view that they look expensive and that we have no intention of holding them until they are attractively-valued.

**Q:** Should I take out a cash or equity ISA this year?

**Andy:** This all comes down to an investor's personal objectives and attitude to risk. In the current climate investors should be aware that the returns currently available on cash ISAs are low and in some instances struggling to keep up with inflation. For those who are prepared to accept a greater degree of risk, they may find that asset backed arrangements offer the potential for greater reward both in terms of growth and income, albeit one has to consider the increase in risk the investment is being exposed to.

**Q:** What does 'special situations' mean? It sounds, dare I say, a little shifty? No offence, but is this just a marketing term to make the fund seem more attractive or daring, or does it refer to instances in which you buy and sell funds?

**Alastair:** No offence is taken. A 'special situation' for us is a share which is significantly out of favour, priced to disappoint, and yet has characteristics which suggest a bounce back is likely. We are not necessarily looking to impress our clients with a mixture of sex and violence!! But instead try and build a combination of stocks with different characteristics and exposure to different industries. Fund names should in general be ignored; it's what's under the bonnet that counts!

**Andy:** Investors just need to be aware that a fund with the title of 'Special Situations' in it can cover a multitude of sins or opportunities. Any investor needs to look closely at key characteristics and ratios around a fund such as the alpha, beta volatility and Sharpe ratios. Key pertinent pieces of information such as this can be found when reviewing funds on [www.share.com](http://www.share.com) within our fund centre.

**Q:** Can you explain a little more about what you mean by share price discounting factors (you mentioned it in your ITV answer). This is a little confusing to me, and would open up a whole lot more understanding when I think of how to consider which shares to buy.

**Alastair:** Share prices move in expectation of future news, for example, the expectation of a good set of profits being announced. This move in a share price prior to the facts can result in the share price already reflecting future good or bad news, and is described as "discounting the future". Sadly, making money from shares is about guessing the future and equally, trying to understand how much is already discounted in the share price.

**Q:** Is the UK really a place to look for growth?

**Andy:** The UK market offers the investor a broad spectrum of opportunities with companies offering the opportunity of growth, income or a balance between the two. To assist investors, at The Share Centre we have tools within our website that allow investors to search by key criteria, thereby helping minimise the investable share universe and make it more manageable.

**Q:** If I invested in the Investec UK Special Situations Fund then what type of other funds would you suggest to balance this in a portfolio?

**Andy:** I am unable to provide a specific recommendation as investment is always unique to the investor around their objectives, time horizons and attitude to risk. Within the Share Centre, our Platinum 120 range of funds allows investors the opportunity to review, blend and select funds offering varying investment objectives.

**Q:** Why is everyone so worried about emerging markets?

**Alastair:** I hadn't noticed they were! Investors seem to worry about the odd political incident (!) but seem confident that the long-term prospects for emerging markets remain superior to developed markets. However, there are many complexities in emerging economies - not least the unstable politics of most of the regions, and their continued reliance on stable economic development in the West.

**Andy:** Despite all the current attention around inflationary and interest rate pressures, it is unquestionable that over the longer term these markets will still provide significant reward. Over the next 20 to 30 years, we will no doubt be talking about many of these "emerging markets" as developed super-powers.

**Alastair:** I doff my cap to Andy's superior long-term forecasting skills! I don't even know what I'm going to have for lunch in five minutes time; any forecast that long-term in the future must have a wide margin of potential error.

**Andy:** Let's have this webchat again in 20 years time!! Come and join us.

**Q:** Any thoughts on how UK companies will fare in 2011, compared to the rest of the world? Gut feel says it might be a year to avoid developing countries and stick to UK / Europe / N. America.

**Alastair:** My most recent manager's commentary covers the subject of gut-feel aka intuition. The quick conclusion is that it doesn't work and is in fact no better than guessing. Expectations are already pretty poor for UK-centric companies this year, and we would be surprised if this negativity didn't throw up some interesting investment opportunities. My latest commentary can be read at: [www.investecassetmanagement.com](http://www.investecassetmanagement.com)

**Q:** If I want to profit from the current increase in oil prices are there any companies (other than oil companies obviously) that I should look at?

**Alastair:** You would have to be very confident that oil has reached a new sustainable level, and is not just spiking up in the short-term. We do not get involved in such speculation and would not necessarily encourage others to either. Perhaps a trip to the casino would be cheaper and more enjoyable!!

**Andy:** We do not speculate on oil prices and it is fair to say that there are external pressures and tensions that are having a significant influence at the current time.

~ Webchat ends ~

**Alastair:** A lot of questions seem to have focused on prospects for 2011; I think investors can control their risk much better if they lengthen their investment time horizons.

**Andy:** Thanks to everyone for submitting questions, it's been fun answering them, and I hope everyone has enjoyed the company and thoughts of my guest Alastair Mundy.