TRANSCRIPT: EPISODE 167
6 January 2022 (pre-recorded 2 December 2021)

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[INTRODUCTION]

Sam Slator (SS): I'm Sam Slator from FundCalibre and today I've been joined by Ben Wallace, co-manager of the Janus Henderson Absolute Return fund. Hi Ben.

Ben Wallace (BW): Hi, how are you?

SS: I'm very well, thank you.

[INTERVIEW]
[0:14]

SS: I thought we'd start with the fact that this fund used to be more focused on the UK, but you've now got a more global remit with it. How have you used this flexibility and has it been a benefit over the last year or so?

BW: Yeah it's interesting. We started the process of kind of giving ourselves the flexibility with the ability to invest more overseas probably about five years ago. And actually our rationale back then was very much that whilst we invested in London-listed equities, you know, the FTSE100 had very little to do with the domestic economy. So, you know, you go through the biggest ten companies in London, it was Unilever, Billiton BP, Shell and HSBC. So it was a really global index. So what we found was that we were spending a lot of our time doing research on these global companies. And quite often we were finding a better way to express that long or that short view in a stock that was listed outside of London. So that's what drove the decision.

Interestingly, the last 12 months, we haven't used it that much, the international, it’s not particularly gone up per se, but where we found ourselves where we did use it, was probably about three or four years ago when we were in the real eye of the Brexit storm. We found that a lot of domestic equities were being really knocked around by the kind of weekly Brexit news flow, as you probably remember. And the other issue UK equity specifically had, is that because in the FTSE100, let's say 75% of the earnings are international earnings, as Sterling was moving around between $1.20 and $1.60, I think during that kind of four or five years of Brexit talks, that was really moving around a lot of UK equities daily as well. So having that flexibility to invest outside the Brexit noise was great for us.

[2:01]

SS: And you mentioned shorting there, at the moment, I think you've got, you’re short some index derivatives, could you perhaps explain what these are and why you're doing that?

BW: Yeah, of course. So we're obviously conscious that, you know, we're trying to deliver an absolute return to investors. So part of that is always trying to manage a bit of the downside there's as kind of markets have bumpy periods. Now in general, we prefer to be short, you know have negative bets on companies that we think are vulnerable or can fall, or can be overvalued. But I think at the moment, we're quite conscious that there is a lot of corporate activity out there. There's a lot of private equity activity out there. So actually the stock specific risk of being short lots of names is quite elevated. So therefore we're using some index futures just to protect the downside of the portfolio in case we go through a rocky period in markets.

[2:58]

SS: And I noticed you’re also invest in Berkshire Hathaway, which is the company owned by legendary investor Warren Buffett. Can you perhaps tell us a bit more about that?

BW: Yeah, of course. Yeah. That's an example of one of our international holdings. Interestingly, the reason we like it is that you know, Berkshire Hathaway's primary business is obviously insurance-based, that's sort of where the origins are. But as the years have gone by, and obviously, you know an immensely successful business and track record, they've invested in lots of quoted companies, for example. So I think broadly they've got a $50 billion stake in Apple, for example.

The reason we liked the actual Berkshire Hathaway equity though, is that if we add up all the stakes that Berkshire Hathaway has in quoted companies, we then knock off the cash in the business. We think the earnings multiple that you're paying for Berkshire's operating businesses is only about six times earnings. So to us that looks a really undervalued equity.

Now without getting too morbid and bear with me on this one. The only reason we don't have more is because obviously you've got a situation where both Charlie Munger kind of Warren Buffett's partner in crime, and Warren Buffet himself, are both in their nineties. And whilst I think they've got lieutenants in place who broadly run the business, I would imagine if mother nature takes its course at some point, you know, these gentlemen are reasonably old. You might have a negative reaction on day one if one of them was to unfortunately pass away.

But actually I think in the fullness of time, there's actually just a big conglomerate discount in this business. And actually I think the pressure to split the group up would actually increase with the passing of either of these gentlemen. And it's interesting, it's something that Buffett himself has said in a public forum that he thought the sum of the parts is worth a lot more than the value of the group. And ultimately that would probably be realised at some point in the future. So that's our rationale and thesis for holding it. If with the slightly morbid twist I had to throw in for the benefit of the listeners.

[5:09]

SS: I've just been talking to my boss Darius about the outlook for next year. And he's basically said he doesn't think anyone knows what's going to happen. There's so many uncertainties. The only thing he thought was that actually volatility is going to be pretty high, particularly in the first quarter, just as things sort of pan out and we perhaps get a better idea of the new variant and things like that. In that type of environment with this heightened volatility, how could being invested in this fund help?

BW: Yeah. So I would say if I look back over, I guess let's say we've had the strategy as a whole is probably year 17 of the strategy. On average, we tend to do better in periods of slightly elevated volatility, as long as it's volatility we get our heads round and the stocks and so on. I think that's because on average we have just over half the capital of the fund invested in what we call the tactical book, which are shorter term, slightly more opportunistic ideas, both on the long and the short book. So generally volatility is something that we're not afraid of. And I think we probably shared Darius' view that, you know, it feels like, you know, there's a lot of kind of different currents in the markets, whether it be interest rates, inflation, Covid, that are all sort of colliding, you know, pretty frequently, it feels like which makes the market interesting.

[6:37]

SS: And crystal ball time or just general thoughts I suppose, if you had to pick one market in the world at the moment, which is the one that you're most positive about and which would be the one that you're most negative about?

