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[INTRODUCTION]
Darius McDermott (DM): Welcome to the Investing on the go podcast from FundCalibre. I'm Darius McDermott and I'm really delighted to be joined by my friend Henry Dixon from the Man GLG Undervalued Assets fund and Man GLG UK Income fund, both of which are Elite Rated by FundCalibre.

Henry, we've known each other a long time and, you know, you've always promoted yourself as a value manager. But value has been out of favour for a long time, yet you still managed to do pretty well, particularly on the income fund, which has, you know, been very top quartile since you took it over. How so?

[INTERVIEW]
[0:42]

Henry Dixon (HD): Well thank you Darius. Look, we definitely do portray ourselves as value managers, but we're not just value managers and we definitely want to be very aware of a quality factor. That is: a very strong balance sheet, as defined by modest gearing and indeed, in many cases, net cash. And then further to that, we also concentrate on an element of momentum, specifically earnings momentum. And we hope, therefore, that if we do at the outset have value, but we can compliment it with a good balance sheet and also earnings momentum, then in many instances we can screen out some of the value traps that have be so damaging these last few years and just boiling it down to I think the very simple conclusion. We really do feel if we can get cheap portfolio together at the outset, with a great balance sheet where earnings can grow, then we have a really strong possibility of outperforming.

DM: And I presume you don't have hard and fast balance sheet rules, it's company dependent or sector dependent. How do you decide when a company's got too much debt or actually needs to be net positive?

HD: Yeah, great question. I think firstly, you would look at companies versus a long history and then you can also come up with a lot of other measures around their financial stability, which might be margins relative to the long run for example. But at the end of the day, I think we'd love to keep talking about what we call the balance sheet option. And if companies are net cash, we find in some instances they have the ability to basically redefine their prospects relative to maybe the wider economy - that might be doing a very attractive [inaudible] deal, might also be a buyback if times are difficult and their share price is low. And then also repeatedly growing their dividend, which is also usually very well-rewarded. So ,we keep trying to come back to companies that have that balance sheet option.

[2:25]

DM: Now you're a UK equity fund manager, but you can go “off-piste,” so to speak, and invest in equities outside of UK listings. How often do you tend to do that? And have you got a recent example of one that is either in the portfolio today, or working, or not?

HD: Yeah, so it's pretty rare where you wouldn't want this to get to more than 10% of the fund. Our rulebook for investing in Europe, and it is only Europe for us, so we like to have sort of comparable examples across maybe Europe and the UK that we can compare. And the only reason we'll invest in a European company over a UK company is if we think it is providing us something from a valuation perspective that we cannot get in the UK.

So maybe if I rewind a year, and I'll give you an example of two pharmaceutical companies. One is AstraZeneca, which I think will be known well by UK investors and then one I think will probably also be reasonably well-known, but European listed - specifically Swiss listed - which would be Roche. But a year ago, Roche was on 14 times with the balance sheet transitioning towards net cash. AstraZeneca was on over 20 times with a balance sheet that kept seeing its debt pile continue to grow. So, I hope very clearly there investors can see that we felt we got valuation leg up and a balance sheet leg up by visiting the European company and not the UK company. So, it's all really in the quest of improving the metrics within our fund to find better value and better balance sheets in Europe.

[3:48]

DM: And with respect particularly then to the income fund, you allow yourself a little flexibility again from time to time to actually buy a company’s bond. Could you outline what set of circumstances that you look at the bond and again, give us an example of the type of bond that you have had in the portfolio?

HD: Yeah, so our check list for being in a bond is threefold. We must have that listed equity that we can analyse, we must be of the view that we think there is equity value in that equity issuer. And the final and the most important point is we must be able to express that view of equity value by going up the capital structure when more safety, if you like, cause you to go up the capital structure into the bond, relative to the equity. But critically we can't just accept an attractive running yield from a coupon. What we also want to have is attractive capital upside as well.

So, we do get alerted when UK listed plcs their bonds fall below 90 in the pound. Because if that bond can transition back to par, then we have that lovely double edge sword of attractive capital upside and also income. An example that I'll give you, which probably two years ago would be Prudential bonds, but there was a very sort of localised event particularly the financial portion of the bond market whereby we'd had rate rises at the start of 2018 ,we'd had fears over the Italian budget, and there it was also quite a localised event in the market with regards to some funds in liquidation mode, GAM for example, so this confluence events did take…

DM: So it was making the bond market less attractive and then hence the yield and the capital upside more attractive.

