

Large Caps, Income and Capital Growth

The companies with rising cash flows are more likely to raise dividends. Neil Cumming at PSigma Investments is looking to invest in large-cap companies for the safety of the principal but also in companies with rising cash flows and a history of growing dividends. With 70 holdings in some of the largest UK-listed companies, the Fund balances the rising income from the dividend and the growing corporate earnings.

Q: What is your investment philosophy?

A: We are looking to benefit from both income and capital growth in the UK large-cap sector. We are stock investors, so we look to invest in companies that are likely to sustain earnings growth but we do overlay that with the macro economic analysis of what is going on in the economy and what we think is happening to interest rates, taxation and other macro economic developments. Many UK large cap companies are operating globally, so it helps to have an understanding of the world view.

Q: Who are the people directly involved in the fund?

A: Tim Gregory, our Chief Investment Officer, and I are co-managing the fund. We have known each other and worked together for quite a long time. James Knowles understands asset allocation and he contributes a lot of the top-down economic analysis to develop fund strategy. Matt Sharp is the third person who is involved in daily investment issues and handles technical issues related to investments. As a whole, PSigma has approximately 30 staff members.

Q: What is the origin of the fund?

A: PSigma Investment Management is part of the Punter Southall Group companies. The Punter Southall

Group provides a wide-range of investment solutions covering independent financial advice, asset management, product solutions and independent research, employee benefits, pensions consultancy and actuarial services. PSigma Investment Management was set up in January 2003 as a company with no assets under management. At present we have a total of almost 500 million sterling under management. Unit trust was launched in October 2003 and currently the unit trust has 15 million sterling.

Q: How do you put your core beliefs into practice?

A: We are looking for both income growth and capital growth. To be in the UK equity income sector we need to provide a yield of at least 10 percent above the FTSE All Share index yield. We aim to grow the income every year so there is a steady record of income growth; not necessarily the highest starting yield, but one that can be grown over the course of time.

Q: Do you look at companies outside the index?

A: We invest in UK listed companies. We would look at anything within the FTSE All Share index or the AIM listed market as well as the few UK convertible securities. Collectively, we can look at more than 1,800 companies.



NEIL CUMMING is co-manager of the PSigma UK Income & Growth Fund along with PIM's Chief Investment Officer, Tim Gregory. Neil has 22 years investment experience having started with Royal Insurance after graduating from Durham University with a degree in Economics and Mathematics. At Royal Insurance Neil passed his Society of Investment Analyst exams and, after three years as an analyst, moved into fund management. He moved to Prolific Asset Management in 1997. Neil was part of the team managing the award winning Prolific UK Blue Chip Trust. The team was also responsible for other UK equities worth over £1.5bn. Following Prolific's acquisition by Aberdeen Asset Management, Neil became Head of the Equity Income team, responsible for a product range with c£800m assets and a track record stretching back for 25 years. He joined PIM in May 2004.

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Q: What are the things you look at before you decide to add a company to your portfolio?

A: We are looking for strong management teams. Whenever possible, we meet the management of the companies we are invested in. We also focus on the operating cash flow of a company and the related financial measures. Hard cash is one of the most difficult things for companies to manipulate in the financial statement. If you pay attention to the nature and level of cash flow, it gives you a good steer on the business and quality of its operations. If a company is generating cash, it makes it a lot easier for them to raise dividend in the future and help drive share prices.

We also pay attention to the strength of the balance sheet. When companies have excessive leverage on the balance sheet, companies are managed from the debt holder’s perspective and have little room to pay or raise the dividends. Also company has very little margin of safety if business conditions deteriorate.

We invest in companies that are leaders in their own industries. If the company has not got a significant competitive advantage it will be competed away in terms of price. Once it becomes a commodity provider, it be-

comes very difficult to succeed in the long run. So, we are looking for companies that do have bargaining power and strong product portfolio.

Q: How do you go about portfolio construction?

A: We rely a lot on our contacts in the broking community to initiate the search for an idea. Large cap companies are well researched by the brokerage community and it helps us to use their information to start our research process.

The portfolio has between 60 and 70 holdings. There have been times when we have been worried about a lack of direction in the market and we have had more than 70 names. At the moment we have 64 holdings in the fund.

We don’t set specific price targets for our holdings, but we do monitor them closely and we are looking for any change that may make the momentum of that company slow down. As long as the company is doing well in meeting our financial and business expectations, we would keep the company in the fund.

Q: What is your sell discipline?

A: We have a strong sell discipline and do not just let unsuccessful investments lie around on the portfolio. Once the company has started to disappoint investors, it takes a lot longer than the market often expects for that company to return to the normal profit level. Quite often the first profit warning that you get is not the whole truth. Then you often get a second or a third more significant profit warning that will lead to management change. The whole process can become quite drawn out and can actually destroy more shareholder value in the process so we have strong sell discipline for stocks that disappoint and we do sell stocks of the companies from the portfolio as soon as possible.

Q: Do you benchmark yourself against any index?

