The Interview - Matthew Smith, Majedie Asset Management: "The underlying backdrop remains pretty lacklustre given the headwinds of deleveraging and weak wage growth"

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GFM: What is the background to your company and funds?

MS: Majedie Asset Management was established in May 2002, focusing solely on high alpha UK equities. We have an experienced fund management team with an average of 21 years of investment experience. The founding fund managers, James de Uphaugh, Chris Field, Adam Parker and Rob Harris, have worked closely together for 15 years, having comprised the successful Alpha Team at Merrill Lynch Investment Managers.

Both of our institutional long-only funds, the UK Equity Fund and UK Focus Fund, have been firmly top decile since launch on March 27, 2003. The firm's assets under management total some GBP4.1bn from 82 clients.

On August 31, 2007 we launched the Tortoise Fund, which allows us even greater flexibility to make money for our clients over the long term. An Irish-domiciled and Dublin-listed Professional Investment Fund, it is moving to a Ucits III structure in the autumn. The fund has four directors, two from Majedie and two independent.

Having joined Majedie in 2006 from Deutsche Bank, I run the fund with Chris Reid, who arrived, also from Deutsche, in 2008. The fund has returned 58.3 per cent since inception, including 12.1 per cent in 2008 and 25.4 per cent in the first half of this year.

The Tortoise Fund currently has some GBP32m in assets under management. We view capacity as scarce; we believe that staying small is firmly in our clients' interests as we can hold on to our liquidity edge for the long term. The fund will close to new investors when inflows have reached GBP250m.

Majedie has a simple, highly effective, common-sense approach to investment. We focus on shares in which we can make the most money, whilst ensuring that our portfolios are well balanced and risk is carefully targeted. We have no inbuilt style biases, but instead seek opportunities across the market, giving us the flexibility to add value regardless of economic and market conditions. The key to the firm's sustained effectiveness is its flexibility - market and economic contexts may shift over time, but inefficiencies will always remain for those committed and small enough to take advantage of them.

GFM: Who are your key service providers?

MS: Goldman Sachs is prime broker; BNY Mellon Fund Services (Ireland) is administrator to the fund, BNY Mellon Trust Company (Ireland) is custodian and KPMG is the fund's auditor.

GFM: What is the profile of your client base?

MS: The Tortoise Fund is aimed squarely at institutional pension clients and family offices, including a London local authority and a UK university, which comprise the existing client base.

GFM: What is your investment process?

MS: The aim of the fund is to generate positive returns in the medium term, and all investment ideas are considered in this context. We focus on ideas that we think offer attractive risk/return profiles, and spend considerable time focusing on what the worst-case and best-case scenarios would imply in terms of the share price.

We put together a portfolio of stocks where we think the potential upside is three to four times the downside, and weight positions according to the risk/return trade-off. Our largest holdings are in stocks where we think the downside risk is most limited rather than the stocks where the upside is the greatest.

We put together a 150-line financial model covering P&L, cash flow and balance sheet, valuation, leverage and return metrics for each position in the portfolio before the investment is made. In terms of timing investments we focus on price and earnings momentum, placing emphasis on investments where trends support our fundamental analysis. We generally try to avoid big mismatches in momentum between our long and short positions.

GFM: How do you generate ideas for your funds?

MS: Majedie currently has four fund managers running its long-only funds and two of us running the Tortoise Fund, and the firm places significant emphasis on teamwork - ideas flow from the Tortoise team to the long-only team and vice versa. There are no specific sector specialists; each person is free to look across the market.

We employ a combination of top-down analysis in order to identify the most and least attractive sectors and bottom-up to identify the best and worst companies within sectors. The relative importance of top-down versus bottom-up analysis varies according to the particular point of the investment cycle.

GFM: What is your approach to managing risk?

MS: We manage risk on a holistic basis as opposed to a single-track mathematical approach. Our main aim is to minimise the chance of losing money in the medium term, and we seek to achieve this by investing in cheap companies where expectations are too low and shorting expensive companies where expectations are too high.

Specifically, there is a weekly oversight meeting between myself, one of the long-only team and one of the trading team. We carefully monitor relative price momentum, balance sheet risk and earnings momentum of longs and shorts, and keep gross exposure as low as we can and monitor net exposure on a beta-adjusted basis.

We track sector and style exposure of longs versus shorts, price relative to peak and trough and five-year average for longs and shorts, the foreign exchange exposure of all positions and the overall liquidity of longs and shorts. We do not invest more than 25 per cent of NAV in long positions with market capitalisations of less than GBP1bn, while shorts are focused on stocks with capitalisation greater than GBP1bn. We have concentration limits of 15 per cent on longs and 5 per cent on shorts, and 30 per cent stop loss limits on the short positions.

By looking at risk in this holistic way we have so far managed to generate robust returns with relatively low drawdowns.

GFM: How has your recent performance compared with your expectations and track record?

MS: Recent performance has been stronger than expected given that we have been running the fund with a view to minimising the risk of capital loss. Strong returns in the first six months of 2009 in particular are related to very attractive investment conditions in the first quarter that have to a large extent now normalised.

GFM: What opportunities are you looking at right now?

MS: Our main focus at the momentum is on building up the defensive exposure of the portfolio. Following a strong run from the stock market it is becoming more difficult to find stocks with a good risk/return trade-off. We think the most interesting sectors currently are pharmaceuticals, telecoms and oil integrated.

GFM: What events do you expect to see in your sector in the year ahead?

MS: Sentiment has swung from excessively pessimistic to what appears to be excessively optimistic on the back of significant action by central banks and governments. However, the underlying backdrop remains pretty lacklustre given the inevitable headwinds of deleveraging and weak wage growth. As a result we expect the pendulum to swing back to a more measured assessment of the future profit growth outlook.

GFM: Are investors' expectations shifting between capital preservation and growth? If so, how do you deal with this?

MS: Investors generally worry more about capital preservation in falling markets and growth in rising markets. Given the market has been rising, people are likely starting to worry more about missing out on gains rather than capital preservation. We are paid not be swayed by these issues and focus on capital preservation. This could lead us to lag a strongly rising market as we now think it is appropriate to take a more cautious stance following strong gains.

GFM: What differentiates you from other managers in your sector?

MS: Majedie has a deep understanding of the UK equity market as evidenced by the strong performance of its long-only funds. It also has a very pragmatic approach and we don't allow ourselves to be boxed in by a dogmatic process.

GFM: How do you view the environment for fundraising in 2009? How does this affect your funds?

MS: Investors have been cautious regarding committing capital, especially to relatively new funds. However, we have been patient and have focused on high-quality institutional clients, and our patience is now paying off.
Majedie_Asset_Management_Matthew_Smith.jpg

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