



ST. JAMES'S PLACE
WEALTH MANAGEMENT

AUDIO CONFERENCE

INVESTMENT MANAGER AUDIO CONFERENCE

John Wood

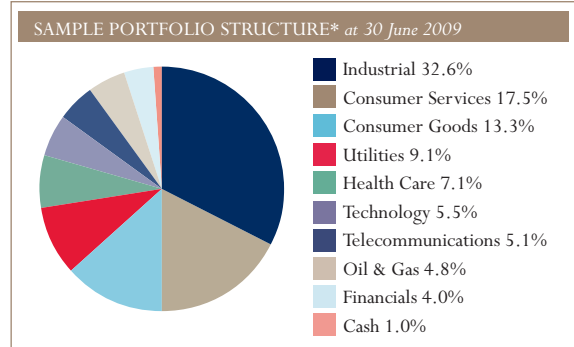
JO Hambro Capital Management - 9 September 2009



John Wood
JO Hambro Capital
Management

SAMPLE TOP HOLDINGS* as at 30 June 2009	
GlaxoSmithKline	3.9%
British American Tobacco	3.8%
Reckitt Benckiser Group	3.8%
Compass Group	3.7%
Tesco	3.7%
Capita Group	3.6%
Vodafone	3.6%
Scottish & Southern Energy	3.5%
Experian	3.5%
BP	3.4%

Funds managed: Part of the UK & General Progressive Unit Trust from 1 September 2009



*Sample holdings taken from the JOHCM UK Opportunities Unit Trust

Investment style and approach

- ◆ Our key objective is to achieve above-average risk adjusted equity returns. In other words, we aim to always provide absolute, not relative, positive returns for our investors
- ◆ We define risk as absolute loss, not the movement of the fund relative to a benchmark index. A relative gain in a falling equity market is still a loss for investors – you can't pay the gas bill with a relative gain
- ◆ There are three key aspects to our approach:
 - Avoid the tyranny of the benchmark - we do not use an index for portfolio construction
 - All valuations are based on absolute cash flow return on capital - we do not use any relative valuation measures versus other assets, as this implicitly assumes that the other asset is appropriately valued. When the value of that asset falls, the basis for your entire valuation fails
 - The main risk to a portfolio is holding a bad share, not missing out on a good one – I believe that this is the most underrated yet most important skill for a fund manager. We always sell an asset to zero if it becomes expensive or over-valued
- ◆ Essentially, what we are looking to do is identify companies that grow in value over the medium to long-term. We do this by looking at their intrinsic value and, specifically, existing and potential cash flows
- ◆ We look for companies that produce high returns on capital. That way, if the management are able to deliver the forecasted growth, the impact of cuts or suspension of dividend payments is negligible. The return on capital provides growth
- ◆ Another consideration is not to buy, or hold, an over-priced or over-valued asset. We have very strict valuation controls and this avoids the 'greater fools' theory: the belief that someone will always buy an asset from you, at an even higher price in the future. This is a very dangerous assumption if you're holding over-valued assets – when markets fall, there is nowhere to turn

- ◆ The valuation criteria is crucial to any decision we make to invest in a company, however, identifying the areas or sectors of the economy that present these opportunities is another key aspect of our approach. It is easier for management to run a business and earn high returns in an industry that is growing and developing, as opposed to one that is contracting and declining. These ‘trends and themes’ provide a starting point:
 - One of my favourite examples relates to the aging population. In the western world, it is much easier to run a cruise business than it is to run a nightclub business. There will always be an increasing number of greys and a constantly decreasing population of teenagers. This demonstrates exactly what we are looking for – easily observable and sustainable trends. This is not rocket science
 - Another theme we have observed we call ‘fatness and fitness’. Obesity and jogging are great for companies that manufacture artificial knees and hips. Even in an economic downturn, we cannot stop ourselves getting older and stop our bodies deteriorating. Smith & Nephew is a great example of a company that stand to benefit from this trend – and, more importantly, it meets all our valuation metrics

Portfolio construction

- ◆ We do not use an index in anyway to construct the portfolio. We are entirely unconstrained in our approach and won’t hold a particular stock or sector because of it’s weighting in an index. Every investment in the portfolio is there on merit and because it meets our stringent valuation criteria
- ◆ Similarly, if we don’t understand something, we can’t get our heads round something, we have a ‘too hard’ box. We’re not sure what the outcome will be we, so therefore we don’t invest in it. If it’s in the portfolio at any time, then we sell it
- ◆ At any time the portfolio will hold 30 – 40 stocks. New positions start at 1.5% of the portfolio and build up to a full weighting of 3%. We adopt a self-imposed limit of 5% for a single holding, if a position makes 5% we trim it back to 4%. If the fundamentals remain then we continue to hold the stock. In essence the fund has a very low turnover rate. Given our strict valuation criteria we have an investable universe of about 70 stocks
- ◆ The more comfortable we get with a company, the more we buy, which often means we buy it at higher prices. This is not about market timing, this is having confidence in that the stock can deliver the fundamental upside we predict
- ◆ The sell discipline is the most important skill of a fund manager. We would sell a position to zero for 2 reasons:
 - A permanent fall in the intrinsic value of the business – this is usually because some factor has changed and is often picked up during the screening process. So we re-evaluate, re-examine and then, if we’re not happy, sell the position to zero
 - Over-valuation – as before, if an asset becomes over-valued then we sell it. We do not retain residual holdings because they provide some sort of benchmark weighting. If we don’t like it, we sell it
- ◆ Cutting the losers and letting the winners run is a vital part of the investment process. It’s a reversal of normal psychology. All investors love to take a profit but the hardest, yet most important, decision is to crystallise a loss and is what I call ‘the cut’. It needs to be a fast and effective cut. These stocks can fester in a portfolio and take more of your time emotionally – it becomes painful but, as a fund manager, you must make the decision and invest the capital somewhere else
- ◆ I normally expect to pay a premium for the things that I like: consistency, sustainability and predictability. We’re looking for equity assets that display broadly ‘bond-like’ characteristics
- ◆ We do not normally focus on dividend streams. We prefer companies to invest to grow the business. In the current environment, where dividends are being cut and rights issues are prevalent, this is an extremely powerful point. We believe this is an indicator that our cash flow analysis is accurate and has been successfully implemented
- ◆ Currently the yield is in the region of 3.75%. This has grown by around 5% in the past year and we expect this to continue, at a similar rate, going forward

Views on the economy

- ◆ To understand the economy today, we have to look back 10 years to the Technology bubble. The response then, as this time, was for central banks to slash interest rates
- ◆ When you cut the price of something, people buy more. Manufacturers and consumers bought more and now governments are buying more. Debt is everywhere
- ◆ What we have is a balance sheet recession. There is far too much debt in the system and leverage has become structural. Everything is dependent on maintaining the levels of debt
- ◆ The consequence of the lack of liquidity was a major economic downturn. What it is very important to understand is that the financial system was broken
- ◆ The policy response has been equally extreme. Interest rates are abnormally low, fiscal policy is loose and now we have the governments quantitative easing program
- ◆ Fiscal and monetary policy cannot get any better than this. However, what is happening in the real economy is interesting. People talk about a V-shaped recovery but, for me, V stands for vulnerable. A fall of -4% followed by a recovery of +1% is still a fall of -3%
- ◆ For us, using an investment process that is focussed on cash flows, this means that those cash flows are still down year-on-year. We are not seeing a material recovery in the real economy to drive a strong recovery in corporate profitability across the board

Final thought

“We aim to provide absolute, not relative positive returns for our investors. The ideal situation is heads we win, tails we don’t lose.”

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