



Majedie UK Equity Funds – overseas stock inclusion change

This note is addressed to the Officers of the Audit & Pensions Committee of the London Borough of Hammersmith & Fulham Council (the “Officers”) in respect of the London Borough of Hammersmith & Fulham Pension Fund (the “LBHF Fund”).

Background

The Fund has had an active equity mandate in place with Majedie Asset Management (“Majedie”) since August 2005. This consists of holdings of the UK Equity Service Fund, the UK Focus Fund, and the Tortoise Fund.

The UK Equity Service Fund and the UK Focus Fund (the “Funds”) invest long only in stocks listed on the FTSE All-Share index. In March 2012, Majedie informed the Officers of their intention to amend the stock restrictions such that up to 20% of the UK Equity Funds may be invested in stocks not listed on the FTSE All-Share index. The overall return target will be maintained at FTSE All-Share + 2% p.a.

This note provides the Officers with the reasoning behind this move, details of Majedie’s ability and experience in investing in overseas stocks, and P-Solve’s view on the proposed change. P-Solve have discussed the proposed change to the Funds with Majedie and our views are based on the outcome of these discussions.

Rationale for the change

The main driver for the change is because Majedie believe that adding a handful of overseas shares in certain defined circumstances is an opportunity to improve the risk/ return mix for the Funds.

They state that certain sectors of the FTSE index are too concentrated or thinly populated. For example, the Pharmaceuticals sector, which is dominated by GlaxoSmithKline and AstraZeneca, and the Technology sector, where ARM Holdings is the only significant stock. This limits the manager’s ability to invest in certain sectors which they believe will perform well without taking a large amount of specific stock risk.

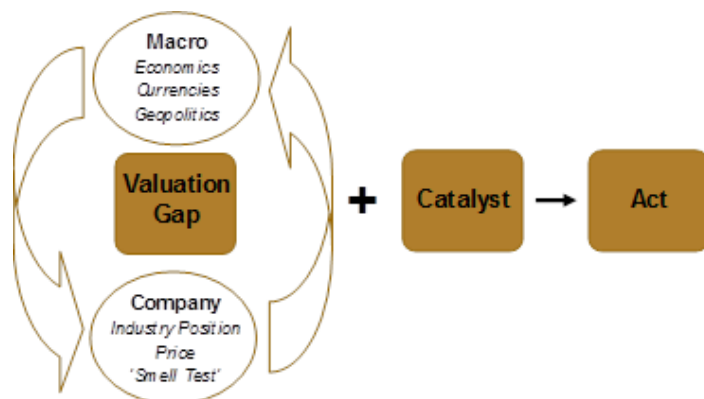
By permitting up to 20% of the Funds to be invested in non-London listed stocks, the manager will be able to diversify this specific stock risk. It will also offer the manager the ability to invest in overseas stocks where they believe the opportunity is better.

Majedie will continue to invest at least 80% of the Funds in London-listed stocks. The remainder will be invested in cash and stocks not listed in London. This will ensure that the Funds continue to be UK equity funds at their core, but have the ability to invest in a wider universe to implement their themes. Majedie noted that in order to be classified as a UK Equity Fund by CAPS Mellon, a minimum holding of 80% in London-listed stocks was required. Majedie also mentioned that one of their clients requested this change five years ago. At the time they accepted it in principle, but were concerned to build the capability before executing on it.

Process and Experience

The main investment process will be unchanged, whereby their research process is designed to be efficient, and the Funds are split between four managers. Majedie state that part of their research process already involves analysing overseas stocks. This is necessary for them to understand sectors as a whole and the relative merits of stocks; this is particularly relevant as London-listed stocks have exposure to a wide variety of foreign markets.

As a reminder, the Funds adopt a three stage process. The following summary, sourced from Majedie, provides a reminder of the investment process used.



"Finding the valuation gap' entails in-depth company research and assessing the impact of the economic and geopolitical climate on the market, industries and individual companies. We are looking for those shares whose price is jarringly below the real, industrial or long term worth of the company. We scrutinise the current price of a company's share in a market context, the dynamics of its industry, and its strategic positioning within that industry. External research is sourced to help us analyse the global economic and geopolitical environment, which in turn allows us to identify pressure points and long term themes that affect our stock selection and overall portfolio balance. In this wider analysis, company research itself provides a useful aid to inform and modify our view of the macro environment.

'Identify the catalyst' is our search for the agent that will narrow this fundamental gap – such events could be meaningful director share buying or a strategy change. A catalyst ensures that the momentum of performance is kept high.

'Act' is our conviction to get good ideas into the portfolio fast. The individual accountability that flows from our innovative portfolio structure (see below) and the ability of a small team to test ideas for traction ensures the shortest possible time from well researched investment idea to transaction. As mentioned above, because we are small, we have no liquidity issues getting our transactions into portfolios quickly, a significant competitive advantage."

Matthew Smith, one of the managers for both of the Funds, also manages the Tortoise Fund. This fund has an allocation of up to 45% in overseas stocks. Whilst the styles of the three funds are different (UK Equity Service Fund and UK Focus Fund are long only, Tortoise Fund is long/short), we can see that there is already experience in researching overseas stocks.

Furthermore, Majedie appointed a Global equity team in August 2010. This team will provide input in the discussion process, though the Global fund has a buy-and-hold style compared to the rotational style of the UK Equity Funds used by the LBHF Fund. It should be noted that the Global equity fund team will not be involved in the decision-making process, and the UK Equity managers will be fully responsible for any overseas stock investment.

P-Solve's view

Based on our discussions with Majedie, we are supportive of this move by Majedie. They have already demonstrated an ability to generate strong performance, and we believe they will now have additional tools to provide them with more opportunities to continue generating the required performance.

However, the UK Equity team, who are responsible for deciding on what overseas stocks to invest in (if any), does not have a specific track record in overseas investment. We have therefore been unable to perform a full due diligence on their ability in selecting stocks in these markets. There are differences associated with investing in local markets and overseas markets, such as currency exposure, accounting standards, and legislation; these will have to be factored into the decision-making process. We take comfort in the fact that Matthew Smith already has experience in these markets and the team & process will remain unchanged.

We would propose monitoring Majedie more closely once this change has been made to give ourselves comfort in their ability to select overseas stocks.

P-Solve
April 2012

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