• Issue 60 / March 2020 •

Trustnet

magazine

GOING THE DISTANCE

For how long can star managers outperform?

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Why the best funds of the 2000s collapsed in the 2010s

COLLECTING COINS
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LAST MAN STANDING
The impact of consolidation in the platform industry

Fund, Pension, Trust / Sector Profile / Stockpicker / What I Bought Last

ISSUE 60

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TRUSTNET MAGAZINE IS PUBLISHED BY THE TEAM BEHIND TRUSTNET IN SOHO, LONDON

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Editor's letter

The publishing cycle of this magazine means I commission articles from journalists about a month before we go to press. This means that, from time-to-time, something unexpected happens that makes the entire issue appear redundant before it has even hit the virtual newsstand. This is obviously one of those occasions. Yet while I don't wish to play down the human impact of the coronavirus, the lack of coverage we have given it in this issue should serve as a reminder – despite the biggest one-day fall in the FTSE since 1987 and the growing likelihood that the global economy will enter a recession, the principles of successful investing haven't changed: hold a diversified portfolio appropriate for your time horizon and attitude to risk. But just as important is resisting the urge to do anything stupid when everyone else is panicking – it is natural for stock markets to fall as well as rise and after the longest bull run on record, we were always due a major correction. While I wouldn't be so foolish as to attempt to call the bottom of the market or the severity of any downturn, at times like this I feel it is worth reacquainting yourself with the investment advice of Berkshire Hathaway chairman Warren Buffett: "Be fearful when others are greedy and greedy when others are fearful."

Enjoy reading,

Anthony Luzio
Editor

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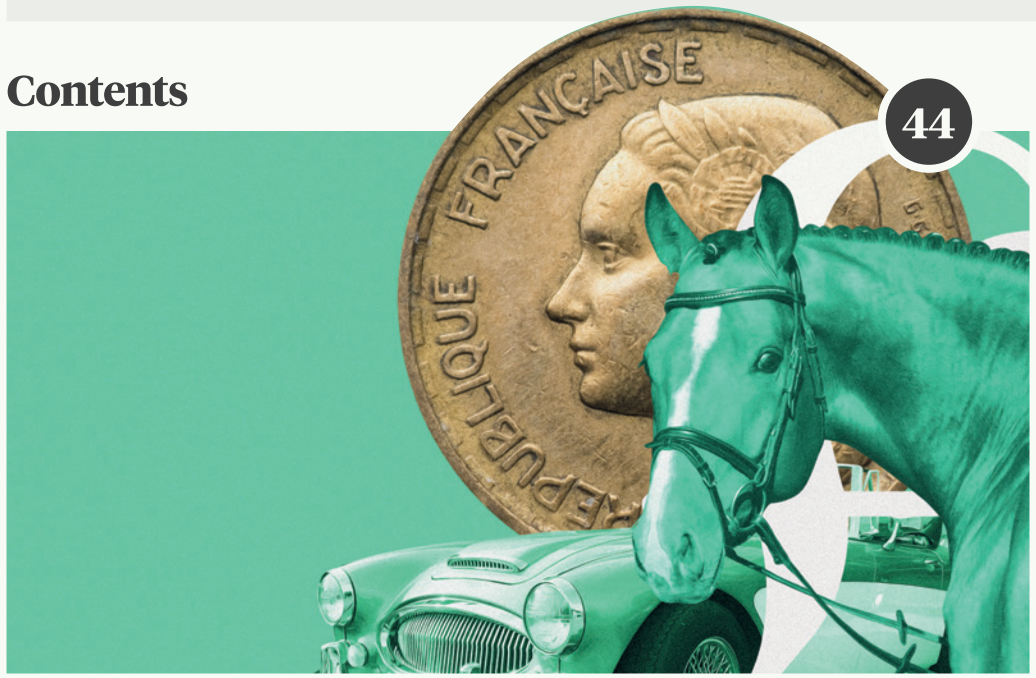

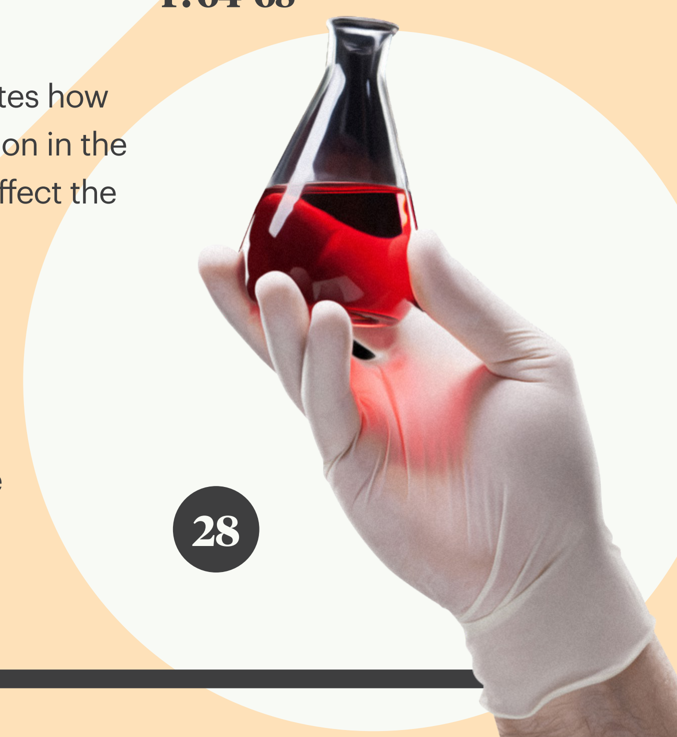

Anthony Luzio attempts to find out how long a top fund manager can be expected to maintain a period of outperformance

Going the distance

The downfall of Neil Woodford brought the entire concept of a star manager into question. If the standard-bearer for active management in the UK can capitulate so spectacularly, what hope is there for anyone else?

Of course, the exact circumstances that led to Woodford's downfall are unique and it is unlikely anyone will take such a reckless approach to liquidity again. Speaking more broadly, industry commentators warned long before last year that it is always a cause for concern when a star manager decides to change strategy – even though such a small number connected the dots with Woodford.

But this begs the question: how long can a star manager "keep it up" when they stick to what they know?

Warning signs

Aside from a change of strategy, there are numerous other warning signs that investors need to look out for. Paul Green, a member of BMO's multi-manager team, points out these will vary depending on the type of manager and the style they adopt.

"If it's a stockpicking manager with an active multi-cap process and there is fast asset growth, this is a potential warning sign, because the manager may be forced up the market-cap spectrum where there is typically

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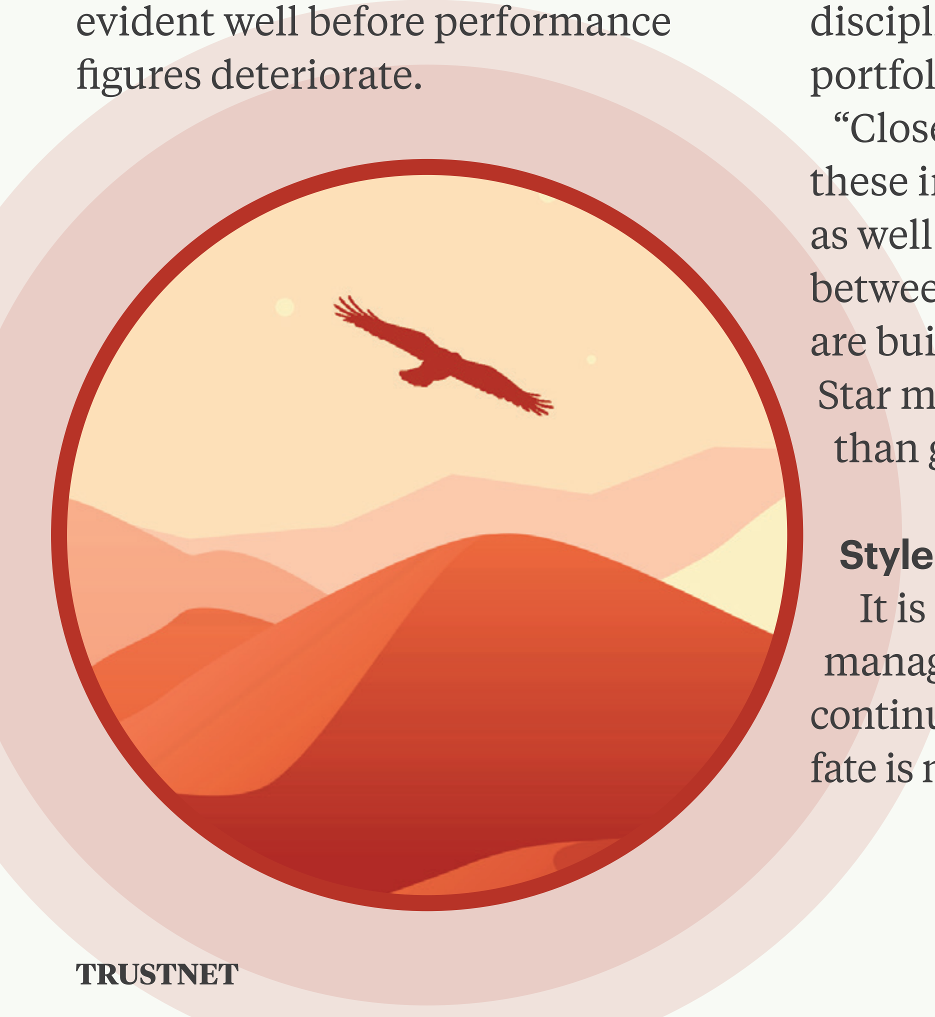
"If it's a stockpicking manager with an active multi-cap process and there is fast asset growth, this is a potential warning sign"

more liquidity but less alpha opportunities," he says.

"From here you need to consider how this asset growth affects the liquidity in the fund. Is the unit-holder register concentrated? What would happen to the liquidity profile if the large holders sell? Has the manager been forced to hold more securities? They could also have been handed more mandates outside of the fund you are backing as a 'reward' for success – which potentially dilutes the attention they pay it."

Andrew Hardy, co-head of research at Momentum Global Investment Management, says hubris also plays a part, and the warning signs are often evident well before performance figures deteriorate.



"Close monitoring is required to spot these incremental and subtle shifts, as well as acknowledging the margins between great and average investors are built across many small factors"

He says the excessive growth in assets and strategy proliferation cited by Green can be symptomatic of this problem. However, he believes other subtler signs are often more valuable.

"These include evidence of overconfidence, a loss of process discipline or ceding accountability for portfolio decisions," he says.

"Close monitoring is required to spot these incremental and subtle shifts, as well as acknowledging the margins between great and average investors are built across many small factors. Star managers wane slowly rather than going out with a bang."

Style conscious

It is not all down to the individual manager, however – even if they continue to do everything right, their fate is not always in their own hands.

Terry Smith appears to have inherited Woodford's crown as the UK's number-one fund manager, and Nick Train isn't too far behind. Whatever your view on the merits or otherwise of active management, praise for the pair looks well warranted: Smith's Fundsmith Equity fund has beaten its MSCI World benchmark in eight of the nine full calendar years since launch, while LF Lindsell Train UK Equity has beaten its FTSE All Share benchmark in nine of the past 10 years.

Yet while the post-financial crisis environment has favoured the managers' buy-and-hold approach to quality growth stocks, over the extreme long term it is the value style of investing that tends to win out. So what will happen to these managers when the market no longer works in their favour?

