FundCalibre. investing ON THE go

TRANSCRIPT: EPISODE 350

13 March 2025 (pre-recorded 28 February 2025)

Please be aware that the accuracy of machine-generated transcripts, such as those utilised in our interviews, may fluctuate based on factors like audio quality, subject matter complexity, and individual speaker enunciation. Consequently, these transcripts are unlikely to achieve 100% accuracy. However, it is important to note that, at FundCalibre, we do not consider the correction of automatically-generated captions to be an effective or proportionate use of resources.

Given the inherent limitations of machine-generated transcription, we strongly advise against relying solely on this transcript when consuming our content. Instead, we encourage you to use the transcript in conjunction with the accompanying interview to ensure a more comprehensive and accurate understanding of the topic.

Please remember we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at your time of listening.

[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. This episode focuses on innovation, adaptability and how one fund manager blends quantitative strategies with hands-on portfolio construction to uncover exceptional companies.

James Yardley (JY): I'm James Yardley and today I'm joined by Mark Ellis, the fund manager of the Nutshell Growth fund. Mark, thank you very much for joining us today.

Mark Ellis (ME): Thank you very much James for having me.

[INTERVIEW]

JY: Now Mark, your fund has recently been Elite Radar by FundCalibre. It's still a fairly new fund, I think you launched in 2020, but it's starting to get onto a lot more people's watch list, radar, a lot. It's quite an interesting fund and we're delighted to learn more about it. So if you could give us a bit of the history of yourself and the fund and its philosophy, that'd be really interesting.

ME: Yeah. Great. How long do you have? Because really this has been a 40 year journey. I grew up in Yorkshire in the eighties and as a young boy badged my mom to open up a share trading account. It was a time of all the Thatcher Supply side reforms. So we were having lots of privatisations. I participated in all those privatisations. And I subscribed to the penny share focus and the penny share guide. And as a young 10, 11-year-old boy, I was investing in equities you know, all those years ago. And that really gave me the kind of incentive to forge a path into the city.

I was fascinated by equities and stocks and I then studied hard at school and read economics at LSE and then went into a graduate training program. My first role was at NatWest Markets, after that I went back to university and did a master's in finance and got my dissertation published in the Journal of Asset Management. And that was really the kind of start of this strategy and this process.

The paper was called Momentum in the FTSE 350, and I found that using accrued momentum strategy, you could get around 17% per annum returns off the FTSE 350 after costs. I then went back into the city and was a prop trader, and then more recently a hedge fund manager at a leading hedge fund. And all that experience and academic research, which I've done is involved to some extent in the strategy and the process of the current fund.

JY: Fantastic. So, I mean, you've had a very successful career as a trader, as you say, and now you've become a fund manager. And do you wanna tell us a little bit more about how the process works?

ME: Yeah, so the process is very quant driven. My research suggested that although momentum is a really nice factor to have, it's probably as a standalone factor, one of the best factors to use. However, it has these inflection points where the drawdowns can be really aggressive and really nasty. So, for example, it will get you totally long tech companies into January 2000, and then the bottom of the market in say March 2003, you would be short tech and long defensives, and the drawdowns of a long/short portfolio in that environment would be really horrific.

So I found that by adding more fundamental factors, especially the quality factors the risk adjusted returns would smooth out. And that's where we start to investigate how we can diversify the set of factors we look at and create a return profile, which was very attractive.

At the moment, we look at over 30 different factors. I think it's around 37 at the moment. We're continually doing research to add new factors to improve the process. We added two new factors last year and like every PM you have this dilemma where to invest. You could probably select up to 10,000 different securities. And how do you get that reduced to a portfolio of 30? Now we do that originally, initially in the cloud. So we have minimum hurdles for the factors we like. So we have one of the minimums, we require is minimum profit margin, minimum return on invested capital, and the minimum retention ratio. So we like can we say keep earnings internally and compound up over the long run. And we apply the kind of skill and method globally because information ratio is proportional to the square root of breadth for a given skillset. So you want to apply that across the globe.

