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[INTRODUCTION]
Ryan Lightfoot-Brown (RLB): I'm Ryan Lightfoot-Brown from FundCalibre and welcome to the Investing on the go podcast. We're joined today by Chris Kinder the Elite Rated manager of Threadneedle UK Extended Alpha fund. Chris, thank you very much for your time today.

Now, you make money from rising share prices and from falling share prices. Can you explain how this is possible?

[INTERVIEW]
[0:19]

Chris Kinder (CK): Yeah, absolutely. Thank you so much for having me on the podcast.

First and foremost, the traditional way of making money, as you know, is from rising share prices by investing in companies. Where do you think the fundamentals look good? [Where's] the valuation attractive? And then owning them. That's, that's a pretty standard, well-understood way of monetising the stock market. Perhaps the more interesting thing that we do is the process of short-selling whereby we are able to benefit, to a smaller degree if we're honest, it's a relatively small part of the portfolio, but we are able to create short positions which benefit as share prices fall away.

RLB: And with the long, sort of the ones that you're holding for the long term, being those that make up the most of the portfolio, can you explain what you sort of look for in those sort of companies that you want to invest in?

CK: Yeah, absolutely. It's a very, I would call it a very traditional fundamental based investment process where, at our core, we're looking for decent quality businesses - quality as defined by returns, cash flow, balance sheet strength, and then management who we sort of have a good dialogue with and a good relationship with - at decent prices. So good companies, good prices and then long-term ownership. That's often, that's always been, I guess the key to what we've done.

[1:30]

RLB: And, conversely, what sort of traits do you look for in the companies that you're shorting?

CK: Yeah, sure thing, it's very much the reciprocal or the inverse of that process whereby we're looking for generally speaking, quite expensive shares. So, one of the, one of the key determinants of what we do is that we have to believe that the shares are overvalued. So, if the sense of an overvalued share sense of a highly consensual share where we feel that that the owners are very happy, very complacent, they've done very well. Then sort of the idea is of a lazy consensus, so expensive shares that are, that are well-owned and very well liked. And yet this is really important in shorting - and we're very focused on this — where there is something going wrong with the company. So, something that is going to disturb the status quo, it's going to sort of change people's opinions, and that could be either something internal or something external.

So expensive, consensual, yet deteriorating. So, it's quite sort of a, it's a much harder filter to get through to be sure we have much fewer short positions.

RLB: Okay and do you have an example of one of those that you've had recently?

CK: Yeah, I mean a successful one over the last year has been a company called Metro Bank, which was a reasonably high-profile challenger bank that they had some troubles throughout 2019. And I think when I reflect back on what we did well with that position, that was a very clearly analysed view. The shares, as I said, were extremely expensive relative to the assets of the company. There was clearly a level of complacency - among the people who held it - about the nature of the risks the bank was taking. Clearly there was a lack of understanding about the view of the regulator with regard to that bank. And our view was that when these risks became apparent, there could potentially be quite a meaningful fallout, a) in terms of the share price but also in terms of the capital position of the company. And that was revealed to have been inadequately capitalised. Hence the rights issue.

RLB: And that’s something you identified as well, their capital positioning, because that's what really pulled it down the first time.

CK: Yeah, it’s one of these things when shorting, the way I always think about it, it’s all about asymmetry. Because obviously it's a position you take, it's possible that one can lose money in a short position, of course it is. But we're always debating this question, if I'm wrong, how much would I lose? And if I'm right, how much am I going to make?

So, I didn't know when they were going to need to be recapitalised - I just thought there was a fighting chance of it. I thought there was a reasonable chance - when you looked at the nature of the risk they were writing - how the business didn't generate any capital organically and it was one of the things if they have to raise capital, there's real trouble here. And then that's how we sort of appraise all of these things, it's kind of a risk/reward.

[4:06]

RLB: And sort of towards the back of last year, over the last three and a half years, Brexit's been the main thing affecting UK equities,

CK: Yes it has.

RLB: You being a UK manager yourself, has it created any more or less of these sort of opportunities for you?

CK: Yeah, both on the long and short side actually our view basically since Brexit happened, was that, well that there has been and still remains to a degree, a very significant valuation discount in the UK for political risk. And so, I mean, clearly I'm not sitting here in denial of the political risk, that has been created by Brexit. Clearly a big chunk of that political risk has been removed by the formation of a government with a proper majority who does seem to be able to 'get things done'— I say that in inverted commas, don't really know. But at least they have the ability to get things done and they have a majority to get things through parliament. So as long as that discount persisted, we've been quite constructive on the UK domestics actually, made some really nice investments and again, that really suits my sort of philosophy. Everybody hated the UK, real deep discounts of valuation, and actually some really quite good companies and the economy as we all know is held up pretty well. So ,we've been constructive on the domestics, which has been great.

[5:22]

RLB: Now you are a growth manager, but you sort of spin off a bit of a natural income anyway, how are you doing that?

CK: Yeah, I mean there's a yield to a degree. I've always felt that, certainly my colleagues here and I have always felt that, income does form a reasonable percentage of the total return from investments over time. You know and so to ignore the ability of these assets to generate income, well it's cutting off a source of return in my view. So, income's important. Absolutely.

But it's, for me it's not so much buying the yielding shares, it's appraising. We always talk about the quality of the dividend policy. The dividend policy is obviously a function of the underlying company, the balance sheet of the company, the capital allocation decisions the company makes. And it may well be that when one considers it a high dividend yield is actually a pretty damning indicator. What you want is a reasonable dividend yield growing, paid by a company that is a solid going concern.

[6:23]

RLB: I'm going sort of big picture now, we touched a bit on of UK and the politics, but what's your outlook for UK equities for the rest of the year?

CK: It's okay, it's reasonably constructive. I mean it's always a difficult question to answer, I'll be the first to admit. My stance for many years is what you would call cautiously optimistic. That kind of suits me as a person. So, you know, I acknowledge it's always, and it's always very difficult to make a constructive case to assets when even though we've lagged global markets, I mean most of the funds in our universe are at all -time highs. But I still feel that it is possible to make decent total returns going forward. I think when I look into the underlying situation within the UK market, we have an astonishing, what's the word, bifurcation between the stuff that is very popular that's doing very well, that is outrageously, dare I say it, expensive relative to history, but in many cases being justified by the strength of the economic proposition these companies offer.

And on the other side of the boat there are these chronically under deeply undervalued looking shares where there are questions around them as a going concern. So, the scope to make money long and short I think is really great. There's a very, very diverse opportunity set in the UK market. And I guess it's just up to us to sort of get into the weeds, pick the stocks, and let the stocks do the work really. So, I think there are opportunities there. At the headline level, we've continued to be buffeted by political risks. The pound will go up and down. But bottom-up is my world and I see plenty of opportunities.

RLB: Fantastic. Well, Chris, that's been really interesting. Thank you very much for your time today.

CK: Pleasure, thank you very much.

RLB: And for more information on the Elite Rated Threadneedle UK Extended Alpha fund, please visit fundcalibre.com and don't forget to subscribe it to the Investing on the go podcast.