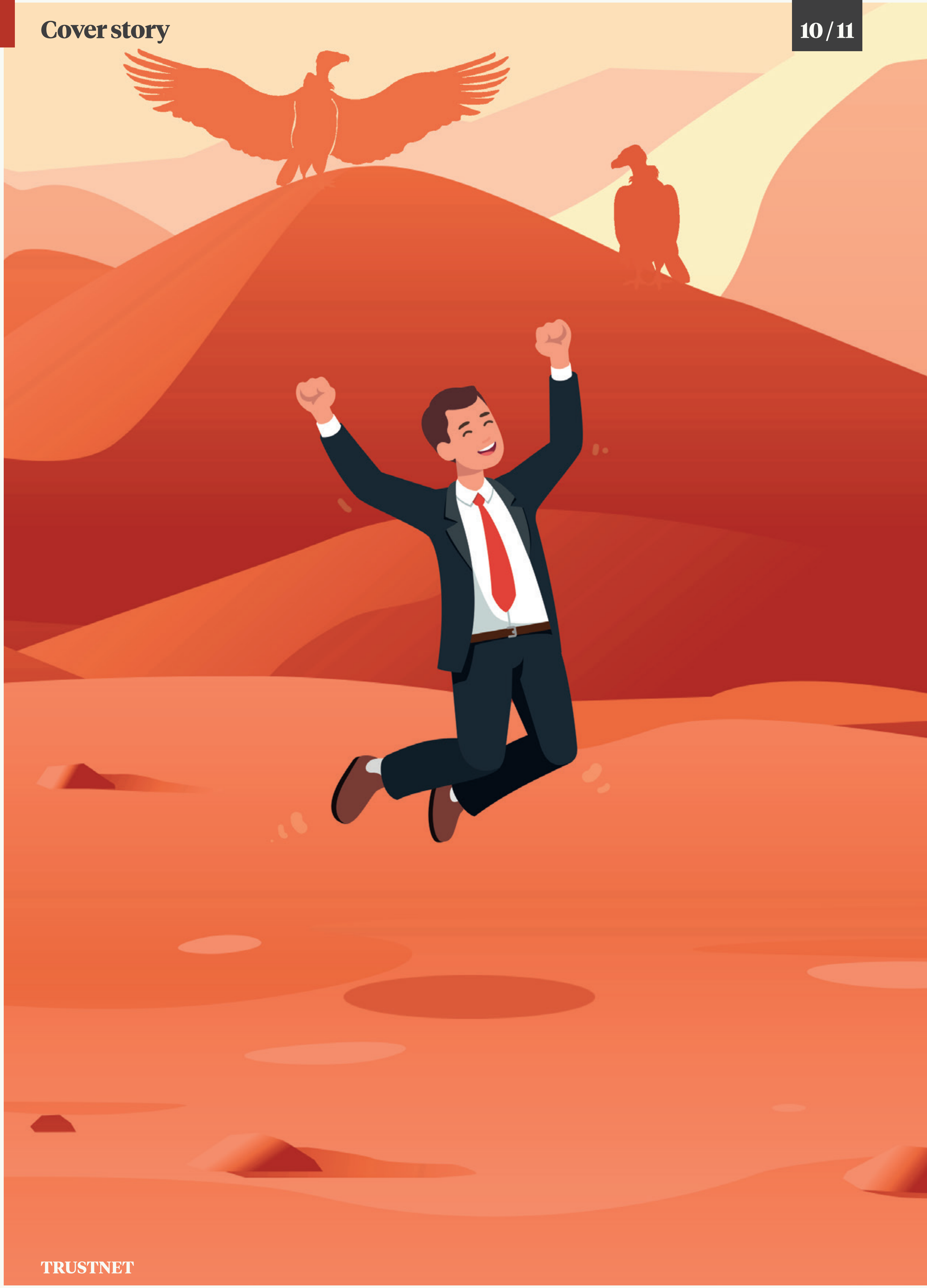
While the post-financial crisis environment has favoured the managers' buy-and-hold approach to quality growth stocks, over the extreme long term it is the value style of investing that tends to win out

"Dogged determination"

Charlie Parker, managing director of Albemarle Street Partners, says that a period of underperformance looks inevitable for quality growth managers such as Train and Smith, but this will not necessarily be a reason to sell out of their funds.

"The dogged determination of these individuals to stick to their investment style even as the valuation opportunity in value stocks grew and grew has been a significant driver of investor returns," he explains.

"But overall, the golden rule is to not believe that any fund manager is immune from the wider pressures acting on stock markets. A quality growth manager – however skilled –



is highly likely to underperform in a rampant value market and vice versa.

"A period of underperformance does not mean an investor was wrong to trust a fund manager, rather it is an opportunity to test whether the individual has what it takes to cope with tough times, acting with consistency and focus in the face of unfavourable markets.

"Vitally though, we must avoid those individuals who become entrenched in views despite mounting evidence against them and who have not surrounded themselves with people who can provide challenge."

Staying power

So what is the longest that a fund manager has been able to maintain their outperformance in light of all of these issues?

Anthony Bolton is an obvious place to start. By focusing on undervalued and out-of-favour companies, the UK's original star manager made a total return of 14,124 per cent between the launch of Fidelity Special Situations at the end of 1979 and the time of his departure in 2008, compared with 3,336 per cent from the MSCI United Kingdom index. To put it another way, £1,000 invested in his fund at the start of this period would have grown to £142,240 by the end.

"A period of underperformance does not mean an investor was wrong to trust a fund manager, rather it is an opportunity to test whether the individual has what it takes to cope with tough times"

Difficult second album

Unfortunately, that wasn't quite the end of Bolton's story and after stepping down from Fidelity Special Situations, he launched the Fidelity China Special Situations trust in April 2010.

In a classic case of what can go wrong when a manager changes strategy, he found the lower corporate governance standards harder to navigate, and two of his holdings were accused of fraud.

While Bolton eventually turned things around, with the trust beating the MSCI China index under his tenure, four-year returns of 5.76 per cent disappointed anyone hoping for a repeat of his magic touch on Fidelity Special Situations.

Bolton is not the only manager who has outperformed over a multi-decade period, though, with Green drawing attention to Nigel Thomas, who retired

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in 2019 after 40 years in the industry. Thomas's performance is more difficult to track as he managed several funds, some of which have now merged with others or closed. However, he more than doubled the gains of the FTSE All Share during his time on Artemis Capital between December 1986 and May 2002, and significantly outperformed while managing AXA Framlington Select Opportunities, between September 2002 and the end of last month.

Yet this is in the UK, where – as passive advocates often point out – tilting your portfolio towards smaller companies is usually all it takes to outperform the FTSE All Share. What about the ultra-efficient US market?

For example, a study by S&P Dow Jones Indices suggested the chances of picking a fund manager capable of beating the S&P 500 over the long term appear slim at best: 85 per cent of large-cap funds underperformed the index over 10 years, a figure that grows to 92 per cent over 15.

The Sage

Of course, one man has managed to consistently beat the index, and not just over 15 years, but 55: Warren Buffett. The Berkshire Hathaway chairman has made a compound annual gain of 20.3 per cent over this time compared with 10 per cent from the S&P 500 index.

So what is the secret to his success? In his letter to shareholders for 2018, Buffett referred to "a great collection of businesses, a Niagara of cash-generation, a cadre of talented managers and a rock-solid culture".

Andrew Vaughan, who aims to follow Buffett's approach in his CFP SDL Free Spirit fund, would add to this list a focus on economic moats, access to cost-free capital in the form of insurance premiums, an aversion to selling businesses once they have been acquired, "and supremely rational capital allocation".

Yet there are signs that even Buffett's star may be on the wane – Berkshire Hathaway made 11 per cent in 2019 compared with 31.5 per cent from the S&P 500. However, Vaughan notes this is not a like-for-like comparison.

> "We must avoid those individuals who become entrenched in views despite mounting evidence against them and who have not surrounded themselves with people who can provide challenge"

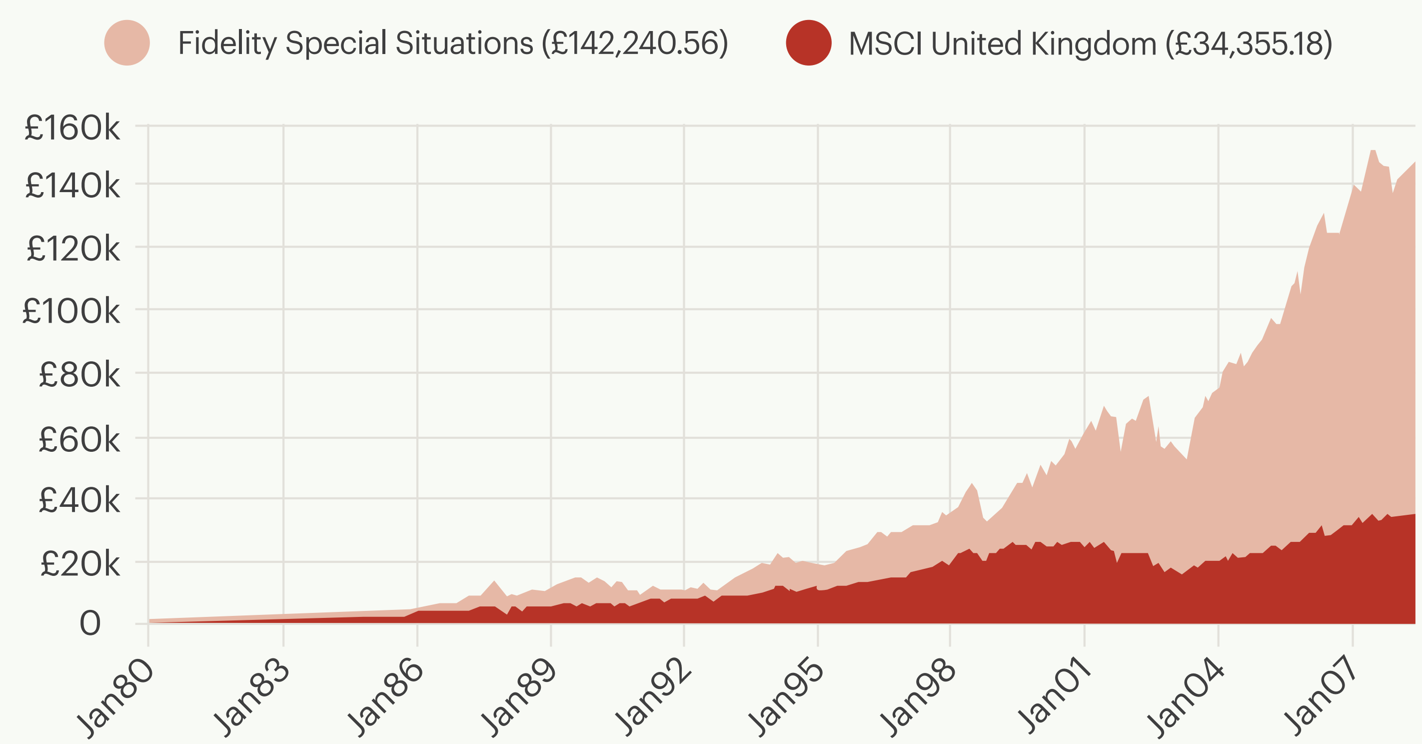
"Almost half of Berkshire Hathaway's book value is in non-listed operating subsidiaries which are not 'marked to market' and therefore cannot be expected to track the S&P," he explains. "Buffett and [vice chairman Charlie] Munger berate themselves for failing to invest in Google when the value of its advertising to Berkshire's own businesses was plain to see.

"However, their investment in Apple and this year's disposal of Berkshire's local newspaper businesses confirm there is no brittle inability to evolve."

But what does Buffett have to say about star manager outperformance?

"I've often been asked for investment advice," he said in a previous letter to shareholders. "My regular recommendation has been a low-cost S&P 500 index fund."●

£1,000 INVESTED IN FUND UNDER ANTHONY BOLTON VS INDEX



Source: FE Analytics

From 3D printing to industrial biotech, companies in the Scottish Mortgage portfolio are taking technological advances to the next level. A new generation of businesses are reshaping our world and what is possible by reinvigorating the manufacturing process

The future of manufacturing

The value of your investment and any income from it can go down as well as up and as a result your capital may be at risk.

The Santa Fe Institute's Professor Brian Arthur has done much to revitalise economic theory in the light of 21st century advances. His research on how technology evolves, how innovation works, the study of complexity economics and the concept of increasing returns, has been seminal and has greatly influenced our thinking over time.

Twenty-five years ago, Arthur asserted that "Western economies have undergone a transformation from bulk-material manufacturing to design and use of technology – from processing of resources to processing of information, from application of raw energy to application of ideas." This transformation created the base for the concept of increasing returns to scale in industry, where knowledge reigns supreme over mass manufacturing. Professor Arthur used Microsoft to illustrate the shift to an increasing-returns world: the dominance of Microsoft's Windows operating system meant that as more people used Microsoft's programmes, the need for compatibility across programmes and between users made Windows both the natural choice for new users and then kept them locked in because it did not pay for users to switch.

This does not mean that it is game

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The next generation of computing is driving a new paradigm shift today, helping to completely reinvent traditional industrial processes that have been commonplace since the 1800s

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over for traditional manufacturing-based businesses. While the insatiable demand for physical goods continues, traditional industry will remain a mainstay of the global economy, albeit a smaller part than previously. In the past, economies of scale were the friend of the manufacturer. However, these economies of scale would eventually hit a limit, requiring a fundamental paradigm shift in the system's design in order to grow beyond that inflection point. The next generation of computing is driving a new paradigm shift today, helping to completely reinvent traditional industrial processes that have been commonplace since the 1800s. Several of the companies in the Scottish Mortgage portfolio are at the forefront of this evolution.

One example is Uptake Technologies, which sells predictive analytics software to customers in major industries across the globe. Founded in 2014 by entrepreneur Brad Keywell, the US-based company uses data and applies machine learning to help customers improve the productivity, reliability and safety of large machinery, such as trains, trucks, and wind turbines. Data collected from sensors are fed into Uptake's algorithms and analysed to predict faults and suggest improvements. Uptake has a huge opportunity to add value for large physical asset owners, many of whom operate in industries which haven't seen significant innovation since the industrial revolution. Large companies have been quick to understand the possibilities, with Caterpillar and Berkshire Hathaway Energy already valued customers.

The 3D printing industry has got off to a less auspicious start, with the

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difficulties associated with scaling production having dampened widespread uptake, despite the technology's obvious promise. Recent Scottish Mortgage investment, Carbon, a Silicon Valley-based 3D manufacturing company, may change that. It has pioneered an alternative means of 3D printing which uses light and oxygen to rapidly produce products from a pool of resin. Carbon's technology significantly increases the speed of producing printed parts, improves their quality and range and reduces printing costs. These improvements make it possible to use 3D printing for scale manufacturing for the first time. Founded in 2013 by polymer chemist and professor Joseph DeSimone, Carbon has an impressive list of strategic partners, including Adidas, Johnson & Johnson and BMW. We believe that, with its internet-connected machines and innovative technology, Carbon has the opportunity to disrupt the $12 trillion manufacturing industry.