And we have these minimums, so that quickly reduces the sample set down to around 600. And then we have our own internal model and process where we push the 600 kind of stocks through the model which shows us typically how aligned and calibrated a specific stock is to the factors we like and the factors we want to have exposure to. And then we push it through a checklist because obviously models sometimes can't pick up everything. And then we generally create, then that gets the kind of sample set down to around a hundred.

Then I use what we call what would be identified as a traditional kind of PM discretion to create a portfolio of around 30 stocks. The whole quant process basically means that it's hopefully trying to get us to a focus set where it is as PM proof as possible. Warren Buffet loves companies which are manager proof. We want to be looking at stocks which have got really great quality characteristics, really compelling growth profiles, really good technicals, including capital preservation and also great value so that the process which we run gets us to the kind of focus set of these rare exceptional companies. And then we do our kind of traditional PM role on top of that to create a portfolio.

JY: Yeah, very interesting. It's interesting that you want the high retention rate that you are, I guess, biasing against dividend stocks because you want that compounding at the high return equities which makes a lot of sense.

I mean, one of the other big features of this fund, I guess, is that you do you regularly reposition, I believe a few times every month. I mean, there's quite a few high quality growth funds in the sector but most of them are kind of very sort of sleepy, long-term investors. You are much more pragmatic, aren't you? And you are much more focused as well on this momentum factor and some other things.

ME: Yeah. that's right. I mean, what we do in practice is we compare like for like across the globe and we do it twice a month to make sure we're in the best companies for the best possible price. So we start with a blank piece of paper. I mean, I did the last recalibration on Monday, and it takes a lot of time. It's hard work. We don't have to do it. We could easily stick with the January 1st portfolio and let that run for the year, and it'd be a very nice portfolio similar to our peers, and we do really well, however we do it because we're trying to capture those small bits of alpha which are usually driven by movements in stock prices and movements in expected returns because of those price appreciations or declines.

So we start with a blank piece of paper twice a month and create the portfolio from scratch. Generally it's as I said, it's the valuation factors which do a lot of the movements in terms of positioning our portfolio or dropping out the portfolio. But, in essence what it creates a portfolio with a kind of earnings multiple of around the S&P or slightly higher than the S&P, but it's a portfolio that holds the best companies on the planet. And in our view, when you compare quality growth, technical factors and valuation.

So yeah, it's hard work. I mean, on Monday I was in the office for from 7:30 till 9:30 in the evening. So a good 14 hour shift, not because I want to, but because it adds value and I'm passionate about the fund. I'm a owner manager, so I'm really incentivised for the fund to perform. I have all my savings and my pension and my kids' money in the fund. So, and I really wanna work hard for my investors who've given me the trust to manage their money.

JY: All very, very, very positive things. What would you say to those people who say that kind of traditional view that, you know, trading a lot within funds adds in a lot of cost?

ME: Yeah, I've got very strong views on that.

JY: I thought you did, that’s why I asked <laugh>

ME: Yeah, I mean, a lot of this kind of view is based on out of date academic research. I mean, I read a paper that someone posted recently and the dataset goes back to the eighties when it was kind of, I don't know, maybe virtually any, probably not, most PMs hadn’t even excel then. And in that environment it's dominated by fear, greed, and probably broker entertainment. I mean since then we've moved on. And if you've got a systematic process, you can just capture the kind of maths behind the expected, the movements and expected returns for a given set of quality factors sake.

And also the cost of trading has collapsed. We trade for virtual medium, which we do the majority of our trading in the closing auctions. So we get price and we've just agreed a super competitive brokerage deal with one of the leading brokerage houses out there where we get charged virtually nothing. So the cost is limited, but it enables us to pivot and switch from one stock to the other. But I would also say, and because of my trading background, we also do a significant amount of trade in intraday. So I have a system here which alerts me when any of our portfolio, any of the stocks in our kind of portfolio or watch list move significantly into today. And we often fade that move and actually get positive slippage.

