

Responsible Value

The combination of financial and social responsibility analysis provides unique benefits, according to the manager of CIS Sustainable Leaders Trust. The integration of social, environmental and ethical issues allows a more rounded appreciation of the risks and opportunities within potential investments.

Q: What is your investment philosophy?

A: We have a value investment approach that is based on proven investment principals. We also incorporate industry leading social responsibility analysis into our decision making. We use this approach to identify mis-priced companies and to encourage good governance. By proven investment principals we mean that this is established industry and it's intriguing that successful investment principles haven't changed a lot.

Essentially, we combine a financial and a non-financial perspective in making investments. We operate a responsible shareholder policy, which basically involves integrating governance, social, environmental and ethical issues into our investment process. The research we get from the broker community focuses purely on the financial aspects of the company, while we build detailed analysis on the governance, social, environmental, and ethical issues.

I believe that this dual approach to investing is a long-term advantage. The non-financial analysis often highlights risks that can have a financial

impact. Also, there is an increasing number of people and institutions in the U.K. that feel that there is a responsibility to know how companies they invest in deal with important social, environmental and ethical issues. Another advantage is that our highly skilled responsible shareholder team is difficult to replicate.

Q: How that philosophy translates into an investment process?

A: On a day-to-day basis of building the portfolio, we have three key investment principles: focused, valuation-driven, and low-turnover fund.

We are focused investors in the sense that we're rigorous in defining what we're looking for and we select a relatively small number of investments. This focused approach, as opposed to a more diverse one, enables us to quickly narrow down companies that we are interested in. In that way we can spend more time in understanding these companies and, potentially, do more within the areas that we understand.

When we find something that we like both from the valuation and from



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“I believe that the most important risk control comes from appropriately pricing and understanding risk before you make an investment.”

the social, environmental, and ethical perspectives, we tend to invest a material proportion of our assets in that idea. Our largest holdings are 4% to 5% of the fund and some are not particularly large companies in the benchmark we're measured against. The benchmark we measure ourselves against is the UK FTSE All Share index.

The second principle is that we are valuation driven. We spend most of our time thinking from a bottom-up perspective. Of course, we do pay attention to top-down thematics going on around the world, such as understanding the sustainability of long-term trends in populations, the environment and regulations. Fundamentally, however, we seek to know companies well, to meet the management teams, to understand the cash flows and the future trends so that we can make the best possible investment decisions.

The final principle is that we are a low turnover fund. With annual turnover rates in the industry running at about 100% on average, I believe that it is fair to say that money is being managed more and more on a short-term basis due to the rise of hedge funds. We stand very apart from that. Ideally, we would like to own companies for a minimum of three years, preferably for more than five years. We aim to invest in businesses with stable business models, managements we trust, and businesses that we feel will have a competitive advantage for at least 5 or 10 years.

Q: Would you explain your perception of value as there are different definitions in the industry?

A: We use primarily cash-based valuation techniques and we tend to be naturally cautious towards business-

es that we can't value with a simple cash flow technique. There are many stereotypes attached to value investing and we have our own definition. When we talk about value investing, we first think about mispriced opportunities, about valuation and potential for change.

But we also seek to think differently from the market, which often means that we have a contrarian approach, but that's not exclusively so because on occasions we can be more optimistic than the market. We like to buy the businesses cheaply but we are a bit more pragmatic and we don't restrict ourselves to just that.

We are pretty focused on downside protection; that's almost always our first goal in the process. We try to make sure that we don't lose money before we know how we are going to make it. That's achieved particularly by inverting our arguments before we buy a company and figure out what would happen if we are wrong.

We have quite a strong sell discipline - perhaps an area overlooked by a great part of the investment community. We scrutinize why we are successful, and we also scrutinize when we fail if we get it wrong. That kind of honesty in the process constantly challenges our investment assumptions to reassess whether it is appropriate to hold our investments. Finally, when our view becomes the consensus view, we'd typically move on because then the valuation is normally close to our target.

