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[INTRODUCTION]
**Darius McDermott (DM):** Hello I'm Darius McDermott from FundCalibre and this is the Investing on the go podcast. Today our guest is Alex Savvides, who is the manager of the JO Hambro UK Dynamic fund and has been Elite Rated since we launched FundCalibre nearly six and half years ago. Alex, thank you very much for taking some time to come and talk to us in what I know is a busy time in UK equities.

**Alex Savvides (AS):** Hi Darius. Yeah, thanks very much for inviting us. It is a busy time, busy time in UK equities and a busy time in my life having just had a third child, as we were just discussing off-air.

**DM**: Yeah, well congratulations.

**AS**: Thank you.

[INTERVIEW]
[0:44]

**DM**: So here we are. I've seen a headline today which describes it as a Biden bounce, I tend to think it's more of a vaccine bounce that we've seen in equities globally. We've seen a real rotation – actually a violent rotation to favour value stocks. How has your fund done and how do you see the recovery heading into the new year?

**AS**: Yeah, well, looking back at the beginning of Q3 we had to do our update for our clients and it wasn't a particularly good message at that point in time for us. We'd had three consecutive quarters of underperforming the market, but one thing we did say in that slide pack was that you could guarantee that nothing would be the same in Q4. We had an election to look forward to, and even if Trump had romped it, I don't think anything would have been the same market-wise afterwards.

We have still to hear on a sort of UK trade deal. And then we also had the sort of background of the vaccine potentially. So, you know, we were pretty confident in saying that the outturn in Q4 would be better. As it happens, it has been a violent turnaround where the fund is up to a 10%, I think it was up 10% last week in absolute terms.

**DM**: Yep

**AS:** Presented quite powerful outperformance of the market. Maybe 200-300 basis points, but then since the beginning of November, we have turned on a sixpence, again in absolute terms, the fund is up 21% I think if you look at the retail accumulation units. Quite crazy, really. But only because, you know, it was sort of artificially low I think coming out of Q3. You know, we were surprised by the performance of the fund in Q2 and Q4, given the news flow, but the markets were doing what they were doing, and you can't fight that. So, you know, I guess the starting point artificially low Darius is something to say.

**DM**: Yeah.

**AS**: Particularly for a certain cohort of stocks,  I'm sure we're going to talk about that…

**DM:** So you don't feel that because of the quantum of the reversal, you don't think we've missed that bounce? And I hate just calling something a value rally…

**AS**: Yeah, it's a backhanded compliment, isn't it? Damn you for owning something that's cheap.

**DM**: Yeah.

**AS**: No. Do I think it's over? No. Well, I can't call whether it's over or just starting, et cetera. But just a bit of context. Maybe if we think about it as being driven mostly by the vaccine news flow, which kind of links to whether we get a normalisation trade through 2021, confidence comes back and then sort of proper nominalisation through 2022. I think the chances of that have obviously gone up. If we then look at the kind of cohort of stocks that were most effected by what, by COVID-19, I could choose one from my portfolio, a business called Hive, a global events and exhibitions business, on… overnight, business essentially went to zero. Doesn't get worse than that really. You know, I'd say, I'd say that that industry has had it worse than the travel and leisure industry. And, you know, let's provide some context, in two weeks I think that share price has doubled.

**DM**: Yep

**AS**: But if you trace it back to where it started at the beginning of the year and you have to solve for the rest of, you have to adjust for the rescue rights issue, which was inevitable, and the share consolidation, but essentially started the year at six quid, bottomed at 40-something p, sit there at a pound today, and it's still 83%, you know…

**DM**: Off their high

**AS:** You know, we can be dazzled by the percentage increase from the low, and then you forget to look back and see and see where they came from. Does it happen overnight? No, of course it doesn't. The early win, okay we'll get some relief, but then it's a staged process over the next year or so. And there's still more vaccine news flow to come, right? We need to think about that. You know, it's not just these two, I mean the efficacy data, fantastic, right? It's as good as we could have hoped for, but we still need to understand more about how long the antibodies lasts, et cetera, all that sort of stuff. But we still got AstraZeneca news flow to come, we've got Sanofi, Glaxo, both very powerful names in the vaccine market that have been quiet so far, really. With some phase one, two data coming through at the beginning of December. I'm quietly quite competent about that, given their histories with on the one hand, Sanofi's flu vaccine which is kind of the technology they're using, on the other hand Glaxo's adjuvant technology. So there's more to come. That would be important for Europe, I think, just in terms of the ability to distribute…

**DM**: Distribute it.

**AS**: Yeah, exactly. So look, there's potentially more to come, but is this, you know, you can't have two, is it a dead cat bounce? Is it a flash in the pan? Is it, you know, I don't, you know, after all the pain that some cohorts of stocks have taken, I think there's more to it if this is real sustainable news.

[5:31]

**DM**: Before we get into companies and stocks, the other macro headline for UK investors and UK fund managers, of course, is the beautiful Brexit that, I don't know, will it ever go away? We're here, we're coming up to another, another Brexit deadline. What effect do you think that's had on the UK market? And is there anything you can or are not doing in your portfolio to benefit or not from that factor?