I recently got two reports from the new broker and they were amazed that we were actually managing to get positive slippage from the arrival price of the orders gone into the market. And again, back to my background, I mean, I've spent decades at trading desk managing risk trading all day long, and it's what I do. I love doing it. A traditional fund manager probably reads analyst reports, has an investment committee, decides to do something, and then takes weeks to get the position on. We can, because of my background and my skillset, we can go from idea or we can go from information to trade within seconds. And we think that's very different as well.

JY: What should investors expect from the fund in terms of performing in different types of markets? So you clearly you have this quality and growth bias, but as you said, you are cognisant of valuations as well. [**ME:** Yeah.] Presumably that you would struggle in certain types of markets, like a a dash for trash or that sort of big cyclical recovery. Is that fair or not?

ME: Yeah, I think where we've underperformed I mean let's think in an exogenous risk off move, the portfolio would do really well because we have high exposure to profitability and companies which have got really good and stable profit profiles. And we're a UK fund investing around 65-75% of the US. So in a risk off environment, the fund does really well in a kind of bull market, the fund will do really well because of the momentum and the growth factors would outperform where historically we've done poorly is at the end of, I would say a protracted bear market.

So if we look at 2022 we were probably neck and neck with some of our peers who are more defensive, some of the peers which hold tobacco and some more defensive stocks. We were probably neck and neck with those up until Q4 2022. And then our process identified the opportunities in tech and we pivoted into kind of type stocks a little bit early, so from which didn't bottom till December. So we probably underperformed in that period of the last quarter of a bear market. So the process will sometimes get us in early to where we see exceptional value. And that's probably where we'll underperform.

JY: And what have you been seeing, what trends have you been seeing recently and how has that influenced the portfolio?

ME: Yeah I would say because it's a bottom up approach and valuation, there's a lot of movement in the short run. We do see large movements in our portfolio. Our turnover is very high. And recently it's quite interesting, I would say from inception, our holding of US exposure to US equities has always been around 70%. And recently because of the kind of the mismatch of performance between say Europe and US, the allocation to US has dropped. And it recently dropped below 60%, I think 57% for the first time ever really. Actually when I recalibrated this Monday that has flipped back somewhat as we've kind of increased our exposure to some more of the tech names on the back of this week's selloff and last week's selloff. I would say the other themes we've seen are we've increased exposure to financials recently.

So I think we're just around 30% exposure to financials at the moment. And we've taken profit on a lot of consumer discretionary, so the likes of Hermes, Montclair, they've done really well recently. We've taken profit to those off those. So it's generally where we see increased expected returns going forward. So we do take profit and we're back into Novo Nordisk as well. I mean, unlike kind of funds which buy and hold forever, they have that dilemma if once they've bought, when do they sell and if they sell, what do they buy and when do they get back in? So that's generally I think why they hold forever. We got out of Novo Nordisk foe the last year. And I've just recently got back in as it as its prices has dropped from a thousand Corona down towards 5/600 kind of thing. So yeah. So we're back into to to to Nova Nordisk.

JY: And that's all primarily being driven by the quant is just seeing a higher future expected return and driving those actions?

ME: Yeah, generally hat's what it is. And we also, because the process is live, we can react to new information. So earnings numbers that come out, we can immediately react, we can meet immediately, digest the earnings numbers and react accordingly, which I think is another benefit of the fund.

So in Nvidia for example, we were not in Nvidia for several years. I think we might have had it kind of 2020, maybe 2019. So we were not in Nvidia until the blowout earnings numbers in February last year. And then we identified the growth factors were absolutely off the chart and even the valuation looked compelling given that growth. I think the PEG ratio fell below one and we picked upon on that opportunity and bought it straight away after the earnings last February and did really well last year on that. We've now taken profit and it's just a small position, maybe around 2% at the moment. But that gives you an idea how we can react to new news as well.