Industrial biotech has come to prominence in recent years as the desire to move away from hydrocarbon-related to more ecologically sustainable clothing materials gathers pace.
Bolt Threads is an apparel company at the forefront of this upheaval. Its range of protein-based high-performance materials are based on synthesised forms of naturally occurring fibres, with spider's silk its first commercially-available material. It is now also working on a mushroom protein-based replacement for leather. The company can genetically modify the protein structures it recreates to enhance certain desirable properties, such as softness, strength and durability. The management team is targeting the much larger apparel market rather than niche applications. Early on it established a partnership with Stella McCartney to explore how far synthetically produced spider silk could go in the higher reaches of ethically-focused fashion.

The potential to produce synthetic materials which act and feel like their natural counterparts, but which can be engineered to be stronger, more durable and versatile is intuitively attractive. Because Bolt Thread's

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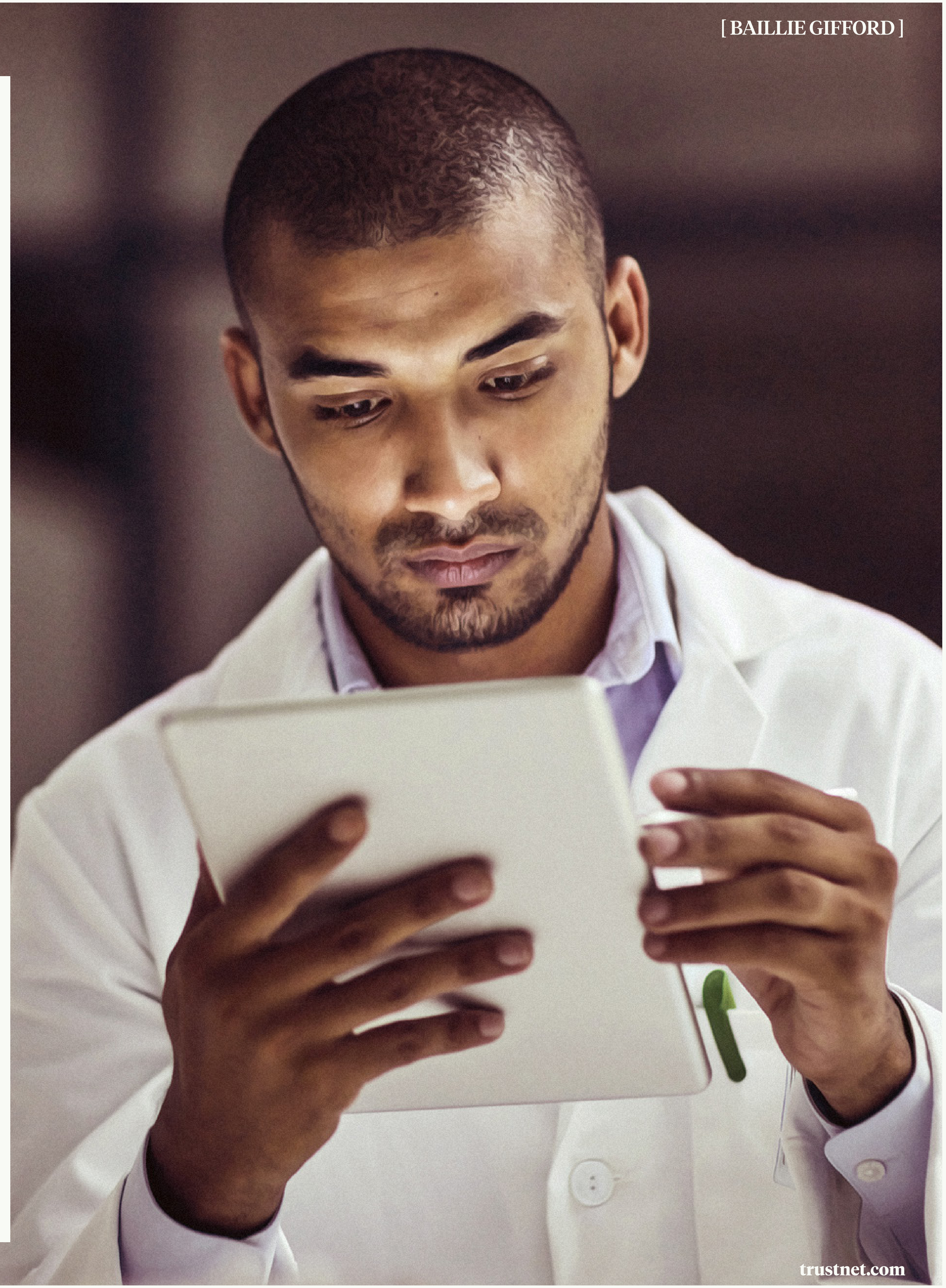

Initial market opportunities will focus on the large markets of flavours and fragrance, but the real attraction is the company's long-term vision

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manufacturing process allows these proteins to be produced at commercial scale more akin to those of existing man-made fibres, it should become increasingly valuable over time, as the benefits of these natural protein-based materials become more apparent to the wider clothing industry.

A similar company in the field of synthetic biology is Ginkgo Bioworks. The company genetically modifies yeast, and then ferments it to manufacture a variety of cultured ingredients, such as rose oil or artificial sweeteners. Ginkgo does not produce or sell the proteins directly; it designs yeast strains, licences the designs to customers and then takes a share of the profits. Ginkgo's competitive position is to some extent self-reinforcing. It is focused on being a low-cost organism engineering firm; this attracts customers and expands Ginkgo's library of genetic codes. The larger the genetic codebase, the quicker it can identify the genes necessary to produce a desired protein, and the lower its costs to do so. Initial market opportunities will focus on the large markets of flavours and fragrance, but the real attraction is the company's long-term vision, which is to make biology truly predictable; opening the door to using biology to manufacture a multitude of different products, most of which we have yet to even imagine. ●

Many of the best-performing funds of the 2000s ended up losing money in the decade that followed. **Rebecca Jones** finds out if they are ready to bounce back

Where are they now?

The early 2000s was a heady time. Britney Spears was riding high in the charts, Britannia was cool again and the commodity super cycle was in full swing. China was the growth story of the decade, with its gargantuan infrastructure boom sending stocks in resource-rich Latin America sky-high. Then, in 2008, the world saw a financial crisis to end all others, and gold went through the roof.

However, the following 10 years couldn't have been more different. As global economic fears dissipated and walls of easy money hit developed markets, investors went back to the future as they attempted to grab the tech bull run by the horns. Natural resources, gold and emerging markets were hammered. However, as we enter a new decade facing fresh challenges, could it be time for these stoical sectors to shine again?

BEST-PERFORMING FUNDS 2000-2010

Name	01/01/2000 to 31/12/2009 (%)	01/01/2010 to 31/12/2019 (%)
BlackRock Gold & General	684.11	-5.5
JPM Natural Resources	613.48	-17.46
BlackRock GF World Mining	526.85	-20.5
BlackRock GF Latin American	445.77	18.76
Scottish Widows Latin American	393.99	14.18
MSCI World	-2.6	201.24

Source: FE Analytics

Mining

Funds invested in the natural resources sector delivered spectacular returns back in the 2000s. JPM Natural Resources, for example, made 613 per cent over the decade-long period, while BlackRock GF World Mining was up 527 per cent. This put them in second and third place in the IA universe over this time.

Yet as investors in these funds will know all too well, the good times didn't last, with both losing about 20 per cent in the 2010s. During this period, tech became king, with the likes of Microsoft, Google and Apple sharing the crown.

While there is little chance of this trend reversing, Darius McDermott, managing director of Chelsea Financial Services, believes technological innovation could create new opportunities for natural resources in the 2020s.

"ESG [environmental, social and governance] will be the theme of the decade, while carbon will face a tough time," he says. "However, electric vehicles need lithium and tech needs copper, and so the drive towards a zero-carbon economy could be supportive for miners."

As a case in point, McDermott highlights a recent announcement from Glencore's chief executive, Ivan Glasenberg, on his plans to expand copper production and sell the firm's coal assets on the first reasonable bid.

Latin America

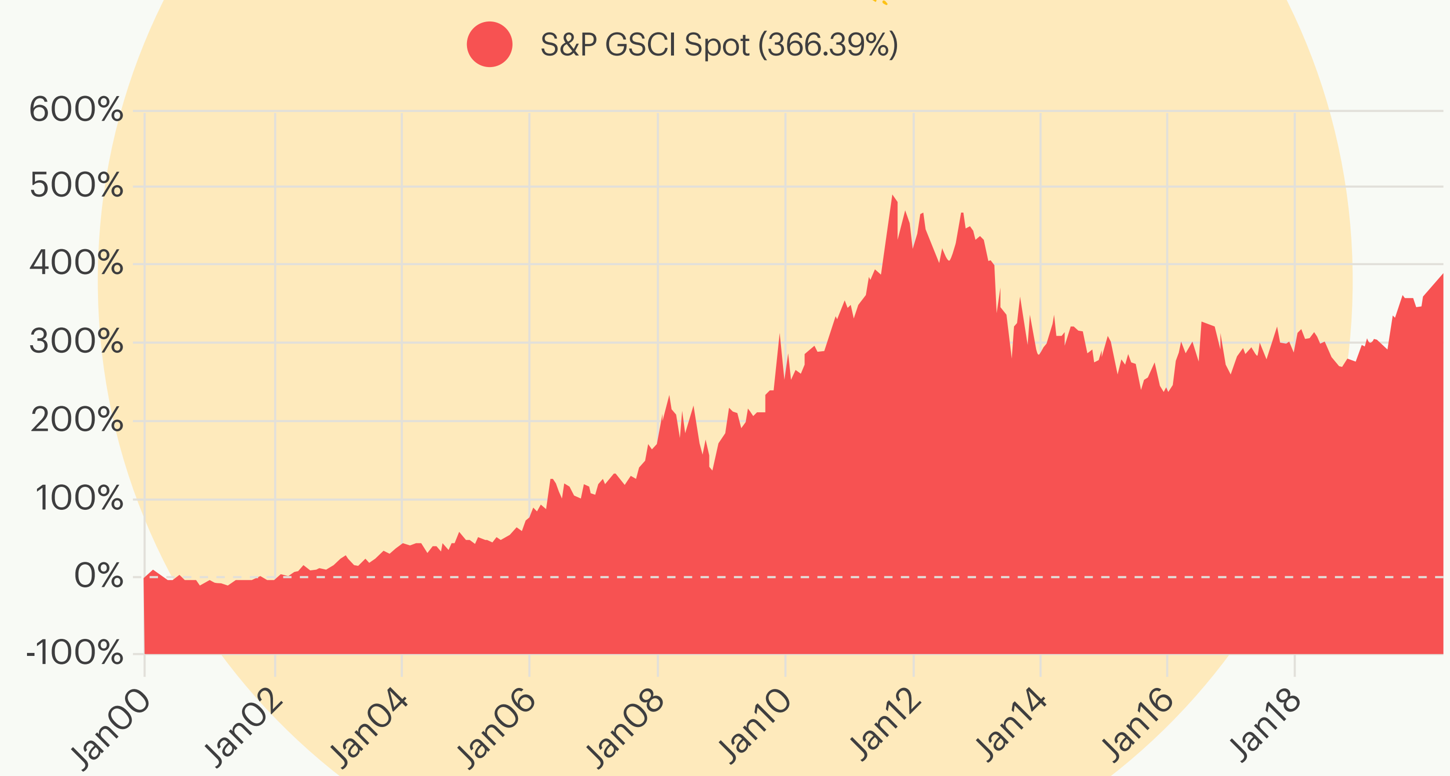
A more nuanced commodity boom will still leave many winning regions of the early 2000s out in the cold. This includes Latin America, which provided much of the raw carbon-based resources to satisfy China's energy demand.

Top-performing funds invested in the region returned between 300 and 450 per cent over the decade, including BlackRock GF Latin American and Scottish Widows Latin American. In the 2010s, however, most Latin America funds struggled to eke out more than single-digit gains.

With the world hoping to become carbon neutral by 2050, you may think there is little hope of a resurgence for this coal- and oil-dominated region. Ben Yearsley, director of Shore Financial Planning, sees it differently: "There is no way we will be able to switch to electric vehicles in the next 10 years: we don't have the charging infrastructure. We should encourage oil & gas companies to move to renewables, but we'll need oil for 10 years yet."

While he acknowledges the political problems in the region, Yearsley also points to favourable demographics and a nascent consumer sector.

PERFORMANCE OF INDEX (IN $) OVER 20YRS



Source: FE Analytics

Gold

One commodity almost certainly going nowhere, however, is gold. The yellow metal was the strongest asset of the entire first decade of the new century, soaring from around $275 to $1,330 per troy ounce between 2000 and 2010. This boosted 10-year returns for BlackRock Gold & General to an astonishing 684 per cent, making it the best-performing fund of the decade. Gold's stratospheric rise continued until 2011, when it reached an as-yet unrepeated level of $1,837 per troy ounce. As post-financial crisis fears over the global economy dissipated, however, the asset tumbled, and by the end of 2019 BlackRock Gold & General was sitting on 10-year losses.

