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Please note that these are unprecedented times and markets can react very quickly to news. The views expressed are at the time of recording and could change.

[INTRODUCTION]
Darius McDermott (DM): I'm Darius McDermott from the Investing on the go podcast from FundCalibre. Today I'm joined via Zoom video conferencing with Andreas Zoellinger, who is the Elite Rated manager of the BlackRock Continental European Income fund. Andreas good morning, how are you?

Andreas Zoellinger (AZ): Good morning, I'm doing very well thank you. I'm in my home office, at home. Like most other people at this stage we're working from home at BlackRock, but so far no complaints - it's all working very well.

DM: Well thank you very much for taking the time to come and podcast with us in these extremely volatile markets and unprecedented times. And, as I say, this is my first, not face to face podcast, so we're going to have a stab at a few questions in and around dividend investing, obviously with a European focus and see how we get on.

[INTERVIEW]
[0:56]

DM: So look, maybe we'll jump straight in. Yields have been all over the place, particularly in the UK. Have we seen the yields on European markets moving in the same sort of magnitude as in the UK stock market?

AZ: Oh, we've definitely seen a lot of volatility over the last week and month and what we always need to remember obviously is that the dividend yields are functional, first of all, the dividends that are being paid in the market, and then second, those at the market level.

So, whenever we see a lot of volatility in the market level, by definition, we’re also going to see a lot of volatility in the underlying dividend yield. And it's been astonishing over the last few weeks - and I'm talking about the month of March 2020 - how quickly the market was pricing in a very bad recessionary outcome from the Coronavirus. And obviously dividend yields have reacted to that volatility too. So, on a day to day basis, they have been very, very volatile in Europe too.

DM: And it is so volatile, what's your view, do you think we're getting, we might get a bit of a settling down in markets or do you see that volatility continuing?

AZ: I think in the very short term, volatility will continue. I very much believe we’re in what I would call the bottoming out phase in the market. That usually means a lot of volatility, but then I generally think on a 12 to 24 month basis we will come out of this crisis. I think this crisis has thrown up a lot of very, very good investment opportunities for bottom up investors like us. We’ll follow our investment philosophy, we’ll follow our bottom up investment process and we’re really working through all the investment opportunities we’re seeing in the market at the moment and particularly from the income side of things. Quite a few of the sectors in the European markets have been hit quite hard in terms of they've been going down a lot. And we're really trying to identify the companies where we think there's some good opportunities, some good dividend yields and we're looking forward to buy these companies at valuations we haven't seen for a long period of time.

[3:17]

DM: Well let's get straight too dividends then, and the fact that we're seeing a number of companies in the United Kingdom that are either postponing or actually cutting their dividends. Are we seeing those same sort of factors in play in the European equity markets?

AZ: It's a very similar picture I have to say and, in many European countries, we have seen government explicitly telling companies more or less not to pay dividends, whenever they receive State aid. The ECB [European Central Bank] as the bank’s regulator has also come out and told banks again explicitly not to pay dividends in this kind of environment. And from our perspective, I think this is absolutely the right thing to do.

The last thing we want - even if it's painful in the short term for the companies we are holding in the portfolio and they have to cut the dividend - the last thing we want is companies paying cash out at the wrong point of time and increasing leverage on the balance sheet. Because all of these things mean even more volatility for the share prices going forward and potentially also capital losses. And the other dimension to that is obviously that none of the companies that receive State aid - and we have a few of them in the portfolio - should pay dividends because we don't want them to get into trouble with the government.

I don't think it's the right thing to do if one receives State aid, to pay a lot of money to shareholders. But again, this is a short-term interruption when it comes to dividend payments. I have to say, in our concentrated portfolio of 40 companies, yes, we had a few cases where dividends have been either delayed or suspended. That means they can still potentially get paid towards the end of 2020. We obviously don't know that yet, but in aggregate, while dividend growth for our strategy most likely will be down in 2020 compared to 2019, I think the impact is not quite as severe as for the wider market where, as there are whole sectors like the banking sector, are not allowed to pay any dividends whatsoever.

[5:33]

DM: Yeah, I mean I think listeners to the podcast and investors or potential investors in the fund would perfectly understand, that dividend growth is certainly far from our minds, as it would be on in normal market conditions.

I think you touched on it, but maybe we just, is there any specific countries or sectors that have been hit badly in terms of sectors, not necessarily on your strategy but maybe just broadly in the European market?

AZ: Yeah, we tend to look at it more by sector than on a country level, you always have some comments from single politicians, I think the French government has been quite vocal in saying that no company in France where the government has a stake in should pay a dividend this year. But we tend to look at it more from a sector perspective. And the bank sector I mentioned already definitely in the eye of the storm. And then there's some sectors which seem to be much better protected. So if we think about the healthcare sector, if we think about food and beverage companies, about tobacco companies, we don't have that many here in continental Europe, but also some of the higher risk sector, like the insurance sector for example. A lot of the companies we're talking to and we talk to a lot of them obviously at the moment, are reassuring us that they fully intend to go ahead with a dividend payments.