HD: Exactly right. So yeah, you can respond to those types of opportunities and hopefully be quite front footed as a value manager. So the bonds that we invested in at that point in time would be Prudential bonds. They were trading slightly below 80p to the pound. And about 18 months later, those transitioned back from sort of high seventies, eighties towards par. So a very attractive, 25% - 30% total return. And then also the running yields just approaching 6% as well. So lit ooked like a fabulous combination of risk adjusted return, and a good yield to us.

[5:56]

DM: And how often have you used bonds as a rough percentage of the fund, the income fund specifically since, since you took it over?

HD: Yeah, there’s been two moments where we have found quite a bit of opportunity in the bond market and at those points in time, the bond weighting is typically got about 6% to 8%. And the two moments specifically where we found quite a bit of opportunity in the bond market would have been in 2016 and the wake of fears around the oil market. For example, some quite well know oil companies, lots of their bonds got to 70p in the pound. For example, we might reference Tullow Oil, for example, where we saw an amount of equity value but not enough to encouraged us to own any equity. But we definitely felt confident in buying into the bonds.

And then the second period of time was that confluence of events I just mentioned with regards to financials in the middle of 2018, which was rate rises in America, concerns around the Italian budget and a more localised event in the UK bond market.

[6:52]

DM: Now, we know that the yield on the UK stock market is at a very handsome level versus a) its own history, but also against the government bond, and your fund is on a premium yield yet again to that and sort of in around the 5% - 5.5% region, that seems high, how quite so high? And is that sustainable?

HD: So, from our perspective, we definitely feel that a really good process for an income fund is to grow its yield every year. I don't think it needs to grow a huge amount, but we definitely target that sort of 5% dividend growth every year.

DM: So that's dividend growth on top of the actual headline rate as we have today?

HD: Yeah. Given the market move that we've just seen recently, yeah you know, the yield is now starting to bear down on the best part of 6% but we absolutely think that, as active managers, you have that ability to rotate out of situations where the yield has fallen and you've harvested some quite good capital upside. So, for example, we've definitely seen some of our real estate names over the last 18 months really start to migrate up much more towards fair value, so yields have normalised about 6% and there were sort of 3.5%, 4% and then you use that capital to pick up other areas that you are currently seeing some opportunities.

So, for example, come on too things like food retail where yields are nearer 7%. So it’s that constant active approach I think of really, you know, moving capital out of over those areas that have done well, being brave in the areas that’ve done badly and, from that perspective ,with an active approach, I think we are in the bit of, do you have the ability to grow our dividend when overall it's increasingly the case that the overall dividend growth of the market is becoming more anaemic?

[8:38]

DM: Well it's as if we had practiced this then because that leads me absolutely into our next question, which is the view for the outlook for UK plc or the, you know, the FTSE 100, the FTSE 350, because it has had this premium market. How does dividend cover look? Are you worried? Are you seeing so much choice? What's going on?

HD: Yeah, so currently we've got dividend cover would definitely be below 2. It'd be about that 1.8 level and long run average for dividend cover is definitely above 2, so we're definitely 20% below normal on average. And then combine that net debt within the market has also grown quite consistently since the crisis, [inaudible] debt is cheap. But as I say, we're always a little bit cautious if debt’s going to grow consistently.

I don't think therefore there was any coincidence really last year saw some quite notable dividend cuts, things like Vodafone, Centrica, M&S, and over all dividend growth in the market last year was a very, very modest indeed, very early single digit. And actually it's forecast this year to be actually slightly negative, to some extent I think sterling will play it's part there given how depressed sterling got with regards to Brexit fears and general election fears towards the back end of last year.

So, in aggregate I’d say the outlook for dividend growth within the UK market is not a strong one this year. So I think we've got to be aware that it's going to be very modest growth - if growth at all. So that really brings back quite a big emphasis to us as active managers to find those opportunities where we think the balance sheets are strong, the dividends can grow, and then also with regards to price performance, we need to be responsive to the areas that have done well and rotate and be brave and rotate into those areas that’ve done badly and that’s the active approach. And that's absolutely the approach that we'll continue to use.

DM: Henry, that’s fantastic. Thank you so much for your thoughts on particularly the Man GLG UK Income fund. For more information, please don’t forget to subscribe at fundcalibre.com