Suggesting old-fashioned cyclicality may still be relevant, however, gold is enjoying a strong start to the new decade. The asset is sitting at $1,645 per troy ounce, driven by fears over the coronavirus and the Federal Reserve's decision to cut interest rates last year. Yearsley has recently upped his exposure to gold, saying: "In a falling interest-rate environment, gold is what you want as it will hold value."

However, with little room to slash rates further, he is not so sure about the longer-term outlook. "Even with the coronavirus, I'm not sure you want to put all your money in gold. It's an asset you really have to get your timing right on."

And as we all know, timing is notoriously tricky. ●

Jamie Ross of the Henderson EuroTrust talks through his stock-selection process using health, nutrition and materials firm DSM as an example

The secret ingredient

When considering an investment for the Henderson EuroTrust portfolio, we tend not to focus on market noise or any technical factors; the main thing we are doing is trying to establish whether what we are looking at is a good company or not. This is a key part of the research process.

There tend to be many features that most good companies have in common, but there are myriad characteristics and features to analyse that will be unique to each and every business. By undertaking detailed analysis of the 50 or 60 companies we have on our radar (a portfolio of about 40 positions and a watch list of 10-20 names) we try to ascertain whether a business is a good business and if so, whether now is the right time to be invested or not. In this article, we will highlight aspects of our process using one of our portfolio companies, the health, nutrition and materials firm DSM.

What does the company do?
The Dutch company DSM was founded in 1902 as a coal miner; in fact the name DSM comes from the English translation 'Dutch State Mines'. The company has changed dramatically since the early 20th century (the last coal mines closed in the 1970s) and over the last twenty years or so, the business has been transitioning again; this time away from chemicals and materials towards food ingredients.

As we stand today, around 1/4 of earnings comes from DSM's

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There tend to be many features that most good companies have in common, but there are myriad characteristics and features to analyse that will be unique to each and every business

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remaining Materials activities and around 3/4 of earnings comes from their Ingredients portfolio. Within their Materials business, DSM produce and sell sustainable thermoplastics, industrial resins & coatings and a strong fibre called Dyneema. Within their Ingredients division, DSM sells vitamins, ingredients and solutions for use in human and animal nutrition. In the company's own words, DSM is focused on 'creating science-based solutions in health, nutrition and sustainable living'.

Does this company generate strong ROIC?

At the moment, DSM's ROIC (return on invested capital) is in the low-double digit percentage range according to our estimates. This is an improvement from recent years, is well above the company's cost of capital, but is materially lower than the ROIC generated by a number of our well-established 'Compounders' within the portfolio. In fact, we see DSM as an 'Improver'; a business capable of improving its ROIC profile over a number of years. There are several things that should help to drive this improvement in returns. First, there should be some natural operational leverage from volume growth (costs should grow more slowly than revenues). Second, we see the movement of the company away from the Materials business and towards the Ingredients business as something that should result in higher margins and lower capital intensity. Third, we back the current management team to improve the efficiency of the business over the medium term.

Glossary

EBITDA (Earnings before interest, taxes, depreciation, and amortization): A company's earnings before interest, taxes, depreciation, and amortization is an accounting measure calculated using a company's earnings, before interest expenses, taxes, depreciation, and amortization are subtracted, as a proxy for a company's current operating profitability.

End markets (animal and human nutrition) will see demographically-driven growth and ingredients are an increasingly important component of nutrition products

What are the risks to the business and to this ROIC profile?

Inevitably, by having some exposure to Materials, which tend to have industrial end markets, there is some cyclicality to the business and if there is an economic slowdown, that could certainly delay the improvements being made to the business. Another risk would be that the company felt compelled to make a large and expensive acquisition to speed up their transition towards Ingredients; we rate management very highly and see this as a low probability risk. Finally, within the Ingredients portfolio, DSM has some exposure to vitamins, whose prices are notoriously volatile; vitamin pricing is therefore also a risk to the return profile of the company.

Is there scope for growth?

The Ingredients business has significant scope for structural growth over the medium-to-long term. End markets (animal and human nutrition) will see demographically-driven growth and ingredients are an increasingly important component of nutrition products. You can also make the case that large ingredients companies with global reach will gain share from smaller local competitors. DSM look very well placed. In addition, and as described above, we see earnings growth as likely to be faster than revenue growth due to margin expansion.

Investment decision?

We have a long standing position in DSM and it has contributed strongly to performance. We remain positive on the company's prospects and can see how the business has a good chance of rerating from its current ~11 x EV/EBITDA multiple towards that of its Ingredients peer group (which trade at >15 x EV/EBITDA). •

Cherry Reynard names three fund managers who have bounced back from a potentially career-ending chain of events

The comeback kids

Fund management has its fair share of former stars who have descended into obscurity, but what about those who have proved to be made of sterner stuff? Who are investment management's comeback kids?

The line between a comeback kid and an also-ran is thin. Let's not forget that Neil Woodford was once seen as the ultimate comeback king. With hindsight, his decision to avoid tech companies in the face of disproportionate valuations in the late 1990s looked insightful, but it could have easily gone another way. The anti-tech bet didn't work out so well for Tony Dye of Phillips & Drew.

There are many reasons why a fund manager experiences a return to form – either from a period of poor performance or relative obscurity. One that crops up regularly is the move from a large fund management group to a boutique, where they may be able to spread their wings, manage less money and do so according to their own philosophy.

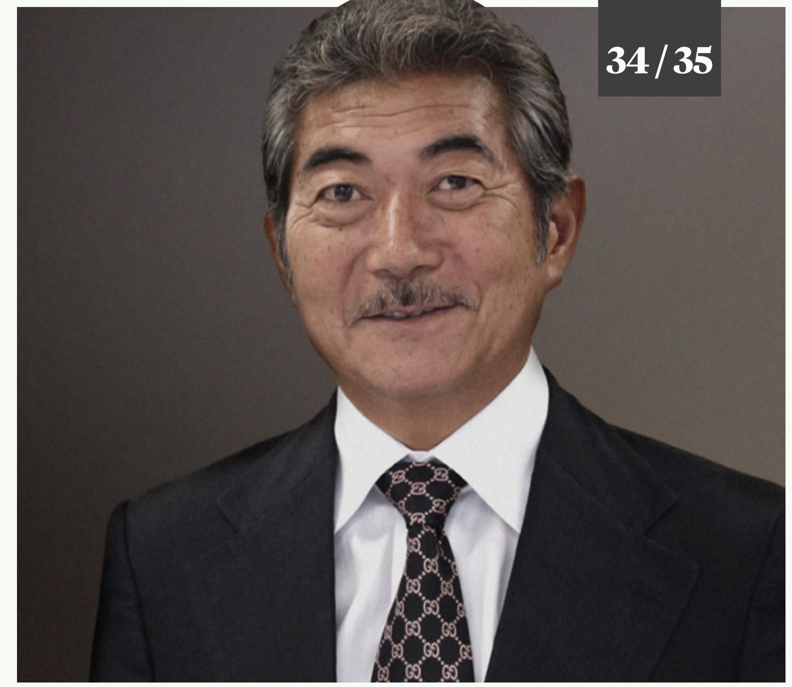
Not a foregone conclusion

There are plenty of examples where managers have shaken off the strictures of a large organisation and done well on their own. Paul Marriage at Tellworth Investments, for example, or Richard Pease at CRUX. This can go either way, of course. Woodford is an extreme example of how it doesn't always work out.

Equally, there will be managers whose high-octane style condemns them to periods of lacklustre returns, while others that are strongly biased to either growth or value will struggle to transcend a strong market bias one way or another.

Here are three fund managers that have "come back from the dead".

Hideo Shiozumi



It would be impossible to talk about fund managers who have "come back from the dead" without mentioning Hideo Shiozumi. His Legg Mason IF Japan Equity fund lost more than 60 per cent of its value between the late 1990s and early 2000s, but then recovered to become the best performer in its sector in the five years to the start of 2006.

Yet this looks like something of a blip compared with what happened next – Shiozumi's focus on small Japanese growth companies worked against him when a high-profile scandal led to the collapse of internet firm Livedoor in 2006 and investors turned their back on the sector. Meanwhile, a number of investments in property companies also turned sour as the financial crisis hit and the market went south. Towards the tail end of 2008, Shiozumi found himself staring down the barrel of peak-to-trough losses of more than 80 per cent in less than three years.

Yet he has since managed to turn it around, and then some: Legg Mason IF Japan Equity was the single best-performing fund in the IA universe of the 2010s, with returns of 701.17 per cent over the decade-long period.

Rory Powe

Twenty years ago, Rory Powe was one of the best-known managers in the industry and his Invesco European Growth fund was a must-have for investors. He had a heavy weighting to tech in the late 1990s and his fund briefly became the largest in the UK, worth more than £3bn.

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However, the glory years quickly came to an end when the dotcom bubble burst in 2000: with half of the fund's holdings in the tech sector, the fall-out was horrendous. It lost almost half its assets and Powe left Invesco in 2001 to run a hedge fund, Modulus Europe. He then suffered a second blow when it entered liquidation during the 2008 market crash.

Yet the manager went on to enjoy considerable success on Man GLG Continental European Growth. Investment consultant Gavin Haynes says: "When Powe re-emerged to run a European fund in 2014, investors could have been excused for being wary. However, he has refined his approach to focus on sustainable growth businesses and produced double the return of the peer group over the past five years."

Hugh Yarrow

Yarrow had been an integral member of the Rathbones UK equity team from 2002, but left the business as the group rationalised its fund range at the market nadir in 2009. Haynes says: "Not many groups were recruiting fund managers at that stage of the cycle so Hugh decided to set up his own boutique – Evenlode – and launch the Evenlode Income fund.

"A decade later, this fund has proved to be a phenomenal success and Hugh is one of the most highly regarded UK fund managers. It is over £3.5bn in size and has returned more than 250 per cent (double the return of the UK market and peer group)."

What was the secret sauce? He added considerable analyst brain power in Ben Peters, his co-founder, but also built an enduring investment strategy. Yarrow helped develop a proprietary risk-management framework and software system to help the Evenlode team consistently execute its process.

The post-credit crunch market also favoured Yarrow's quality-first style. However, even with this tailwind, the fund has done remarkably well: it has beaten the FTSE All Share in every full calendar year since launch in 2009. ●

This fund aims to tap into four "cornerstone" themes: technology, sustainability, geopolitics and monetary policy

Lazard Global Thematic Focus

Launched earlier this year, the Lazard Global Thematic Focus fund aims to tap into structural themes that will shape the global economy over the next decade.

"Profound transformations are taking place in the global economy, as digitisation becomes universal and environmental threats, societal anxieties and regulation gain ever-greater prominence," said Lazard.

The fund is headed up by Steve Wreford, Nicholas Bratt and John King, who also run Lazard Global Thematic. They invest in four cornerstone themes, the first of which is technology.

While Wreford believes the technology sector will be one of the "tent poles" holding up the global economy in a decade's time, it won't be through the stocks that everybody is investing in now.

"Technology is like a rocket ship," the manager explained. "It takes off and people think it's going to go to the moon.

"But actually, technology is connected by an elastic band to the rest of the world and eventually the rest of the world catches up – and that means that regulation will, too. Public attitudes towards these companies are going to change. People are worried about the power that they have."

As a result, Wreford is making a more focused play within the tech sector on artificial intelligence (AI).

The second trend is sustainability as people become more conscious about climate change and their own impact on the environment.

Third is geopolitics, where there is the potential for heightened risk over multi-lateral issues such as trade.

"It matters a great deal for companies who have spent a quarter of a century outsourcing everything they do to China and Asia," said Wreford. "Now that framework of stability is under threat, so we have to think about what will replace it."

Last up is monetary policy. The manager said that a decade of ultra-low interest rates is likely to have changed people's attitudes towards money.

"If it's zero per cent interest, that means money is free. And if something is free, it's usually not worth anything," he added.

"What if money isn't worth anything anymore? That is a very dramatic concept that changes the rules for everything.

"It changes the rules for investors because they need to think about what happens next."