**AS**: Yeah it's a curious one. Obviously it's been ongoing for a number of years now. I think just, just tracking a bit, just focusing on the fund for a second, then I'll talk about sort of market conditions. I think we, going back to when that Brexit vote came through in the UK, we were kind of net-short the UK in the way that we construct the portfolio. So broadly sparked a period of outperformance for the fund for a couple of years. And so, going into this year, we had started to build that UK position, obviously I, like other people, thought that the very clear majority that we got for the conservative party at the back end of last year was a precursor to something a little more constructive going on in the UK, but…

**DM**: Can I just interrupt you there, so when you say had built a position in the UK, you're talking about your own company's earnings, or their…

**AS**: Correct, yeah.

**DM**: Yeah

**AS**: Yeah so, I guess you could sort of think about it in terms of their beta to a sort of UK domestic economy. And maybe their beta to the specific Brexit news flow or trade deal news flow as well. But just again, some context I should have said, you know, we started at the time of the 'vote leave'. I think we had about 18% of the fund that you could say was very focused on UK earnings. So maybe 75% plus of their revenue and profits from the UK. And as we sort of entered 2020, that was probably 40%, you know, so kind of it had doubled as an exposure, we're very open with our clients and what our exposure is, but it doesn't leave us kind of 40/60% UK/overseas.

Yeah, it's a tricky one. There is a clear recovery trade, right? Because I think let's look at it from a company's perspective. If you track the Deloitte CFO survey ever since 'vote leave', it has been the number one risk for CFOs of public and private companies in the UK. What will the trade deal look like? And what does it mean for the UK economy? And therefore, they have adopted very defensive investment strategies for their companies. Ie we won't invest, we won't hire that marginal member of staff, we won't spend on that marginal piece of CapEx to try and generate some new revenue growth because we'd rather have the cash in the bank and wait and see.

**DM**: Yeah

**AS**: We then, this year, had the hollowing out of a lot of balance sheets.

**DM**: Yep.

**AS**: With COVID-19 and so that defensiveness has not, it's not going to have a chance to really pay off, is it? If we don't get a good trade deal or we don't get a trade deal, I think I should say not a good one, I don't want to try and prejudge what is, or isn't good. If we don't get a trade deal, I think there are definite negative ramifications depending on what you are, manufacturing services, how much trade you do with the EU, et cetera. And what WTO rules look like for you. You know, I won't go into the intricacies of that, partly because I don't know, and the other half because it's very complex. But you know, I do think that the stakes are quite high. I do think, you know, give it, let's bring it right up to date. So CFOs have been defensive, but then I think a lot of balance sheets being hollowed out by COVID-19 that's a real shame, that does make it more tricky. I do think the news that's being leaked does just guide us towards there being a sort of deal of sorts, albeit a thin one, you know, there'll be a deal of sorts and that can only be good for a recovery trade. You know, that the market was well positioned.

You've seen it more than me Darius, you know, you speak to a lot of fund managers. You see a lot of data, you go to a lot of presentations. The UK has just been non-existent in the investment mindset of international investors for many years, you know ever since Brexit.

**DM**: Yep.

**AS**: Yeah, you can also predate that we had lots of political issues going on. You know, we had you know, we had a Scottish referendum issue in the UK, and I think you could sort of see, you can sort of see the underperformance of the UK relative to the rest of the world, kind of from 2016/15, not really 20- sort of 18 and beyond. So I, yeah, so there's definitely a recovery trade, whether it becomes a "I want to be structurally exposed to the UK now", because the UK is structurally more attractive to me, than say the US or Asia-Pac or Europe, I could definitely see the argument against Europe, possibly even see the argument against the US but, you know, I think that is going to be a very high bar for investors.

[10:30]

**DM**: So let's talk a little about companies, because at the end of the day, you are a stock picker, you are a UK equity fund manager. What are you seeing from the companies on the ground? What sort of differences are you seeing?

**AS**: Well, there's a lot that they have to navigate. Okay. Let's deal with COVID-19. I think, I think what we're hearing from companies is that things have been better than expected. I think government support, I think the way that the economy has recovered through summer in the UK. I think the way that companies have managed, I think the way that banks have provided support to balance sheets they've been part of the solution, not part of the problem this time round, which is fundamentally different to the financial crisis, et cetera. I think you can only describe it - particularly coming out of the first half, so coming out of lockdown into Q3 - and the bounce that we had, plus with some government support behind it, I think we've seen broadly very good news.

