News & Views

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Does your fund manager have a fear of missing out?

Picking out the next big growth company is what many hope for but few achieve. Here Newton's Nick Clay highlights why an income manager thinks differently and how that may suit investors in the current climate.

Returns have been eroded by the ongoing spate of asset support conducted by central banks since the financial crisis, Newton global income manager Nick Clay states. He describes the idea of the global economy weaning itself off measures such as quantitative easing as "ridiculous", with central bankers willing to step in the moment something goes wrong. Investors also expect it. The result of these actions has been to push up valuations of assets. "There is a cost to that support and that is lower returns and increased volatility."

As a result, Clay believes investors need to think carefully. "One thing you can do is to try and trade that volatility – but good luck. These days unexpected events, like snap elections, make it difficult to build a repeatable process around such an approach." Instead, he believes the nature of sustainable income over time, the power of compounding dividends, can provide a resilient and significant impact to one's total return, which in the long run, leads to greater asymmetry in returns. "Stability of returns is important to clients and in a world of risk and high valuations, it is ever more important."

Fear of missing out

However, many growth-oriented managers are still seeking the big story – the next Amazon or Apple. "They have a fear of missing out (FOMO). But the ability to pick one particular fish out of the sea is difficult.

"I see investing more like Michelangelo who famously, when asked about his art, said it's what you take away that matters. We take a similar view: take away the statistically unattractive stocks. That's what the discipline of income does – it narrows down the bucket and forces us to be patient."

To create sustainable income over time, a company needs to generate sustainable cashflow and return on investment, allocating capital efficiently, Clay says. He cites Microsoft and Orkla, a Norwegian conglomerate, as two good examples of income plays. Microsoft, Clay points out, and in his opinion, wasted a lot of money trying to compete with Apple before it stopped and started returning cash to investors, resulting in better capital allocation discipline and consequently, returns. Orkla had an aluminium business Clay describes as a leach: "They sold it, reinvested in their brands business and are now beginning to reap the rewards." Some of its brands, such as herring paste, are esoteric but possess pricing power unlike an aluminium business, he notes.

World wonders

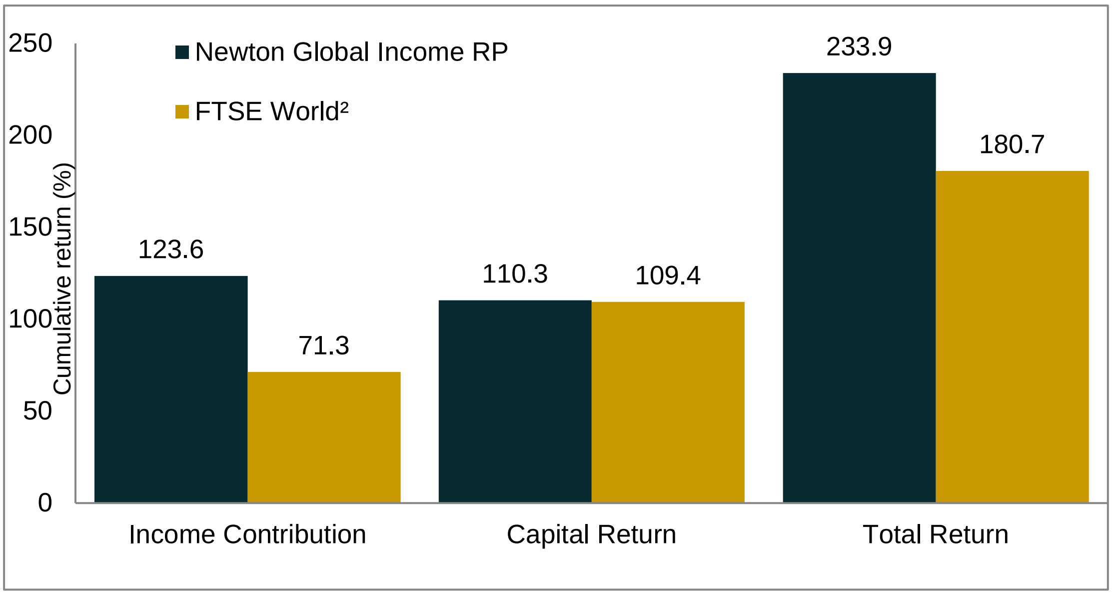
Calling dividends the eighth wonder of the world, Clay says capital may go up and down like a yo-yo but compounding returns provides ballast. "Capital growth will be so much harder to come by over the next 10 years, given starting valuations today," Clay believes.

With respect to his global income strategy, Clay says he remains confident in the sustainability of dividend growth. While noting that dividend growth in general has fallen off since the financial crisis, he says more recently it has had a boost from currency plays such as lower sterling.

Underweight so-called “hopeful recovery” stocks such a miners and banks, Clay is also underweight the oil and gas sector and direct positioning in emerging markets. Instead he prefers what he calls boring stocks – consumer goods and healthcare. “Demand for items like whisky and shampoo are unlikely to be dependent on economic recovery.”

Noting the increased indebtedness of the US, rising valuations and what he feels is a growing threat of a slowdown, Clay says he has moved underweight the region while overweight areas like the UK and Switzerland versus the comparative index (FTSE World).

Newton Global Income representative portfolio (since inception[1] to 31 March 2017)



[1] RP inception: 30 November 2005.
[2] The FTSE World Index is used as a comparative index for this representative portfolio. The representative portfolio does not aim to replicate either the composition or the performance of the comparative index.
Source: Newton. The representative portfolio adheres to the same investment approach as Newton’s Global Equity Income strategy. Performance calculated as total return, income reinvested, net of annual charges (including AMC of 0.75%), in GBP. As at 31 March 2017.

IMPORTANT INFORMATION

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