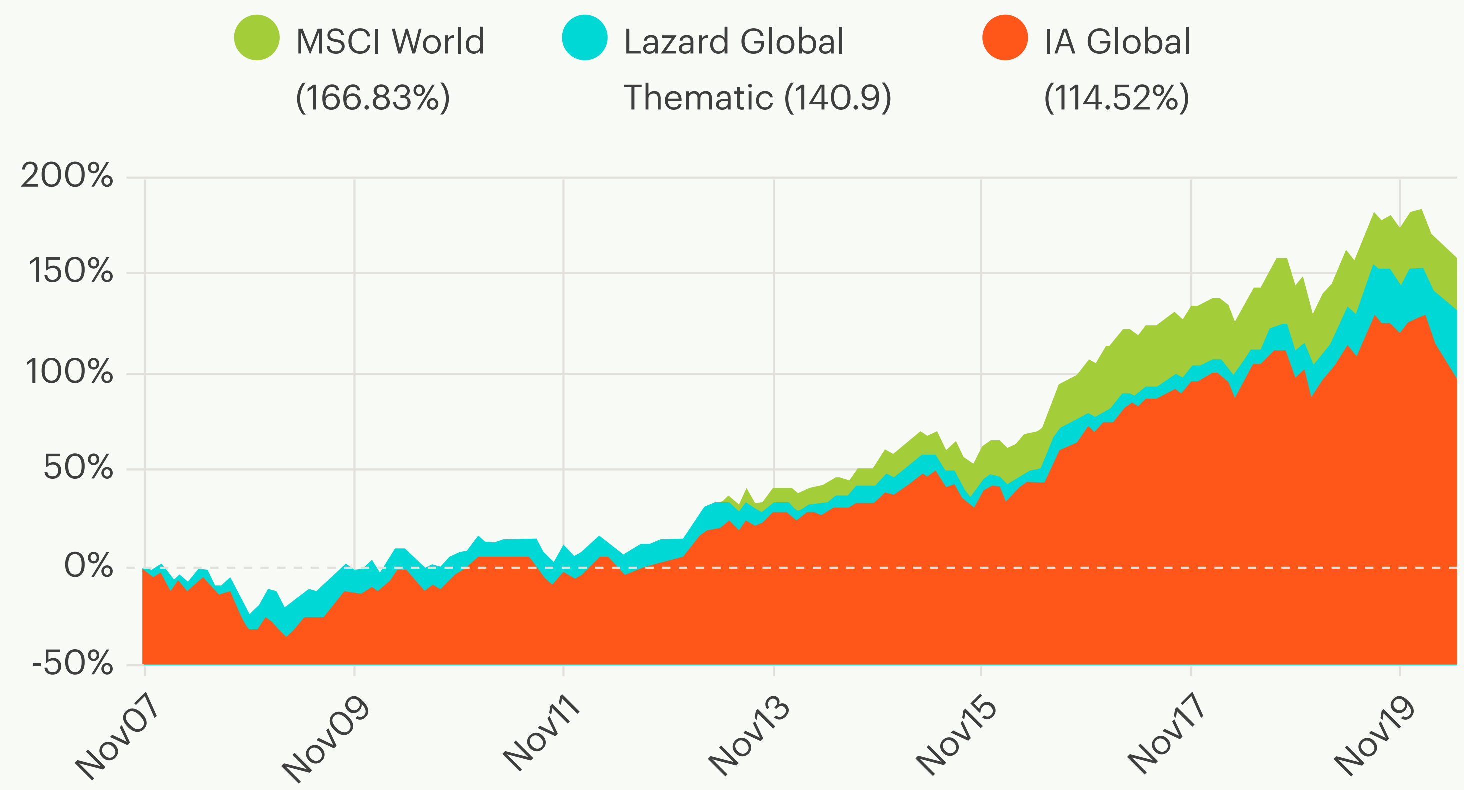
It is too early to judge the performance of Lazard Global Thematic Focus. However, Lazard Global Thematic has made 140.9 per cent since launch in October 2007 compared with 166.83 per cent from the MSCI World index. ●

FACT BOX

MANAGERS: **Steve Wreford, Nicholas Bratt & John King** / LAUNCHED: **10/03/2020** / FUND SIZE: **$17.3m** / AMC: **1%**

CROWN RATING N/A

PERFORMANCE OF FUND VS SECTOR & INDEX SINCE LAUNCH



Source: FE Analytics

This trust has been described as "essential" for investors in retirement who are looking to generate strong income from their portfolio

Dunedin Income Growth

Income investors are often warned to look not just at high headline yields, but the prospect of dividend growth as well. Dunedin Income Growth is a trust that ticks both of these boxes.

The trust is managed by Louise Kernohan and Ben Ritchie, with the aim of providing a quarterly income and long-term capital growth. In terms of total returns, it is the best performer in the IT Equity Income sector over the past three years, with gains of 30.89 per cent; the trust is also in the top quartile over one and five years, and in the second quartile over the past decade.

Philippa Maffioli, senior adviser at Blyth-Richmond Investment Managers, said: "Dunedin Income Growth is essential for an income-hungry retiree. It contains a selection of high-quality UK and overseas companies, delivering a resilient quarterly income. Dividends are paid in February, May, August and November, which is good for providing smooth dividend flows within a portfolio."

FE Analytics shows the trust has paid out an income of £2,258.98 over the past five years on an initial investment of £10,000. This is the sixth-highest payout in the IT UK Equity Income sector, beating the likes of Finsbury Growth & Income, Temple Bar, Edinburgh and City of London investment trusts.

Over recent years, Kernohan and Ritchie have evolved the trust's strategy, focusing more on dividend growth and less on the initial yield.

This means the managers have been selling out of stocks with high dividends that have limited prospects of increasing, while tilting the portfolio towards the small- and mid-cap end of the market.

These smaller holdings still have the same quality characteristics that Dunedin Income Growth has always favoured, such as being run by superior management teams and operating in industries with high barriers to entry.

Top holdings include income favourites such as GlaxoSmithKline and British American Tobacco.

Its biggest sector exposure is to financials, followed by healthcare, consumer goods and industrials.

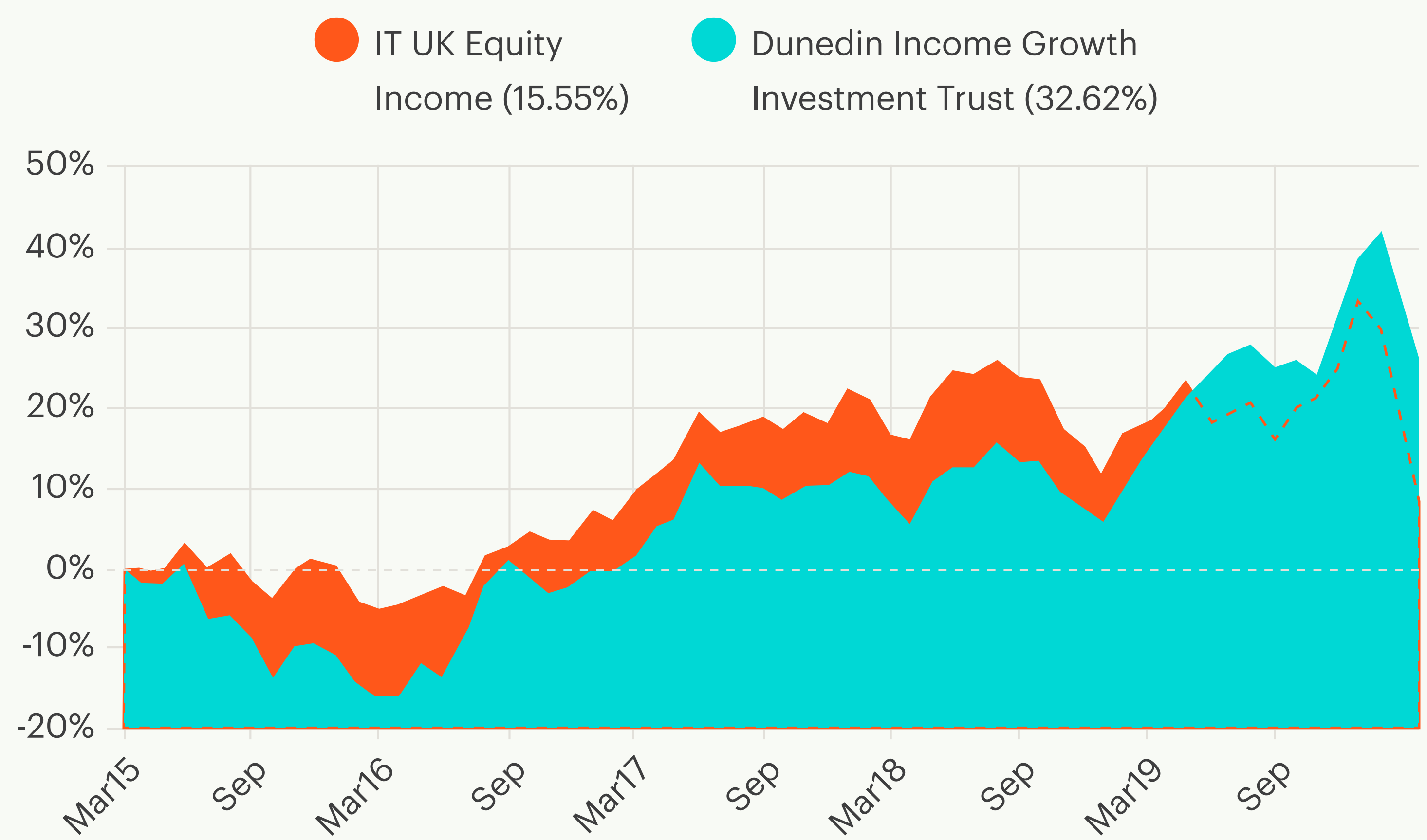
In an update before the coronavirus sell-off, Kernohan and Ritchie said: "Given potentially volatile markets ahead and relatively full valuations, we see little reason to shift from a conservative focus on higher quality businesses." •

FACT BOX

MANAGERS: **Louise Kernohan & Ben Ritchie** / LAUNCHED: **01/02/1873** / DISCOUNT/PREMIUM: **-3.2%** / OCF: **0.63%**

CROWN RATING

PERFORMANCE OF TRUST VS SECTOR OVER 5YRS



Source: FE Analytics

This trust has changed its name and introduced an enhanced dividend policy to help narrow its discount

JPMorgan China Growth & Income

Investing in China may seem like a risky move, with the country closely associated with the outbreak of the coronavirus. However, Chinese strategies proved surprisingly resilient in the initial downturn, with IA China/Greater China the second-best performing open-ended sector in February, while global markets tanked.

Nevertheless, fears over the coronavirus continue to spook investors and a number of top-performing investment trusts focused on China can be found at compelling discounts.

One such trust is the recently renamed JPMorgan China Growth & Income – formerly known as JPMorgan Chinese – which is trading at a 14.8 per cent discount.

This £322.5m investment trust – overseen by Howard Wang, Shumin Huang and Rebecca Jiang – targets long-term capital growth by investing in well-managed, high-quality companies that return money to minority shareholders in a fair manner. The managers take a high-conviction approach that emphasises bottom-up research but with some top-down views.

One such view relates to "New China" and sectors able to capitalise on moves towards a consumer-driven economy. This, they believe, will help deliver stronger returns and let them access some of the fastest-growing Chinese companies.

The portfolio contains internet giants Alibaba and Tencent as well as stocks poised to benefit from changing demographic trends, such as insurer Ping An and healthcare company WuXi.

Recently, the trust has been hampered by a high discount, which the board has tackled with a new enhanced-dividend policy. This targets a yield of 4 per cent of net assets at the end of the previous financial year, paid through capital gains and net revenue.

The move is designed to broaden the trust's investor base and reduce the discount over time. Winterflood said one of the arguments against such a tactic is that there is no evidence it leads to a narrowing of the discount. However, it noted that JPMorgan's other trusts that have taken this approach have been largely successful – notably JPMorgan Global Growth & Income.

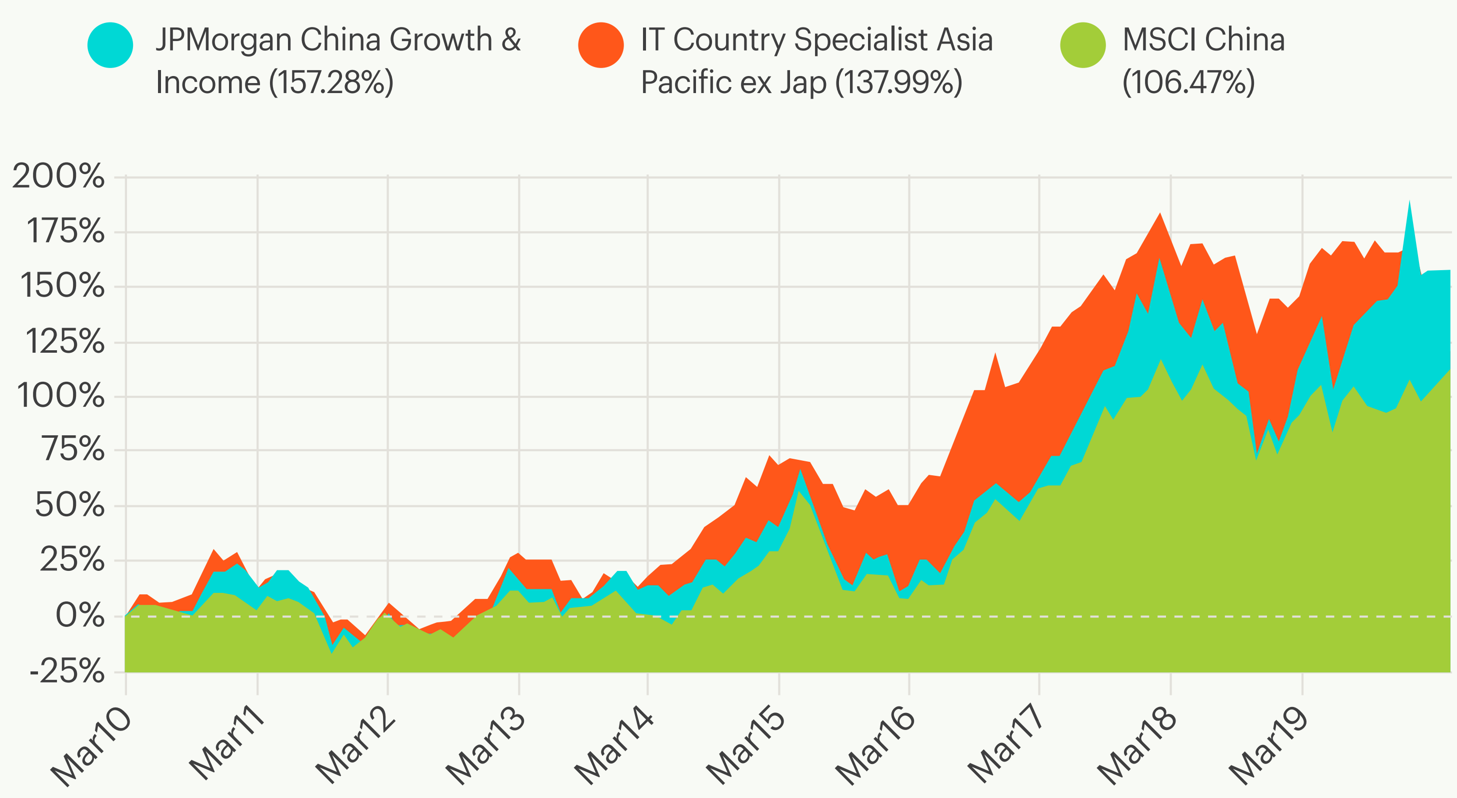
JPMorgan China Growth & Income has made 157.28 per cent over the past 10 years, compared with gains of 106.47 per cent from its MSCI China index benchmark. ●