Q: How is your research process organized?

A: We have two teams of analysts - financial analysts and the responsible shareholder team. The finan-

cial analysts are building models on companies and implementing the principles that we talked about, such as valuation, downside risk, sell discipline and other processes.

The responsible shareholder team looks at the governance, social, environmental, and ethical issues and briefs the financial analysts on these aspects. The analysts document both the social and the financial issues, so when the money managers look at the company, the research is prepared to consider both elements of the investment case.

Then, the ideas typically go forward to a meeting of three or four managers, our head of research, and the analysts who prepared the research. At that point discussion is held about the appropriateness of the investment, whether it meets our philosophy, and whether it fits our cash-based way of valuing companies. We'll invert the arguments trying to figure out if we make an investment where we could be wrong. That meeting is the cross-checking that makes sure that we have considered everything we should consider.

If a company gets through that assessment, then it goes on our core list. The core list represents our best ideas that should be in our portfolios. Typically, it won't contain more than ten names. Around that list there will be a selection of companies that may have not met all the criteria for valuation reasons, or companies that would be suitable to allow fund mandates to be implemented.

Q: Can you give us an example of a stock that became a core holding through that research process?

A: One of our core holdings, a com-


pany called Scottish Power, is a generator, distributor and retailer of electricity in the U.K. It became of interest to us from the financial perspective a couple of years ago as it was a poorly managed business. It also owned quite a significant business in the States, which it sold to an utility Warren Buffet owns. At the time of the sale we felt that the market was underestimating the importance of the change going on, which was followed quite shortly by senior management changes.

It had an attractive valuation relative to its peers, very strong dividend yield, which provided some downside protection, and a stable business model. We also believed that the U.K. electricity sector would consolidate more on a pan-European basis. Indeed, Scottish Power was approached by a German utility. There was a catalyst for change, a strong valuation case, downside protection, and perhaps one of the best social responsibility programs in this sector in the U.K. That's particularly important because Scottish Power has an extremely high environmental impact as a generator of power.

So the financial analysis led us to believe that there was value; the non-financial analysis showed that the company was managing its social, environmental and ethical impacts well. The stock compared well to other investment opportunities and so we added the stock to the portfolio and now it's one of the top ten holdings within the Trust.

Q: What kinds of risks do you monitor and how do you try to mitigate them?

A: Although we look at volatility and tracking errors as everyone else does, I believe that the most impor-

tant risk control comes from appropriately pricing and understanding risks before you make an investment. Since we believe in focused investing and we don't diversify for the sake of diversifying, our tracking error can be high. However, we don't necessarily think that it reflects higher risk because we spend a lot of time pricing the risk before we make an investment. 

CIS Sustainable Leaders Trust

Symbol	GB0001615102
Fund Type	Unit Trust
Website	www.cis.co.uk
Address	Co-operative Insurance Miller Street Manchester M60 0AL
Tel. No.	08457-464646
Inception	1/5/1990

PORTFOLIO

Total Net Assets *	GBP 128.00
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INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	GBP 1,000
Min Subsequent Investment	GBP 500
Min Regular Investment	GBP 25
UK ISA	YES
CAT standard	NO
UK PEP	YES

RETURNS VS. FTSE ALL-SHARE TR INDEX

	GB0001615102	Index
1 Year (Cum.)	22.88%	16.75%
3 Year (Ann.)	N/A	17.09%
5 Year (Ann.)	N/A	6.43%

RETURNS VS. LGC - EQUITY GLOBAL

	GB0001615102	Index
1 Year (Cum.)	22.88%	9.06%
3 Year (Ann.)	N/A	9.06%
5 Year (Ann.)	N/A	2.05%

FEES AND EXPENSES

Initial charge	5.00%
Annual charge	1.50%
Exit charge	0.00%

PORTFOLIO MANAGER

Michael Fox	1/11/2003
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* millions

Data through: 29/9/2006

Source: Company Documents; Lipper

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