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TRANSCRIPT: EPISODE 107
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[INTRODUCTION]
Chris Salih (CS): Hello and welcome to the Investing on the go podcast. I'm Chris Salih and today we're joined by Peter Ewins, manager of the Elite Rated BMO Global Smaller Companies trust. Thank you for joining us today Peter.

Peter Ewins (PE): Thanks for having me Chris.

[INTERVIEW]
[0:18]

CS: It's been a bit of a challenging, or even brutal, year for smaller companies, especially in the UK where you have about 25% of the trust invested. What's it been like investing through these difficult times where small caps seem to be in the eye of the storm?

PE: Yeah, it's been a very, very tough year, a brutal year I think you said. Yeah, it's been very tough. I mean, ultimately, none of us I don't think any fund managers out there have worked with a pandemic situation before, so I think we've been learning as we go along really as to the impact of this, COVID on the markets. And obviously we've seen some huge moves. I think we found it very tough as a team. We found it very tough in the early part of the pandemic where you just saw this horrendous set of company announcements with companies cutting guidance, counting forecasts, et cetera, and share price collapsing. Quite depressing really because you sort of set out with a portfolio that you think is actually well set up for the environment and, all of a sudden, the environment is totally transformed. So I think we all found that quite difficult.

I think we then spent some time looking at balance sheet risk on the portfolio because obviously profitability was going to be falling down sharply for a lot of companies. We looked at each balance sheet closely, took some action in relation to that, to where we thought financial risk was too extended. Then we started thinking about what are the structural longer term impacts of the, of the COVID pandemic on people's behaviour potentially? You know, things like working from home like we're doing now. Is that going to be a longer term thing? You know, there have been modifications across various sectors. We spent a lot of time thinking about that and then obviously

more recently we've had you know, signs of economic pick-up and then another resurgence in virus cases, which obviously sort of hit the markets back again in October. And then most recently obviously we've had the good news on the vaccines, which has led to a massive surge in the market. So it really has been a roller coaster ride, you know, from the market's perspective. And you mentioned the UK, the UK market has been, has been impacted hard by COVID. It's got quite a pronounced skew to some of the worst hit sectors. So, you know, we have seen that market has been difficult this year, but it is bouncing back along with the other markets.

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CS: There's an element of the sort of glass half empty versus glass half full scenario here. So the fact that smaller companies have struggled also means that a number of regions, you know, the small caps are now pretty cheap versus their larger counterparts. I mean, does that mean you've been able to pick up bargains and you know, since the start the sell-off?

PE: Yeah, I mean smaller companies, I think they entered 2020, having had a couple of disappointing years. They had lagged the larger cap indices in most part, in a lot of the parts of the world with you know, as everyone knows the big technology stocks in the US driving, you know, doing fantastically well. Interest was more on the large cap side for, you know, quite a pronounced period of time. And people are worried about the macro environment and people are worried about Brexit and other issues that are going on. So smaller companies have tended to lag going into 2020. I think obviously when the pandemic struck, I think they then lagged again quite sharply in the initial sort of sell-off you know, with that sort of greater economic sensitivities around some small companies, you saw people retreating from them.

Now what we're seeing is obviously that, sort of reversing, and people now actually more positive on the outlook with the vaccine. The vaccine news most recently, people now are looking for recovery plays and we've seen smaller company indices actually outperforming the larger company indices quite strongly since the you know, in the last few months really. So it's turning out to be funnily enough a better year for small companies. And you couldn't possibly believe back in March.

In terms of the bargains. Yeah. I mean, there's obviously, there were bargains to be had and with the benefit of hindsight in March and April when people were panicking. You know, obviously we topped up a few things at that point in time. But you know, we should have bought a few other things as well. So, you know, it's been a very challenging time to manage a portfolio, I think, for any fund manager this year, but yeah, there were bargains there. I think we still think there are some opportunities in the markets now. But obviously things are, you know, broadly, you know, the things that were hit hard by COVID are probably 50-100% higher than they were at the lows. So, and in fact, in some cases more than that, so the bargains are less on the ground than they were.

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CS: You mentioned the vaccine and we've had the sort of vaccine bounce and the catalyst as some would point out. With your sort of globe out, do you think 2021 could be a good year for smaller companies to sort of continue that, you know, continue to outperform perhaps?

PE: It's possible, yeah. I mean, it's always difficult to be too you know, too prescriptive. I mean, obviously at the moment we're, the markets are very confident about the you know, the success of the vaccines and the roll outs, you know, I mean, obviously we don't really know at this stage how successful that rollout is going to be. It could be that you know, there's another resurgence in COVID, further lockdowns are put in place in the start of next year. I think the market is looking for the vaccines to be you know, to be making a big difference to things, you know, at the end of Q1 maybe through to Q2, and is hoping for a more normal sort of summer, summer period. We don't really know when that's going to happen. If it does happen, I think if the vaccine roll out is successful and economic activity picks up, then that is, that is good news for smaller companies and people probably continue to favour them over the more steady larger companies which have done better in the early part of the pandemic. But we'll have to see, you know, I think we've as I said earlier, we've already had quite big moves in the indices. So, you know, we'll have to see as time as time goes through, but smaller companies do tend to do better coming out of sort of recessions you know, and you know, that is what, that is the scenario we are looking at the moment, hopefully subject to these vaccines being effective.

