

Fund Selection with a Macro View

A former advisory company, Margetts now manages four funds of funds. With a risk profile slightly below the average, the Select Strategy product encompasses funds with different investment styles and geographic areas, ranging from income to emerging markets funds. The portfolio is built with a top-down view on the economy, with the idea for consistent outperformance, and with the belief that equities are the best place to be in the long run.

Q: What are the core beliefs behind your way of managing money?

A: We manage a fund of funds with the belief that equities as an asset class will always increase in value over the long term. Everything that we do is based on that principle. We believe that equity markets allow investors to place capital at risk, put that capital in the hands of entrepreneurs, who create businesses that employ people and service their clients. That process is a win-win for everybody if successful, and in line with that philosophy, we are quite negative on hedge funds because they don't create real wealth in the way long-term equity investments do.

We think that, more often than not, markets are very efficient in the way they allocate capital. That's why over long periods of time, they generally outperform most other asset classes. Of course, there are periods when we do see capital allocations in the wrong areas. During these periods we attempt to identify more defensive assets to shift our strategy in this direction. Whilst over the short term almost anything can happen, in the long-run, we believe that equities will always go up and that's our fundamental philosophy.

Q: Do you have a preference for certain types of stocks? Is the dis-

inction between value and growth important for you?

A: We spend a lot of time analyzing the global economy trying to work out where we see opportunities. Sometimes we do consider growth and value styles, but every opportunity that we evaluate is for growth. I believe that the distinction between growth and value is often made by the marketplace; the only distinction that we make is between low-risk and high-risk investments.

We're always looking for sectors that we believe have an advantage. It may be something that's been overlooked by the market and has a trading advantage that can generate profits. We're looking for opportunities and we follow a wide universe as things can change rather quickly. What we might be interested in today may not be the same tomorrow.

For example, in recent years we've been very keen on following inflation. We've watched how inflationary pressures are growing within the economy. We identified areas that we believe have an advantage and areas where we see a problem, and we structured our portfolios to benefit from that situation.

Q: So you do pay a lot of attention to the macroeconomic developments, is that correct?

A: Following the macroeconomic pic-



TOBY RICKETTS joined Margetts in 1994 and is now widely regarded as an industry expert in portfolio management. He performs numerous speaking engagements each year, including PIMS 2001 (on board Oriana) and the Institute of Financial Planning Conferences 2002-2003. Toby is a regular entrant in Professional Adviser's 'Hot 100' list of fund managers and achieved the Number 1 place for Margetts as the top group offering fewer than 15 funds to the retail sector in April 2005. As a qualified stockbroker and fund manager, Toby has a detailed appreciation of changing world economic conditions. As lead manager of the Margetts range of risk rated unit trusts, Toby has primary responsibility for fund selections and the overall Margetts fund management philosophy.

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ture is the vast majority of what we do. I believe that you get a better return from being in the right place and the right fund. Quantitative analysis alone has relatively little importance for us; it is a fairly easy way for choosing funds but generates only a small amount of outperformance if you get it right.

So our choice of funds is determined by our macro view because the performance of the managers depends on the macro environment. There are managers that do particularly well when the markets are moving up strongly. In such an environment we might favor funds that we wouldn't favor in a more volatile environment.

Q: What kind of investment styles do you seek out for the Select Strategy Fund?

A: Our company runs four funds, which are managed with a similar philosophy. The main difference between them is the risk profile of each fund. We base the risk on a scale of 1 to 10 and the Strategy Select Fund is in the 3 to 4 range, so it has a risk profile that's slightly below average.

Currently we seek out funds that generate fairly strong dividends, so we have more income than growth bias. Typically we invest in 12 to 14 funds. At the moment the fund is about 50% in the UK, which is a fairly typical long-term weighting. Normally, we have about 20% in fixed income markets, but right now we have a strong underweight on that with 5% in that market and 15% in cash. The remaining 30% of the portfolio is traditionally spread equally between the US, Europe, and the Far East emerging markets.

Q: What criteria do you follow when choosing the fund managers?

A: We look at how they performed historically but not over the traditional one, three, and five year periods. We take data from periods where we think the market trend changes.

We look for funds that generally outperform when the market is rising and

continue to outperform when the market falls. Of course, the funds that can perform in both environments tend not to be the best fund in either environment. But we look at the ratios and how they're doing on both sides of the curves and those are the funds that we tend to purchase for the long term. But it is not just the performance that matters. We spend a lot of time talking to the fund managers and trying to understand what they're trying to achieve in their fund.

Q: When you talk to the fund managers, what qualities do you look for?

A: It's a difficult question but we'd look for managers who are passionate about what they are doing, who really have a grasp of the value of the market they're investing in, and for managers who give you confidence that they can add value to the portfolio. There are a lot of different managers with different styles, so there's no golden rule, but we're looking for people who give us confidence. We also look for managers whose portfolios are in accordance with our top-down view.

In terms of performance, consistency is the key criteria. Occasionally, you'll find a fund whose annual numbers look good just because of one month of good performance, and I have no interest in such funds. We don't want managers who are gambling, even if sometimes a gamble pays off. We want managers who are consistently adding value, probably a small amount of value over the short term, but the cumulative effect over long periods can be quite impressive. So the consistency of outperformance is one of the most important things for us.

Q: Do you look for firms of certain size, with a certain number of people or years of existence?