FACT BOX

MANAGERS: **Howard Wang, Shumin Huang & Rebecca Jiang** / LAUNCHED: **19/10/1993** / PREMIUM/DISCOUNT: **-14.8%** / OCF: **1.26%**

CROWN RATING

PERFORMANCE OF TRUST VS SECTOR & INDEX OVER 10YRS



Source: FE Analytics

Pádraig Floyd finds out how you can make money from your hobbies

Collecting coins

After years of relatively benign investment markets, concerns about the coronavirus have sent investors scurrying for safe havens.

But some investors are not looking for a safe place to put their money, nor even in the stocks that deliver the highest returns, but in more exotic assets that pique their interest.

Not such a bad idea

This is why some people invest in race horses or football clubs. Not for pure returns, but for the love of it.

In the past, other specialist assets have been regarded as frivolous rather than serious investments. Yet research from P2P platform Sourced Capital suggests classic cars, fine wine and coins have proved to be sound investments over the past five years, delivering double-digit annualised returns.

However, Adrian Lowcock, head of personal investing at Willis Owen, warns that making money in these specialised areas is not as straightforward as it sounds.

"The big issue with things like classic cars is that not every classic car will go up in value, so you have to be extremely knowledgeable on which one you're buying and which one is likely to add value," he says.

"It's not like a company where you can look at the reports and accounts and go, 'okay, that company is making X profit and in scenario ABC, we think this will happen based on the analysis'.

"The car doesn't produce anything, so it is like gold in that respect: it is basically only worth what people think it's worth."

As a result, Lowcock says

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the value of these assets is dependent on sentiment, which is determined by collectors and trends – for example, he points out fine wine started to do well about 10 years ago when it became fashionable among high net-worth individuals in China.

These specialist investments also present more practical problems.

"With anything like that, they are physical assets so there will be additional costs," Lowcock adds. "If you buy a classic car, for example, you are either storing it or maintaining it, and both of those have a cost. You need a garage to store it in the right conditions and if you're driving it, you will have wear-and-tear costs, insurance premiums and all that."

Going for a song

Not all of these specialist assets are luxury goods that need to be locked away in a safe or warehouse. Some have no physical properties at all, but their popularity has made them valuable investments.

"We have been investing in songwriter royalties and value their bond-like characteristics," says Gary Moglione, fund manager at Seneca Investment Managers.

Royalties have become increasingly attractive to investors with the formation of Hipgnosis Songs, the

Streaming has boosted the value of song revenues and they have another characteristic shared with assets such as fine wine and art

trust created in 2018. It currently owns the rights to songs by artists such as Justin Bieber, Little Mix, Beyoncé, Emeli Sandé, Rihanna, Jay-Z and James Arthur.

Streaming has boosted the value of song revenues and they have another characteristic shared with assets such as fine wine and art.

"Music royalties have a low correlation to other asset classes," says Moglione. "This is important to us from a portfolio construction and risk perspective.

"We believe music-industry revenue is more heavily influenced by factors such as music piracy, legislative change, emerging market growth and technology than interest rates and stock market fluctuations."

Buying into the brand

Not everyone will want to own fine wines or luxury handbags. Why bother, when you can access high-end companies via a fund?

The growth of the middle classes,

particularly in Asia, has fuelled demand for their products. Over the long term, these types of companies tend to outperform the broader market, says Sam Morse, manager of Fidelity's European Values trust. His portfolio includes global luxury goods companies that offer defensive characteristics as a result of top-quality franchises and growing sales in emerging markets.

L'Oréal really is worth it, says Morse. The world's largest cosmetics company, with a 13 per cent market share, generates strong returns, is growing fast and pays a 2 per cent yield.

"Total shareholder return from L'Oréal in the next three to five years should be very attractive relative to the market," says Morse.

LVMH is a well-diversified company that has delivered "excellent performance for the past few years", making it a "long-term buying opportunity" due to fundamental growth in the business.

"Hermès is the ultimate luxury company," says Morse, adding that it produces the finest bags, scarves and ties and limits stock, often keeping customers waiting for years to buy their first items.

This scarcity helps keep pricing up and creates a secondary market, which allowed it to ride out the financial

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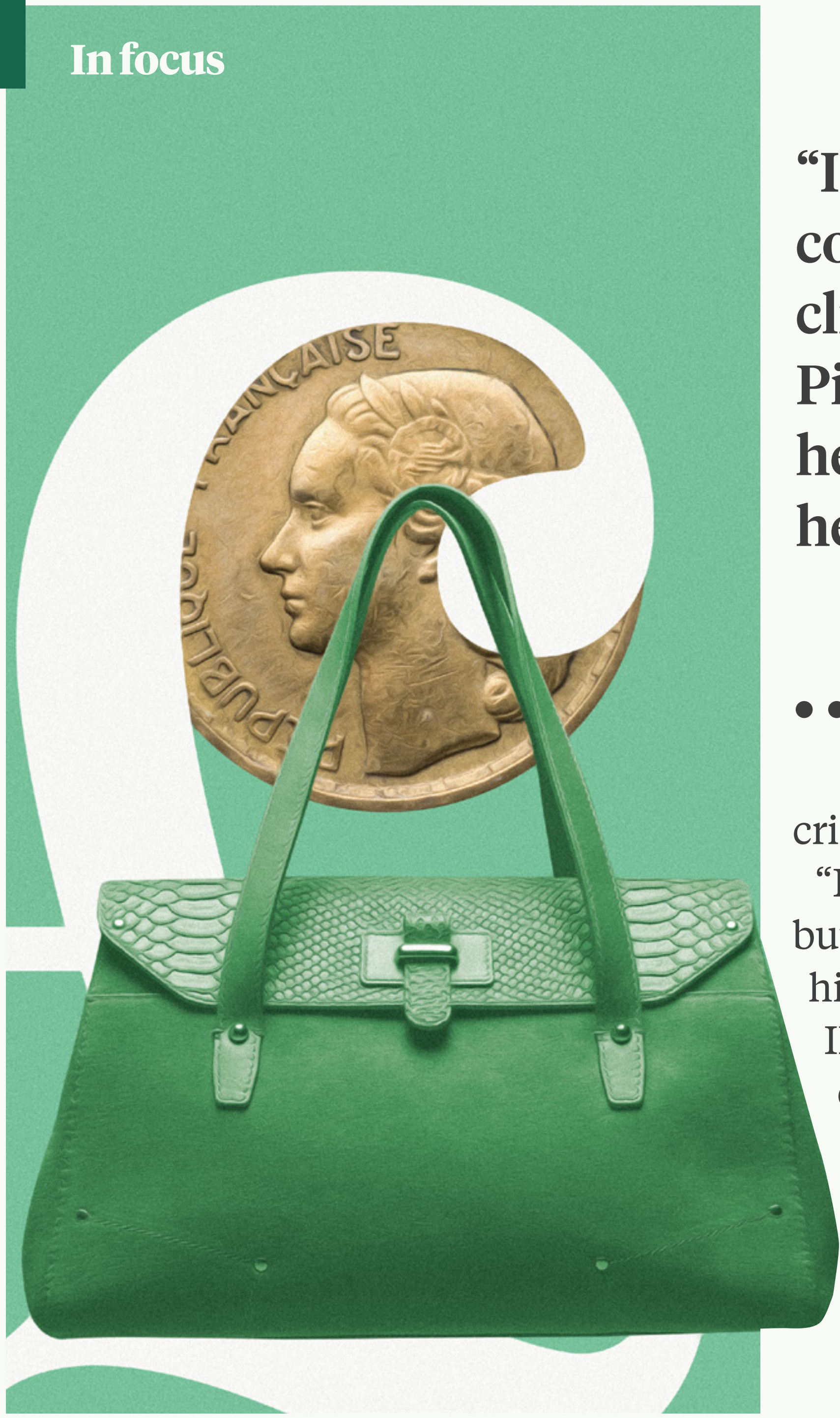

"I used to have brilliant conversations with one client because he collected Picassos. It sounds like he was incredibly rich, but he wasn't"

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crisis and pay double-digit dividends.

"Hermès trades on high multiples, but this reflects the exceptional historical performance since its IPO in 1993 and the visible growth outlook from here," adds Morse.

Despite the setback from coronavirus, the growth of middle classes in Asia is likely to maintain demand for luxury brands.

PERFORMANCE OF FUNDS VS INDEX

Name	1yr (%)	3yr (%)	5yr (%)	10yr (%)
Morgan Stanley Global Brands	13.86	34.21	92.02	251.26
Fidelity European Values	11.64	38.35	55.66	186.77
Amundi S&P Global Luxury UCITS ETF	4.14	28.07	49.17	164.26
MSCI World	8.96	20.15	61.03	175.67

Source: FE Analytics

Whether you own them directly, or via a fund, making it a success all comes down to making the right decision and not getting emotionally involved in the assets you buy. As a result, Lowcock says it is a good idea to keep hobby investments separate from your core portfolio.

"I used to have brilliant conversations with one client because he collected Picassos," he adds. "It sounds like he was incredibly rich, but he wasn't: he just bought some of the drawings and unfinished works for about £5,000 a pop.

"He always said to me, 'it may be worth something, but the fact is I hang it up on the wall and I enjoy it'.

"That's the way to combine a hobby with an investment – you get satisfaction from something and any added value is just a bonus.

"This is important when it comes to hobbies. Although wine is a difficult one, because you can't enjoy it if you want to make any money out of it."●

Morgan Stanley Global Brands

The theory behind Morgan Stanley Global Brands is that high-quality companies capable of generating superior returns over the long term are typically built on dominant market positions, underpinned by powerful, hard-to-replicate intangible assets. FE Investments says the fund's managers have a proven track record of picking long-term industry leaders that can defend themselves from disruptors. However, it warns that the fund is concentrated and spread across just four sectors, meaning it should be used as a satellite investment among a diversified portfolio of funds rather than a core strategy.

Amundi S&P Global Luxury UCITS ETF

Amundi S&P Global Luxury UCITS ETF seeks to replicate the performance of the S&P Global Luxury index, which comprises 80 of the largest publicly traded companies that produce or distribute luxury goods or services. These companies must meet specific investability requirements. Companies in the investable universe are ranked first by luxury exposure, through one of four scores from 0.25 to 1, then by market cap. The ETF's top-three holdings are Tesla, LVMH and Kering. It has made 164.26 per cent over the past decade, compared with gains of 175.67 per cent from the MSCI World index. The ETF has ongoing charges of 0.25 per cent.

Fidelity European Values

Investors who want to tap into the growth available from brands and luxury products and services but who don't want to put all their eggs in one basket may wish to invest in a more general fund or trust with some exposure to this theme. Fidelity European Values fits this bill. The trust has a bias towards quality and growth, with the manager seeking out attractively valued companies that are able to consistently increase their dividends. It has made 186.77 per cent over the past decade, compared with gains of 162.18 per cent from its IT Europe sector. Winterflood named the trust as one of its picks for 2020.