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CS: So just going back to the vaccine, it's only sort of been, you know, a handful of days since we had the news. Have you had any companies that have felt sort of the benefit of the bounce?

PE: Well, I mean, yeah, the markets are up very, very strongly Chris, you know, and not just the smaller companies, the markets as a whole are up, you know, very well in November, so far. So obviously, you know, we've had some good rises. I mean, the companies that have done best November to date, have been the mirror image of what did well in sort of March, April, ie companies potentially perceived to be maybe hit by the lockdowns, companies in leisure, travel, hospitality. Those sort of companies have been very much favoured as people are looking forward to the time where things normalise there. So, you know travel agencies, transport companies, restaurants, pubs, are the companies that have been very strong in the last few days since that vaccine news come out. And at the weaker side, the things that have done very well, maybe some of the technology stocks, some of the beneficiaries of the staying at home trends, you know, some of the food companies, maybe companies that have you know, just done well through that period of people's forced staying at home. Those shares have lagged in the rally, but yeah, the markets are up very strongly and we do have some good movements.

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CS: Okay. And one area that perhaps has done surprisingly well, is Japan, could you maybe explain why that is? I mean, is it purely political? And maybe talk us through some of the funds that you favour in that space?

PE: Yeah, Japan's doing okay this year, I mean it's not top of the charts in terms of performance this year. It's benefiting from you know, it's maybe its geographic location cause ultimately as we know, China when it was the first into this crisis, but got it suppressed quite well. And Japan is very closely linked to China and other regional markets out there in the Far East. So the fact that China is recovering is helping places like Japan. Their economy is going to shrink about 5% this year, 5-5.5% I think is the current forecast, that compares to the UK shrinking at more or less 10% or even more than that. And other countries in Europe, similarly, you know, worse hit by COVID.

Japan's stock market has, you know, has actually got quite, there's quite a few sort of more cyclical companies in it. So some of the things like automotive companies and the automotive supply base. Those have been picking up as demand in China for cars has picked up more recently, so that some parts of the Japanese market now are doing better then on the cyclical end. And yeah, so the market as a whole, the Japanese small company market has done okay this year, but it's probably not done much, much better than that most other parts of the world to be honest.

I'm think in terms of our fund, we do own three funds in Japan to give us exposure to Japanese smaller companies, as opposed to individual holdings. And those are managed by Aberdeen, Baillie Gifford and East Spring. Aberdeen have done well this year, that's sort of a quality growth approach. Baillie Gifford have done absolutely fantastically this year. And obviously they've done well in the last few years with their focus on the tech and tech medical companies, health companies and if you like in the innovative digital sort of companies. That sort of strategy has worked fantastically again in 2020. More recently, it's maybe not been quite the place to be in this post-vaccine sort of news period, but it's done very well for us this year. And then East Spring, the last one we own is much more the value end of the market, it has struggled in 2020. But it's actually recovering as we've seen the vaccine news, it's good news for that fund probably as it's more aimed at, more investing in the more cyclical and more lower value, lower value stocks. And I think we certainly have seen a bit of a trend towards value stocks, the post growth stocks in the last month or so. So we've got a blend of different funds, but they all, they're all investing in different holdings, but overall they're actually doing well in 2020 for us.

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CS: And just finally Peter, the trust isn't necessarily known for generating an income with investors, but you've actually got a great track record of increasing the trust's income. Have you managed to

maintain that this year and maybe have you been using the revenue reserves for this type of scenario?

PE: Yeah, so the company's financial year is the end of April. So it did report in June that it was that the dividend was pushed up for a 50th consecutive year by the board. We're obviously not, we've not, we haven't released interim results at this stage at the moment and the board will be looking at the dividend, that period, in the coming weeks. The company has grown its dividend over the years consistently by effectively benefiting from investing in companies that themselves are increasing their own dividend. So it doesn't happen by magic. You've got to invest in companies that are actually paying out increasing dividends themselves. So you know, in most years we found them, since I've been the manager of the fund most years, we've found really good dividend growth from the portfolio.

In 2020/2021, the current financial year, the new financial year, it's going to be much more difficult because a lot of companies have cut dividends or passed dividends. We saw that obviously at the start of the pandemic, we saw a lot of the UK companies in particular doing that. So this year is going to be a very challenging year on the income side for the fund and for other funds really across the market. So it'll be up to the board as to whether they wish to continue with the dividend growth record. And you know, the policy we have got is, we've got a strong revenue reserve of nearly £18 million going into this year which is there to support you know, the dividends going forward. And it's up to the board to look at the outlook when they come to make the decisions in December and in June next year, the interim and final, as to what they want to do with that.

We think the income situation will improve a little bit through the start of next year as companies that cut dividends in March, maybe March, April 2020, we think some of those will start paying again in March or April 2021 but again, it will depend to a degree on how that vaccine roll out is going and how the economic environment is looking at the time. And so, you know, it's difficult to be too prescriptive going forward, but, you know, we hope that by investing in growing companies that have got good growth potential in the future, that we can carry that, carry that record on.

CS: That's great Peter, thank you for joining us today.

PE: No problem at all, thanks for having me.

CS: And if you'd like to learn more about the BMO Global Smaller Companies trust please visit fundcalibre.com and while you're there, remember to subscribe to Investing on the go podcast.