[7:03]

DM: And another thing which I think is fractionally different in the European market versus the UK stock market is the frequency with which dividends are paid. I understand that that's less frequent in Europe, is that correct? And how do you see that impacting as you already mentioned, we might get some postponed, dividends may be paid later on in the year?

AZ: And I think it's absolutely correct, in continental Europe we do have a very strong bias towards the second quarter, the period between April and June, where roughly two thirds of the total dividends are paid and the other quarters are not quite as important. What we've also seen at the moment is that a lot of companies are postponing their AGMs [annual general meeting] because there are a lot of restrictions at the moment in terms of the amount of people that can gather in one room. There are ways around it. One can do virtual meetings, virtual voting, but a lot of companies, and again I think this is very sensible, have decided to postpone the AGMs more towards June, July or even longer. So, the uncertainty about which dividends will get paid is very high at the moment. I would think as we'd come out of this crisis, a lot of the companies towards the end of this year or as a catchup payment, maybe at some point of time in 2021, will definitely look to resume the dividend payments again.

[8:30]

DM: Yeah. So, it's a big quarter ahead I suppose as we just set into April. How those companies actually deal with those postponements or indeed dividend cuts. Just broadly then on your strategy, can you tell us and the listeners, what sort of companies you look for, what characteristics is it that you traditionally go for in this [BlackRock] Continental European Income fund?

AZ: In general, I'd say we have some very well-defined stock selection criteria. We are bottom up stock pickups at heart. What we're looking for are really quality companies with a differentiated business model, driven by a strong management team and adequate balance sheets, a good dividend level, and also long-term dividend growth opportunities.

And we've been running this strategy since 2011 with good success I think in terms of delivering on the objectives, there's always been volatile periods in the past, but the one thing that has always helped us is really sticking to our investment process our philosophy, sticking to these bottom up stock selection criteria, and this is exactly what we're doing at the moment also. One important feature of our strategy is also resilience, i.e we want to lose as little money as possible in absolute terms when the market goes down, capture as much of the upside as possible, and again we've been very clear over the last few years that in very uncertain times, like we are at the moment, resilience of the portfolio to protect the value of the underlying assets and we're importantly also sticking to our bottom up fundamental conviction, always takes priority compared to delivering a dividend growth for the sake of it.

So what I mean by that is that we're not going to do any changes in the portfolio that would go against our fundamental conviction just to make sure we can deliver dividend growth or sell a quality businesses at low prices because they decide to suspend the dividend. That's definitely not something we're going to do.

DM: No but you're still going to pay a premium income [compared] to the market because clearly dividend cuts won't just happen for your strategy, they will happen at a market level as well.

AZ: I think that's a very good point. The premium over the last few years has always been quite significant for us, we're talking 40% to 50% premium over the net dividend yield of the underlying benchmark. Then as I mentioned earlier, yes obviously we have companies in the portfolio where the dividend is delayed, suspended, canceled, whatever we want to call it, but compared to the wider markets, I think we're holding up reasonably well, so I'm quite confident that we're going to have another year of a significant yield premium. Even if in absolute terms the dividend growth for year over year might be down.

[11:30]

DM: Well that's excellent Andreas and that is of course what I suppose investors look for from an income strategy. Maybe just then in closing, and I know we sort of touched on this, but given the volatility in the market and in fact whatever it is it's so hard to keep up whether we're down 20% or 30% at the moment.

AZ: I know.

DM: Are there any sectors, that have come back to you that stocks either you didn't own that you really like or stocks that you really, really liked and are now 30% cheaper and you're adding to? I know you won't mention stocks specifically, but maybe sector examples or anything where there's real attraction for you today.

AZ: I think every crisis has it's opportunity and particularly now that European markets as we speak, are down 25%, 30% year to date, and some sectors are down even more, by definition there will be a lot of good opportunities, businesses we're working on. More specifically by sector I think, some of the utilities for example, have not lived up to the defensive qualities over the last month or two, that's where we see some very good opportunities. Equally the insurance sector, which is quite a large weight in our strategy already. I think there are some companies in there which have been punished to a much larger degree than I think is warranted. Again, we're doing a lot of work on that and also on the industrial side of things. I think there's a lot of thinking going on at the moment of how are we going to get out of this crisis? What does government stimulus mean for underlying economic activity? And I can well see a scenario in the next 6 to 12 months view where we'll get more significant fiscal stimulus where some of the industries that are hardest hit at the moment, like travel, like airlines, like construction, potentially will rebound very, very strongly. So we have, some exposure there in aggregate, very little on a portfolio level as you would expect for a more defensive strategy. But these are the areas where we're doing a lot of work as a team at the moment, and I think we're finding some interesting investment cases there.

DM: Andreas, thank you so much for your time this morning and for being Investing on the go’s first online podcast, or over the wires, really think we've made a great effort and you've given us some excellent answers. So thank you very much, Andreas. For more information on the Investing on the go podcast, please subscribe at fundcalibre.com