Crunching the biggest trends down into figures

STAYING POWER:

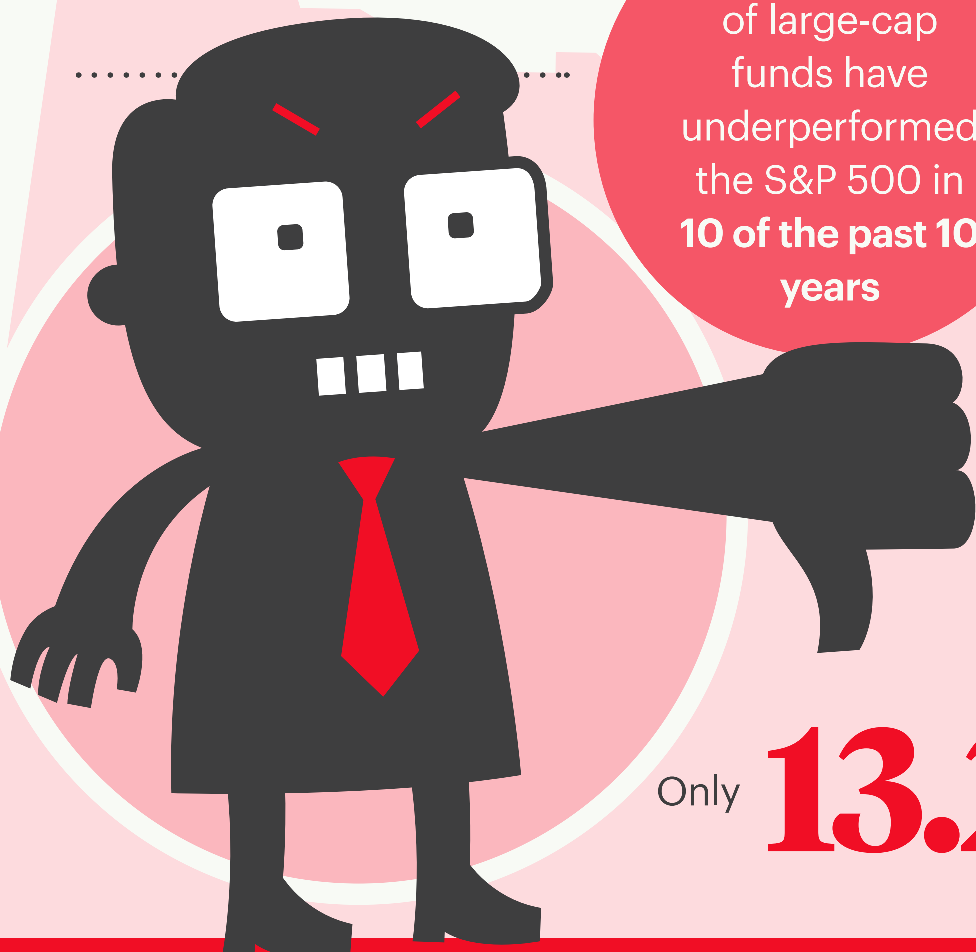
The challenges (and rewards) of beating the market over the long term

85%

of US large-cap funds underperformed the S&P 500 over **10 years**

92%

of US large-cap funds underperformed the S&P 500 over **15 years**



The majority of large-cap funds have underperformed the S&P 500 in **10 of the past 10 years**

Just **2.4%** of funds in the IA universe generated consistent top-quartile returns over the past three years

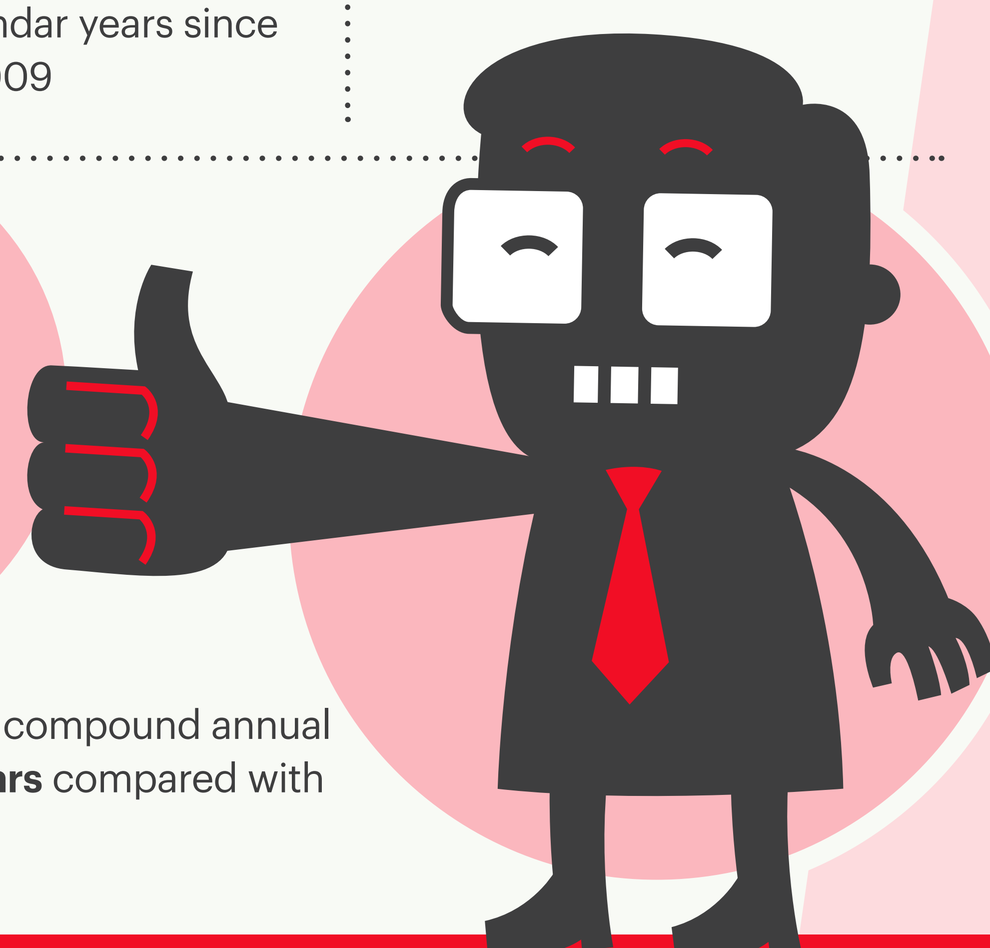
Only **13.2%** generated above-average consistency

Yet...

Hugh Yarrow's Evenlode Income fund has beaten its FTSE All Share benchmark in **10 out of the 10** full calendar years since launch in 2009

£1,000 invested in Fidelity Special Situations when **Anthony Bolton** launched the fund in **December 1979** would have been worth **£142,240** in **January 2008** when he stepped down. The same amount invested in the MSCI United Kingdom index would have been worth **£34,393**

Warren Buffett has made a compound annual return of **20.3% over 55 years** compared with **10%** from the S&P 500



Sources: FE Analytics, Berkshire Hathaway, S&P Dow Jones Indices, BMO

John Blowers investigates how the wave of consolidation in the platform industry is likely to affect the end investor

Last man standing

In February 2020, interactive investor announced the purchase of The Share Centre, further reducing the choice of consumer platforms available to UK investors.

I would put The Share Centre in the Premier League of investment platforms, along with Hargreaves Lansdown, AJ Bell, Fidelity, Bestinvest and of course interactive investor itself.

Yes, there is still a wide choice of options if you want to look at the smaller players. These consist of independent platforms (for example Strawberry Invest, Chelsea Financial Services and Willis Owen), or from larger players that don't seem to be

The UK's large financial institutions – with all their advantages in terms of scale, brand and marketing power – haven't made an impression on the investment platform market

overly committed to the market (for example Halifax Share Dealing, Close Brothers and Selftrade).

I'm going to put Barclays in a league of its own. Historically, Barclays Stockbrokers was a powerhouse in the UK platform market. More recently, as it has morphed into Barclays Smart Investor, it seems to have lost its way.

This suggests that the UK's large financial institutions – with all their advantages in terms of scale, brand and marketing power – haven't made an impression on the investment platform market.

The cream of the crop

This explains my top-five platform list of specialist companies: Hargreaves, which is well out in front in terms of assets under administration, followed by interactive investor, then AJ Bell, Fidelity and Bestinvest.

Holly Mackay of Boring Money estimates that the platform market had assets under administration of £260bn at the end of last year. That is a lot of money and the number of active customer accounts is also at a record high of 5.9 million.

This is unlikely to represent the actual number of investors, as many people have multiple accounts, but it demonstrates the increasing popularity of DIY investing, or perhaps its necessity, given that financial advice is expensive and in short supply.

Incidentally, if the entire platform industry charged a 0.25 per cent fee, it would earn £650m a year from us private investors. Again, a lot of money, and the biggest investment platform of all charges considerably more than 0.25 per cent.

Winners and losers

So, the questions we're here to try and answer are, who are the winners and losers in the platform market and which platform should I be using going forward?

Will the platform market consolidate further into two or three super platforms and will this cause fees to rise or fall?

No one within the industry is sure why it's so expensive to build this platform technology, but we have been advised that it just is

And finally, what if passive funds take over the world? Do we really need an investment platform if we can buy ready-made portfolios of passive funds straight from the fund manager, avoiding the need to pay a platform fee?

It's all a bit like the UK car industry of old. Remember those wonderful old brands we used to have – Humber, Rover, Triumph, Hillman, Wolseley and Austin?

Streamlining

Is the UK platform industry going to follow suit? The answer is almost certainly yes. The problem in the UK automotive sector was that it was extremely expensive to develop new products, while a large number of manufacturers independently investing in future vehicles for relatively low sales volumes killed profitability. We won't mention militant workers, poor build quality and international competition, but the point is that you need scale to succeed.

In the case of our platform industry, the cost of building the robust technology that you can trust to administer £260bn of our money is eye-wateringly expensive.

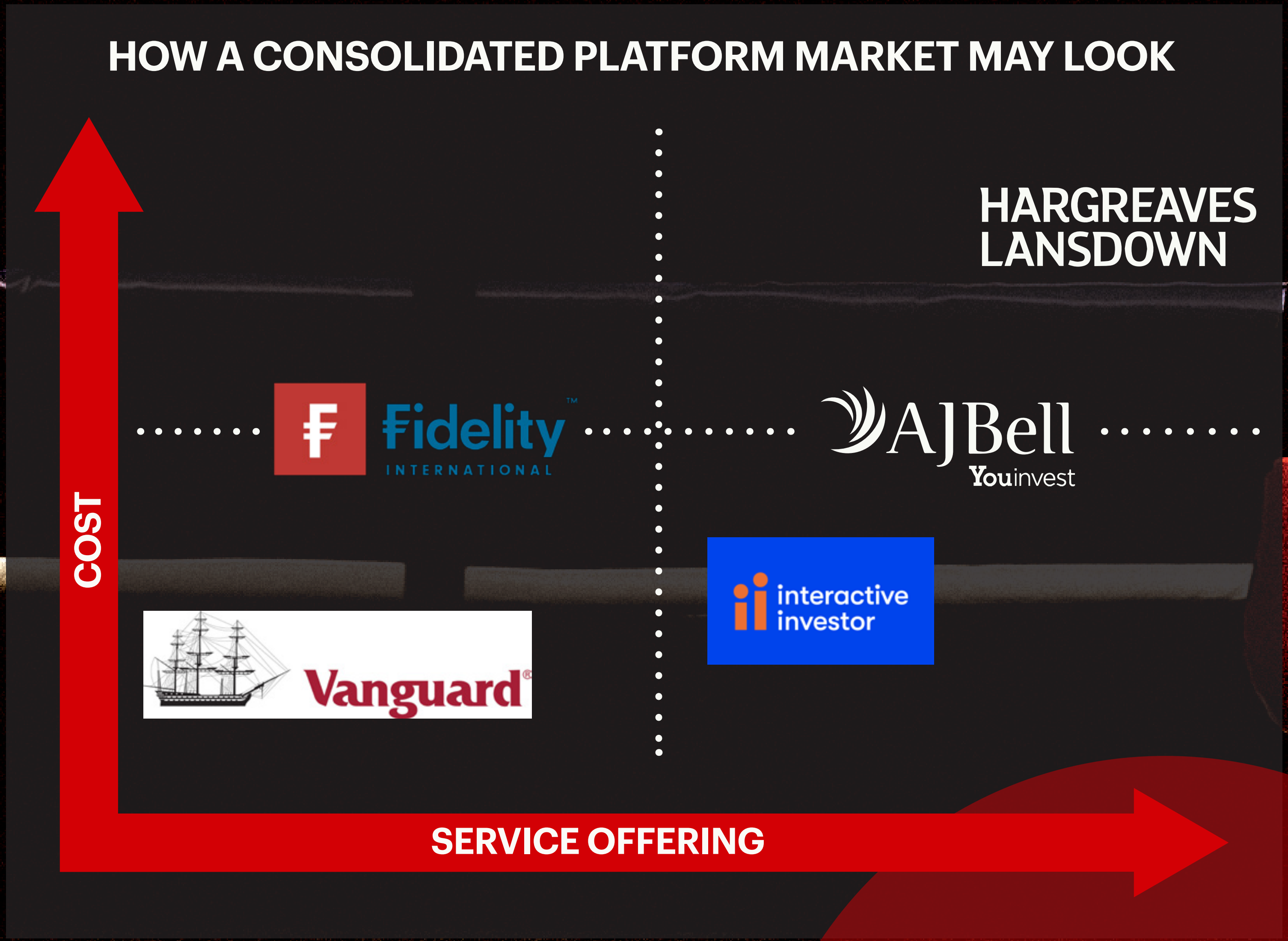
No one within the industry is sure why it's so expensive to build this platform technology, but we have been advised that it just is.