And in fact, it got talking about performance last year because the process is agile and the kind of allocations based on expected future returns. We were up I think 26.7% last year. And of that we had 16 stocks contribute in around 1% or more. So a really diversified set of performers in the portfolio. Nvidia was the highest attribute attribute or driver was around 4% of that 26.7%. But we did have a huge amount of companies adding to the positive year, which is nice to see.

JY: And do you do much in the way of of mid and small-cap as well? Is this a multi-cap approach or would you prefer to stick with the large-cap stuff?

ME: Yeah, again, it's all bottom up. I'm always looking for small-cap ideas. I'm very aware that the size factor has done really well. Mega-cap has done really well recently. So we're actually underweight size in terms of a factor is one of the factors we look at. So we're discriminating positively towards smaller cap, and we often pick up on really. I love it when we find a new small to mid-cap, because often it's under-owned and it's got a decent story.

So a good example was a couple of years ago, 2022, we got a position in a company called Encore Wire, which was just a couple wire producer in the US and kind of no one had really heard of it. And it was by no means a quality company, but because we rank and score rather than hard screen. If a company has some factors which are really compelling, you can still get in our portfolio.

So although a couple wire producers by no means a quality company, its valuation was so compelling. It was, it was a decent enough company. It had a kind of phone to door kind of within 24 hours. It had an onsite recycling, it was providing cloud infrastructure with wiring, but we got it on a PE multiple of three which is why it got in the portfolio and it, and last year it got taken out by an Italian company on a multiple of 15. So we did really well on that stock. And it's one none of our peers would have ever have heard of.

Another one was Coca-Cola Consolidated, the kind of regional kind of manufacturing bottler in the US and we bought that and it didn't even have one analyst covering it. And I still think there's probably no analysts that cover it. And yeah, we did really well there at the price section went exponential, and we eventually got out maybe a little bit early, but we often do find these smaller mid-cap, we call them rare hidden gems. And if you get a good one, it really helps the portfolio to pull away from some of our peers.

JY: Very good. Do you have any thoughts on the overall valuations of the market at the moment? There seems to be quite a strong debate. On one side you've got a lot of people saying, US market is very expensive at the moment. On the other side, people are saying this whole AI revolution is just getting started, you know, the earnings growth, yes, tech has been expensive, but the earnings growth is all coming through and has continued to come through for many years now. Do you have a strong view either way on that?

ME: I would say, we don't try and reflect our views too much on the portfolio. We can do it by changing our allocation to different factors. But what I would say is our tech exposure has been increasing recently. So that gives you one indication when you compare, like-for-like across the globe and include the growth factor. So I think it's a growth factor, which is is doing a lot of that kind of increased allocation. Also what I would say from, if you read a lot of this kind of valuation research that things are expensive, it's often, in my mind, it's often flawed in that they're comparing decades worth of data where, I don't know, maybe you look at the multiple on the indices, the US S&P, and if you go back 10, 15, 20 years, it's a completely different set of companies. I mean, you're not comparing like for like and maybe 10 years ago it would've been dominated or 15 years ago, dominated by natural resource companies and financials, which we don't touch because they're really low quality companies. So they deserve to be trading on a discount to today's kind of incredible tech stocks.

I mean, we're talking about tech stocks like, for example, Meta, which has 4 billion daily users. I mean, you've never been able to kind of penetrate the globe like that ever before. You've never been able to have growth like what we've witnessing today. So in my mind, the market definitely deserves a premium to where it's been historically.

JY: Very interesting. Well, look, Mark, we could probably chat all day. I think it's a really interesting fund. I think you're definitely doing something very different to the average manager from my perspective, seeing all these funds. It's been really interesting and you know, your performance has been very, very strong so far, so congratulations and hopefully that continues. Thank you very much for joining us today.

ME: Great, thanks James. Thanks for having me.

SW: A high-conviction, concentrated, pragmatic fund investing in exceptional growth companies, the Nutshell Growth fund is unlike any of its peers, with heavy quantitative input and a much higher turnover of holdings. To learn more about the Nutshell Growth fund visit fundcalibre.com – and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.