Now interestingly a lot of that news hasn't… and across our own portfolio Darius, which is what I focus on most. Undoubtedly, the balance of news flow through Q2 and Q3 was more positive than negative through everything that I just talked about. So balance sheets better than expected because cashflow management was better than expected, earnings better than expected because the bounce back or management of costs was better than expected. You know, and then, you know, having less leverage, I guess, you know, links through to whether you think the shares in issue number is going to be right for that cohort for some companies and having more confidence about that all should lead to ordinarily, a bounce or recovery or move forward in those share prices. And I think what stood out in Q2, Q3 from a company perspective was that we had very loudly and increasingly loudly actually as time went on companies saying that things were actually better than our first thoughts, than we laid out in March, than we laid out in June and yet the stock market was sort of, sort of shrugging its shoulders and saying, so what? You're not in the right factor cohort for me, you're not a growth stock, or you're not momentum stock. You're not exorbitantly expensive. So therefore you're not high quality, which is broadly the same thing. It's just shortcut maths. And therefore I won't buy you. Until I have absolute 100% certainty. And of course we had to face a second wave and what a second knocked down looked like. So the answer to your question Darius, is that broadly, news flow got better all year, yet the market completely ignored it, particularly through Q2 and Q3 and sadly for us that was quite damaging to our returns and annoyed a lot of our shareholders. Out of our control.

[13:13]

**DM**: But… and there is a but, in that last week…

**AS:** A massive but…

**DM**: We've seen some exciting news for investors in your fund or potential investors in your fund. Is you've had a huge amount of M&A - talk us a bit about that, maybe the rest of the world, the private companies is starting to see this value in some really not so bad UK companies?

**AS**: Well look if the stock market isn't going to say, okay we'll rerate you accordingly. Who's going to bridge the gap? And it can only be other companies in a sector that may be a private, perhaps some cash, or it's going to be private equity. And so, yeah, we've had some good news, right? So I've never had this before. So four companies are being bid for in the last 12 weeks. So that's SDL McCarthy & Stone, Urban & Civic, and now Elementis. Three of those are live, two were kind of industry and one definite private equity, the bid for McCarthy & Stone which is Lone Star, that's ongoing. And then the other one, [inaudible], it's The Welcome Trust going for Urban & Civic, but they're partners on a particular project so you can sort of see them as industry slash a bit of long-term capital.

Yeah, look there's a mismatch between the price that private buyers would pay for assets and the price that the stock market has been willing to put on assets. And, you know, if that mismatch goes on for a long period of time, then M&A will only go up. Another point to make is that it was pretty clear to us coming out of Q3 that M&A was picking up in some of the more challenged areas of the stock market. One of the reasons for that is the dry powder that we talked about. The other reason is valuation that we talked about, it kind of, companies are doing better, but evaluation stays rock bottom, something's going to give - good things happen to cheap companies Darius.

[14:52]

**DM**: Does that leave you positive then as a general outlook for 2021 on UK equities and your fund?

**AS**: Yeah I'll tell you what. Yeah. You know what worries me, is that we lose good companies cheaply. Because of this, the way that that money moves nowadays in sort of factor baskets trying to chase a specific thematic. It didn't really matter what idiosyncratic stuff is going on within the company. It doesn't really matter what value they might be able to create over a 5 to 10 year period. And so the risk across the portfolio is that we lose some good assets, cheaply.

Elementis has a sort of quasai-bid. So the Minerals Tech[nologies} and industry competitor US listed wants to bid 107. These shares started, let's go back to 2018, they did a big deal in 2018, they bought some leverage onto the balance sheet, and they started at that point at £2.50, and they bottomed at roughly 20p and now they sort of rallied with the market a bit and Minerals Technologies wants to pay £1.07. Am I going to support that bid? No, I'm not. I'm not. Now there are some questions that the management team have to answer about what they did with the acquisitions, but I'm certainly not going to give up on that company and the good assets it has at the wrong price.

So the answer is undoubtedly that there was more value to be captured from their stocks. But the worry is that we lose them too cheaply. Not everyone is going to say no to a bid. There're, you know, shareholders will be so in desperately in need of the cash, they'll take the cash and run.

**DM**: Yeah.

**AS**: You know so we have to be very careful, but the arbitrage is still very much alive and it's going to stay alive next year. If you, if you have a good balance sheet and you can borrow at 2, and your borrowing again on your buying on an earnings yield of like 8 to 10 in UK, which it was sort of coming into Q4, that's a pretty good arbitrage, if you ask me. And if you have a mindset that is10 years, not 10 months or 10 weeks, then I think you can see very clearly how you can generate value for your shareholders. I find it amazing that the stock market doesn't like to support companies that achieve more value yet we'll throw money at private equity and ask them to do the job for us.

**DM**: Yeah.

**AS**: Of course, you know, because you've been invested in the fund, that part of what we try and do is to think like private equity and have a 5 to 10 year view business transformation, how can we add value to a company? So it does, it is galling in the extreme to lose good company, McCarthy & Stone, the bid by Lone Star is cheeky in the extreme. But clever them.

**DM**: Alex, look thank you very much for a real time finger on the pulse view on UK equities. I think I would just sum up maybe some of the things that we've said to each other today: UK equities, totally unloved, both domestically and globally; maybe some Brexit resolution; maybe some positives improving COVID news; and then most importantly, really cheap valuation starting point that means 2021 and looking out, could be a good spot for UK equities. So Alex, thank you very much for your time.

**AS**: Thanks Darius.

**DM**: For more information on the JO Hambro UK Dynamic fund please visit fundcalibre.com or if you'd like to hear more of the Investing on the go podcast, please subscribe via your normal podcast station.