Many customers are required to invest all their money on a platform before it can become economically viable.

And to compound the problem, the cost of recruiting new customers via advertising is also sky-high. There's the story of Nutmeg, the UK's leading robo-advisory business, spending £3 of marketing money to acquire £1 of client assets.

Sure, it takes a while for a new type of investment platform to find traction, but there's only so long a company can keep spending more money than it is making.

The best way to attract customers without breaking the bank and taking an age is to buy somebody else's and this is what interactive investor has been doing. First, it bought TD Direct Investing, then Trustnet Direct, Telegraph Investor, Alliance Trust



It takes a while for a new type of investment platform to find traction, but there's only so long a company can keep spending more money than it is making

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Savings and The Share Centre.

Will consolidation of the UK's investment platforms stop here? Probably not and I can see mounting pressure on the larger players to start sweeping up their smaller rivals to form four or five super platforms.

One of these is likely to be Vanguard, the giant US fund manager which has taken its home market by storm and is likely to repeat the feat here.

Keeping it simple

Although it only sells its own funds – predominantly ETFs – it has highly regarded fund portfolios, such as the LifeStrategy range, which are cheap and easy to understand.

If Vanguard owns this part of the market, how will the other main players adapt their strategies to serve the remaining investors seeking more choice, tools, content, analysis and customer service?

The segment where costs are relatively high and service offering is low is likely to be unpopular with customers and no platform would like to be seen there.

Vanguard is likely to occupy the low-cost no-frills part of the diagram on the previous page and it is hard to imagine other players beating it at this strategy. Its proposition is also likely to limit the growth of robo-advisers such as Nutmeg and has the potential to decimate that sector completely now it has a pension vehicle on top of its ISA and general account.

Fidelity, another company with US roots, has again seen success in its home market but has struggled to go toe-to-toe with the larger platforms in the UK. I suspect there is still a level of confusion about whether Fidelity is a fund manager or a platform and whether this biases its offering towards its own fund products.

The three strongest platforms with UK roots are Hargreaves, interactive investor and AJ Bell, purely because of their focus. They are pure-bred investment platforms, not some division of a financial conglomerate and, as such, are commercially driven to deliver the best possible experience to UK investors at a price they are happy with.

Starting point

All three are aimed more at the experienced hobbyist investor, but they are innovative, with a range of ready-made investments suitable for novices.

Their pricing models are all different: Hargreaves has a formidable headline platform fee of 0.45 per cent per annum, but this is helpful for new investors getting started as opposed to a fixed-fee model such as interactive investor's. The latter's model is extremely popular with larger portfolios as it costs proportionately less as your pot grows. AJ Bell has something inbetween – a platform fee of 0.25 per cent which is good for smaller accounts and pensions, as there is no SIPP administration fee.

In terms of investor support, information and analysis offered by the three behemoths, they are all broadly excellent.

Both interactive investor and AJ Bell bought and developed financial publishing divisions to help investors

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make better decisions and Hargreaves has a long-standing commitment to employing expert investors and commentators to share their wisdom. All three sites have high-quality data, charting and analysis that put them in a league above the rest.

Horses for courses

If that kind of information is important to you, then it's a tough choice to pick one platform above another. I suspect we may even see these three platforms' pricing models come closer together – hopefully in a downward direction.

Customer service is important, and this is where Hargreaves excels. It makes a point of hiring high-quality graduates and training them well.

It's hard to split AJ Bell and interactive investor based on customer service – both have grown fast and this inevitably puts a strain on companies, but there are fewer reports of customer unhappiness.

With the major improvements being made by the firms trying to catch Hargreaves, it is interesting to ponder whether the significant premium levied by the market leader is worth it these days.

With the major improvements being made by the firms trying to catch Hargreaves, it is interesting to ponder whether the significant premium levied by the market leader is worth it these days

This is an example of scale at work. All three platforms now have the turnover to invest in high-quality systems and personnel to deliver a reliable and robust service and it is hard to see any new entrant making anything other than a niche offering work.

Small pond

Having said that, it's not worth discounting the chance of a major brand such as Amazon or Google taking out one of the major platforms and dominating the market. Or one of the banks could get its act together and create a market-beating platform. But I wouldn't bet on that happening any time soon.

And what of the smaller platforms in the market?

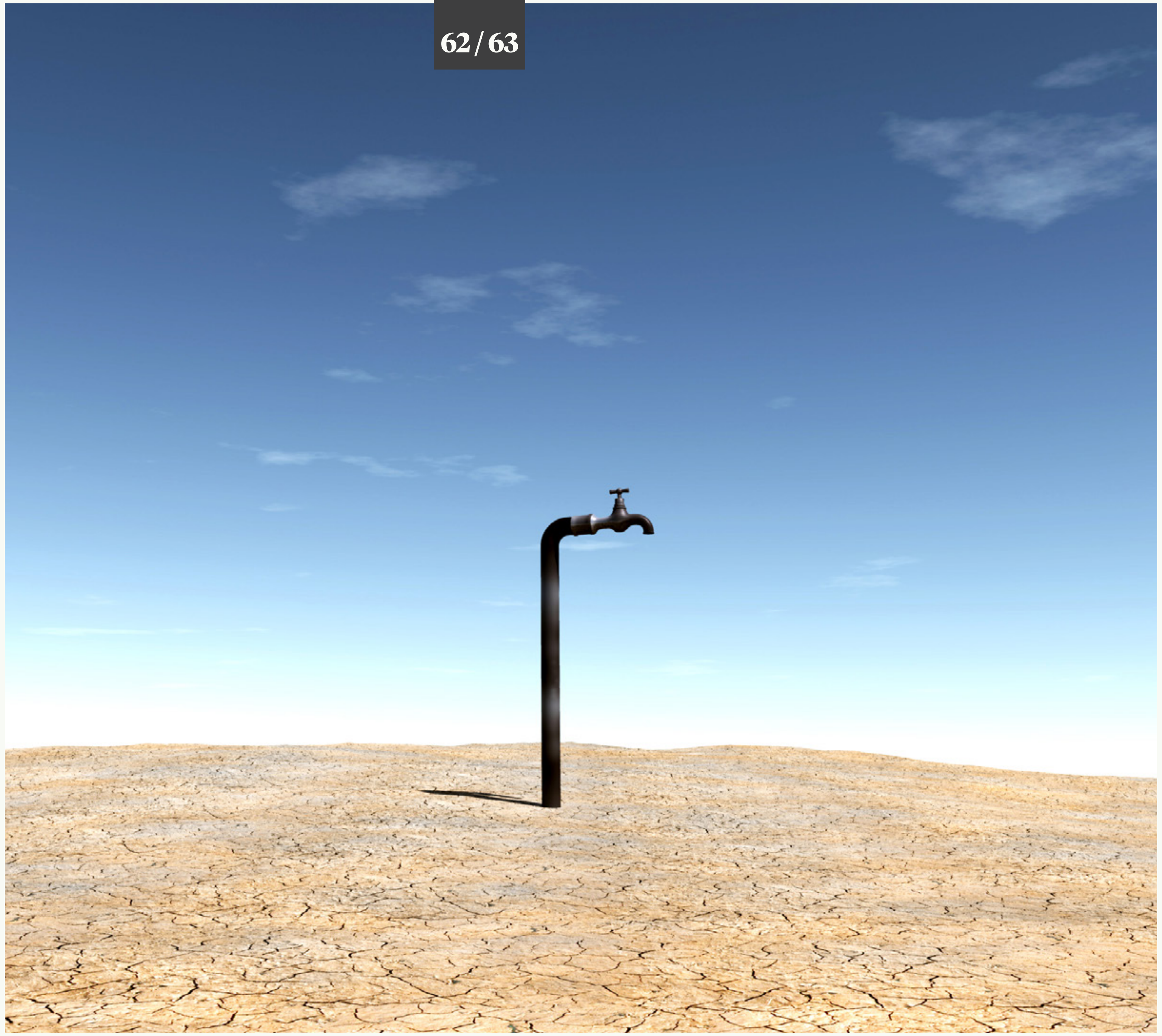
Maybe there will be further consolidation among the smaller players, only for one of the big platforms to digest the last one standing.

We shouldn't rule out the idea that one day, we won't need platforms at all and, just like the philosophy behind open banking, we will be able to buy all our funds direct from the fund manager and see our single portfolio on our banking app without having to pay any platform fees at all.

We can always dream. •

Pictet's **Stephen Freedman** names three stocks that can help tackle the growing problem of global water sustainability

Not a drop to drink



From extreme weather to wildfires and air pollution, the world is waking up to its environment crisis.

Yet there is another planetary emergency that needs to be addressed: the depletion of water, our vital natural resource.

Less than 1 per cent of water on the planet is available and accessible for human use. Up to 3 billion people do not have regular access to water, while some 50 per cent of the world's population could be facing severe water scarcity in less than 30 years.

Up to 3 billion people do not have regular access to water, while some 50 per cent of the world's population could be facing severe water scarcity in less than 30 years

Not only do we need to consume less water, we also need to become more efficient with what we do use.

We believe specialised companies developing innovative solutions to improve our water usage present long-term investment opportunities. Here are some of our favourites. ●

American Water Works Association

Public spending constraints have led to underinvestment in utilities and the need to upgrade infrastructure is pressing. American Water Works is the largest US water and wastewater utility, operating in 47 states and serving 15 million people. While most US water utilities are government-owned, American Water has acquired numerous public assets. Despite being a defensive stock, American Water benefits from strong growth trends due to an ageing water system, which requires significant investment to upgrade and maintain its infrastructure.

VEOLIA

French water utility and waste management company Veolia is another beneficiary of the trend towards privatisation in water and waste management. It has a concession-based business model and is involved in the production and delivery of drinking water to 95 million individuals, as well as the collection, treatment and recycling of wastewater from 60 million people. Some 80 per cent of its sales originate outside of France and its activities span 55 countries. Veolia has been optimising its portfolio of activities recently, which should boost profitability and contribute to a re-rating of its stock.

ThermoFisher SCIENTIFIC

Thermo Fisher (TMO) is a leader in life sciences solutions, analytical instruments and diagnostics, with applications in health and environmental testing including water. Such services are an essential part of the pollution-control process, as one "cannot manage what isn't measured". TMO is experiencing strong growth, driven by organic international expansion. The company also has a track record of acquiring companies with complementary offerings. Its strong brand and financial position have helped fuel its growth strategy, strengthening its economic moat.

Smith & Williamson's **James Burns** says this investment trust will unlock value in Japanese small caps through taking an activist approach to its portfolio holdings

Nippon Active Value Fund

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One of the more interesting opportunities we participated in recently is the Nippon Active Value Fund (NAVF) – a new investment trust that has just listed on the Specialist Fund Segment of the London Stock Exchange. We purchased this for the Smith & Williamson MM Endurance Balanced fund.

Active duty

NAVF intends to take an activist approach to Japanese small-cap equities (those up to $1bn in size) and benefit from the major corporate governance changes that have started to take effect over the past few years. The trust seeks to generate returns by unlocking value; this will be achieved by engaging with companies to be better stewards of shareholders' capital and encouraging them to pay dividends, special dividends and utilise share buybacks. Moreover, the small-cap end of the market is under-researched and relatively inefficient – broker coverage tends to be thin, with the majority of Japanese companies covered by two or fewer analysts. This means there is an abundance of opportunities for active investors.

Historically, Japan has not been regarded as a particularly shareholder-friendly environment (and certainly not one that welcomed activist investors), but this is changing. Six years ago, Japanese stewardship requirements began to move towards Western norms. More recent reforms to Japanese M&A guidelines mean that if a company receives a takeover bid, it has to be evaluated by the independent directors who must act in a fiduciary capacity, especially with regard to the interests of minority shareholders. Protection for the latter group is something we largely take for granted in the West, but it is a relatively new phenomenon in Japan.

Room to run

We think this story can run for several years. Many investors see the benefit of an activist strategy (return on equity and return on investment in Japan are low, as are net debt levels, while many firms are cash-rich – some even have cash reserves that exceed their market capitalisations), but few investors have had the confidence to implement such an approach due to the associated reputational risk in what has always been a conservative corporate environment.

The investment manager of the vehicle, Rising Sun, doesn't expect the broad direction of corporate governance in Japan to change, regardless of who is in government; however, it avoids strategically important companies, as it is unlikely that Japan would ever welcome foreign ownership of these assets.

Stock specifics

The launch proceeds are likely to be fully deployed across a focused portfolio of five to 20 targets over the next six to nine months. Adhering to the trust's own principles, governance is a consideration and there will be a continuation vote after five years and biannually thereafter. This vehicle will hopefully provide us with attractive returns that are not necessarily correlated to the broader market – this will be a much more stock-specific story driven by the success of Rising Sun's engagement with target companies. ●

***James Burns** is co-manager of the Smith & Williamson MM Endurance Balanced fund*

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