BW: Yeah, it's interesting. So I will caveat this by saying that calling markets is definitely not my forte. If that's what I've been asked to do over the past, you know, 25 years of running money, I don't think I'd be here if that's it, but saying that if I sort of go with, you know, put our money where our mouth is sort of, where do we have more net long exposure and where do we have less exposure?

Interestingly the area where we put money back into is actually London listed equities. I think to us, it feels a bit of an area that's almost was a bit of an orphan stock market. I think having gone through the whole process of Brexit, I think a lot of international investors took kind of capital out of the UK market. I think given how well, you know, some of the US technology areas have done again, a lot of actually domestic capital has actually floated out towards those international markets. I think it's left the UK looking attractively valued. And I don't think it's a coincidence that we've seen a lot of private equity activity, a lot of kind of takeover activity sort of happen in UK equities themselves. So that's an area where I would say in terms of our investible universe, where we've been net buyers. And so therefore I would say I'm optimistic.

The area where we have almost no capital on the long side is in what I would say is the high US growth areas of the market now. And it's interesting because I wouldn't say that we're necessarily hugely negative on it because there's some, obviously some amazing businesses in there. And when I say US high growth it's interesting I don't mean the Googles, I mean there's multiples but I think they look pretty reasonable given the growth rate of cash generation of those businesses.

I think it's in the much more, you know, 20 to 50 times sales, the SAS software companies, a lot of those type of businesses, we just sort of struggle with the valuations, but to be fair, we struggled with the valuations for a long time. And to me, they look vulnerable if bond yields go up, but equally if world economies struggle next year and bond yields are lower and those keep going they are very dangerous things to be short of. So I would say somewhere that we don't feel comfortable investing in long, you know, equally we've been doing this long enough to know that, you know, you really want to take momentum on the short side, but it's something we're observing, but definitely not somewhere where we're committing long capital.

[9:17]

SS: And many people are kind of saying that it’s a year for a lot of balance within portfolios, so that if we have this volatility, you know, value has a rally, then you have a little bit of that in there. But equally, if we then go back to growth, you have some of that. And it's just not really the year for one-way bets.

BW: Yep.

SS: When you've got a portfolio where you can go long, so investing in the company for the long term and those that you think the share price is going to go down, would you have more shorts in an environment like this? Or is the balance perhaps where you were talking earlier about the index derivatives and actually you're getting that balance by not betting on particular stocks, but you're actually saying, okay, if something goes wrong, that's how we're going to make the money.

BW: Yeah. So the way I would look at it is let's say the kind of growth versus value debate, for example. So my view is that we’ve always let the bottom up if they're longer growth or shorter value or whichever way we end up, we'll let the bottom up drive that, but we'll never let ourselves get into a position where the entire performance of the fund is dictated by a factor, ie growth or value, because I don't think that's what people pay us to do.

But I guess what I'd say is if I observe what we're seeing bottom up, we are definitely finding good long ideas in what I would call the value buckets and specifically within areas like insurance and so on. And the reason we like the sector is there's a lot of good companies out there. Take something like a Legal & General, just to throw in a name, they’re doing good returns on equity, you know, yield almost 7%, growing the dividend at mid-single digits. They just look to be undervalued, cheap shares. And actually what I like about them is they're generating these strong returns, despite the fact that interest rates are diminimous, despite the fact the bond yields are low. So actually if that changes and bond yields go up, inflation sustained it's actually a tailwind for these businesses. So for me, that's a great place to invest.

On the growth side again I think what is interesting is there's plenty of growth stuff that I can see has rerated a lot as bond yields have fallen over the last decade. And if I look at some of those businesses, I think they're really improved. And so it's justified and actually there could be more upside, but I think there's plenty of those businesses that have rerated just because bond yields have fallen. And in some cases the business dynamics, so actually not quite as good as they were. So for us, we're always looking for the stock specific kind of opportunities. And as I said, if I'm to encapsulate our current positioning, we're probably slightly long value relative to growth, but even within growth, we've got plenty of growth longs and plenty of growth shorts.

But I would view, you know, if I had to look at, you know, if I could sort of wave my magic wand and say, well, I would love this to happen to the market because I think our fund will do better in this environment, I would say let's have a bit of volatility that would be nice. Let's have bond yields and interest rates up a bit from here. That would be nice. And let's have UK equities not be the worst performing equity market again in 2022, those types of things I think would be quite good backdrops for us, given our current bottom up positioning. But would I'd say Sam to your listeners is, you know, we react to what we see in front of us. And I think that's the reason why we're in business this many years later is I'll tell you this today. But if the facts change as the famous saying goes, you know, we will change our positioning as we deem appropriate.

[12:53]

SS: What do you think it'll take for the UK to actually start performing better? I think another manager that I was speaking to said that, as you've mentioned earlier, private equity firms are buying other companies, overseas companies are buying their peers. But no one is actually buying UK stocks, what would it take for people to get back in?

BW: You know, I'll be honest. I don't know. I don't know. I mean I wish I could kind of give you you know, maybe it's just gotta be that the scars last a long time. So we just need that more regulatory stability, political stability. I'll be honest. I do not know the answer, but my view is if the value's there and as long as we can kind of control the performance of the fund and the volatility of the fund, while still seeking out these opportunities that have no obvious catalysts, but have definite upside or downside, then that's what we've got to do. And we've got to manage the risk around it. But yeah, I wish there was a silver bullet, like a spot in the horizon that would change things.

SS: That was a really interesting conversation, thank you.

BW: Fantastic Sam, thanks for your time. Much appreciated.

SS: And if you'd like to find out more about Janus Henderson Absolute Return fund, please go to fundcalibre.com and don't forget to subscribe to the investing on the go podcast.