A: Not really. The more people involved in the decisions, the less interested we are in the firm. We like to find people who have autonomy and are able to make decision quickly. We don't think

that the firms run by a committee deliver as good results as those who are backed by one or two individuals. The size of the team is not really essential but we'd rather have a small team and we prefer small firms.

However, we have to avoid very small firms because we can't hold too high proportion of anybody's fund. So we have to ensure a minimum size for liquidity reasons because we need to know that if we want to sell it, that won't cause any problems for us or for them. Our limit is 10%, but in reality we wouldn't hold more than 5% of any fund.

Q: Can you describe the 14 strategies of the funds in your current mix?

A: We differ a lot from what you would call a traditional growth portfolio. The main holdings, or 50% of the fund, are within the UK, so we have seven UK funds. At this part of the cycle we aim to provide more stable performance, so the majority of them are managers who pick out stocks returning high dividends.

We feel that's the right strategy for this environment because when interest rates rise, a lot of people become more defensive and will look for companies paying dividends. We have a few European funds, mainly income oriented, and that's a continuation of the UK strategy.

We have a big overweight in Asia because that's one of our preferred investment areas at the moment. As there's strong correlation between the US and the Far East markets, currently Asia looks like a better investment to us. With the US being heavily in debt to the Far East, we believe that this is the right type of environment for holding Asian stocks.

Q: Since you have seven managers in the UK, do you care about overlaps and being heavily invested in certain stocks?

A: We absolutely care about overlaps because the reason for holding seven funds is diversification, so we try to avoid combing funds with similar styles. For instance, one of the funds is a purely mid-cap fund and we have only one mid-cap style fund in the portfolio. Two of the funds are income funds but they have quite different approaches to that market. We also have a special situation fund, whose turnover is very high and is looking to profit through a trading advantage rather than through a long term 'buy and hold' structure. But all the UK funds to some extent still correlate with the FTSE All Share Index. So whatever funds you've got in the UK, to some extent there's going to be an overlap.

We measure our performance against the Investment Management Association Balanced Managed Sector.

Q: What is your sell discipline? How do you decide to sell a fund?

A: There are two main reasons for selling a fund. We give every fund in the portfolio a benchmark and if it doesn't meet that benchmark, it comes under review. If it's under review for too long, then we'll sell it. So, one of the reasons to sell a fund would be if we don't like its performance. The second reason is if our top-down view changes and makes that fund unusable, even if it is performing very well against the benchmark. For example, we sold a U.S. fund because we had a negative top-down view, not because of the fund's performance.

Every Tuesday we have formal meetings and we always publish the notes on our website. So investors can see what our themes are, how we're implementing those themes, as well as any changes that might affect our portfolios.

There are no hard rules, but if a fund underperforms for a week, we would watch it without mentioning it in the minutes. If it underperforms for more than four weeks, then we make sure

that we understand why and, more often than not, we'll sell it.


Q: What type of risks are you cautious about and how do you handle them?

A: Risk is always a difficult question in terms of what it really means and how best to manage it. We believe that the main risk is losing money in absolute terms. Sometimes managers think of risk in terms of performance relative to the market, but a client may not see it that way. Even if you lose 10% when the market loses 20%, all that a client knows is that he has less money than originally invested.

We consider the lowest risk to be cash, because cash can't lose money. Bonds are the next least risky investment, then probably would be the utility companies, which tend to give high dividends and are less sensitive to the major market indexes. Next are the large cap stocks in the U.K. and the U.S., and then in Europe. The highest is the risk in the emerging markets.

Calculating the risk on this basis, we then select the funds that are slightly below average on that scale to keep the overall fund risk within the 3 to 4 range on the scale of 1 to 10.

Q: What do you think differentiates your fund from your peers?

A: Our company has a long history in the markets, going back to 1843 and the foundation of the Birmingham stock exchange, as well as experience as independent financial advisors. In 1992 we began developing our own products instead of using third-party products for our client base. Then we started distributing the funds nationally through a variety of independent financial advisors. Now we do very little direct client work as we've become providers to the IFA community, and we focus on the core aspect of managing and designing the product. But because of our IFA background, it's easier for us to understand why the products would appeal to the IFA community and their clients. 

Margetts Select Strategy

Symbol	GB0006584097
Fund Type	Unit Trust
Website	www.margetts.com
Address	Margetts Fund Management Ltd 6 Sovereign Court, Graham Street Birmingham B1 3JR
Tel. No.	0044 (0)121 236 2380
Inception	20/03/1995

PORTFOLIO

Total Net Assets *	GBP 835.33
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INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	GBP 1,000
Min Subsequent Investment	N/A
Min Regular Investment	GBP 100
UK ISA	YES
CAT standard	N/A
UK PEP	YES

RETURNS VS. FTSE ALL SHARE CR INDEX

	GB0006584097	Index
1 Year (Cum.)	19.92%	17.87%
3 Year (Ann.)	14.68%	13.90%
5 Year (Ann.)	10.43%	5.41%

RETURNS VS. IMA UK EQUITY INCOME

	GB0006584097	Sector
1 Year (Cum.)	19.92%	15.96%
3 Year (Ann.)	14.68%	12.80%
5 Year (Ann.)	10.43%	7.04%

FEES AND EXPENSES

Initial charge	5.00%
Annual charge	1.475%
Exit charge	0.00%

PORTFOLIO MANAGER

Toby Ricketts	01/03/1995
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* millions

Data through: 31/10/2006

Source: Company Documents; Lipper

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