A: The index we use as a benchmark is the FTSE All Share Index, which isn’t a perfect match because it hasn’t got any income bias to it, whereas we have, but it gives you an idea of how you are doing at any given point in time. There are around 700 stocks in the FTSE All Share Index.

The AIM market is a market of smaller companies in London and hasn’t got the same status as a full listing. Currently there are over 1,100 stocks on the AIM market. We would not have the ability to monitor all those stocks in the AIM market. Something has to either catch our eye or has to be pointed out to us to make an investment in the main stock. Normally, out of the holdings on the portfolio, you wouldn’t find more than one, two or three holdings from the AIM market and most of them would probably be from the FTSE All Share Index.

Q: There are roughly 700 stocks in the FTSE All Share Index, but how many stocks are actually quoted in London?

A: There are 700 stocks in the All Share Index and 1,100 odd in the AIM index. Then there are also many companies that have got international listings in London nowadays, quite a lot from China and from the former Soviet Union states, which we don’t regard as being part of our index and we wouldn’t follow. The overall number of companies that lists in London would be therefore a lot larger than just the sum of those two numbers.

Q: What kind of risks do you monitor and what do you do to mitigate them?

A: There are risks on several levels. One would be that as we are a long only fund and when the market falls for whatever reason, we wouldn’t have the ability to short the market, so we would be exposed. What we can do is

to raise cash levels, but, again, being a unit trust, there is a limit to how much cash we can hold.

We can switch into more defensive investments, like utilities for example, but a falling market is a risk for us. The other unit trusts in the sector face exactly the same problem, because they too will be long only too.

The other risk, which is a lesser risk, is that we have the wrong economic or market analysis and have got our investments positioned in the wrong sectors or companies for a given set of events. That is a far smaller scale problem because as long as the investments that we are holding are good ones, they will manage to rebound. So, that's a medium risk.

There is also the risk that you have an investment, which despite all your analysis, actually underperforms. But with 60 to 70 stocks in the fund, a lot of the stocks are only going to be about 1% of the portfolio. Those, which are larger, are typically the very large-cap stocks like HSBC, British Petroleum and GlaxoSmithKline, companies which you might expect to have stock price volatility, but are actually unlikely to go out of business. So, we would regard stock-specific risk very low in the large and mega cap sector of investing.

There isn't really much currency risk in the portfolio. The risk in the companies that we invest in are earning money in international currencies and therefore you will have a transaction or a translation risk as they move that money back into sterling for accounting reporting purposes.

At the moment the three main currencies for us are sterling, euro and the US dollar. Compared to other fairly recent times in economic history, those three currencies are probably less volatile than they use to be. Now


people get fairly excited about a 10% move in the US dollar and yet there was a time when the sterling had the propensity to move between almost \$1 and \$2 in a fairly short order of time.

Q: Can you give an example of an investment that really worked out for you?

A: A company we have recently made an investment in is Resolution Group. They are buying up books of closed life business and by stream-lining the administration and investment processes of the company have managed to improve the profitability from those life books. They have recently bought a book of life business from Abbey National, which is now owned by a Spanish bank, Banco Santander. In this particular case, attractive profit projections from the stock brokers for the coming years and our view that the company can support the growth through acquisition has firmed our positive view on the company. In fact, the company feels that there are more deals that can be done in the sector. As a sign of confidence, the chief executive recently borrowed 45 million sterling to buy more shares in the company.

That's another example of a company where we did a mixture of our own work along with information from brokers. We met the management and walked away with the impression that the business can grow substantially in the coming years. I believe that the stock will be in the portfolio for a considerable period of time.

Q: What is the turnover of the fund?

A: It's quite low. In the first half of this year the turnover was about 60% and it was just over 100% for last twelve months. 

PSigma UK Income & Growth

Symbol	GB0033668178
Fund Type	Unit Trust
Website	www.psigmaunittrust.com
Address	PSigma Investment Management 126 Jermyn Street London SW1Y 4UJ
Tel. No.	0044 (0)20 7747 6999
Inception	24/10/2003

PORTFOLIO

Total Net Assets *	GBP 15.19
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INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	GBP 1,500
Min Subsequent Investment	GBP 250
Min Regular Investment	N/A
UK ISA	YES
CAT standard	NO
UK PEP	YES

RETURNS VS. FTSE ALL-SHARE TR INDEX

	GB0033668178	Index
1 Year (Cum.)	14.15%	13.05%
3 Year (Ann.)	N/A	15.99%
5 Year (Ann.)	N/A	8.61%

RETURNS VS. IMA UK EQUITY INCOME

	GB0033668178	IMA UK
1 Year (Cum.)	14.15%	16.10%
3 Year (Ann.)	N/A	18.15%
5 Year (Ann.)	N/A	10.79%

FEES AND EXPENSES

Initial charge	5%
Annual charge	1%
Exit charge	N/A

PORTFOLIO MANAGER

Neil Cumming	01/05/2004
Tim Gregory	24/10/2003

* millions

Data through: 29/9/2006

Source: Company Documents; Lipper

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