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Buchanan

BMO's Gary Potter: Rise in inflation set to redefine markets

BMO's Gary Potter: Rise in inflation set to redefine markets : BMO Global Asset Management multi-manager Gary Potter says inflation increases will redefine markets this year as he looks back at the commodity rally in 2016.

The co-manager of the F&C MM Navigator fund with Robert Burdett believes market reaction to the increase in oil price from a year ago will eventually translate into a boost to inflation figures.

He says: "Look at inflation as a one-year measure. The oil price hit \$26 in January last year and this year the price went up massively.

"This is going to be one of the redefining issues for the market and how the market reacts to headline inflation numbers going significantly higher."

Potter and Burdett's fund was carried over from F&C Asset Management when BMO bought the firm in 2014. The fund, which Potter calls "very established" among investors, has a historical yield of 4.7 per cent, versus an average yield of 1.6 per cent for funds in the Mixed Investment 20-60% Shares sector, according to Lipper.

Mix and match

To get a consistent yield Potter constantly assesses the diversification of the assets he holds, switching between the 2,000 sources of income he has across a concentrated portfolio of 34 underlying funds.

But he says when funds have a dependable income, he does not try to be "too dynamic" by changing asset allocation too often as this would "disrupt" the income stream.

Between May 2008 and the end of December 2016, the fund has paid out £44,154 in dividends for a £100,000 investment, according to Lipper, and has been top quartile in total return terms since launch.

The team has now launched an 'M' share class for the fund, which will smooth out the returns from income-generating assets by holding back surplus income from the fund's holdings to top up the monthly income when necessary.

Another feature of the team's approach is their £1.2bn fund does not appear in any "buy lists", apart from a few exceptions such as the £9.4bn Woodford UK Equity income fund, usually "very big funds" which can potentially constrain the manager's investment approach.

The team prefers to hold offshore funds and smaller funds with capacity controls as well as funds from boutique firms, especially when they are at an early stage of launch.

Potter says: "The boutique model is something we've always been passionate about, given that hunger and passion from managers to deliver the right mandate. This is because it is their businesses, they'll know what their capacity is before they even started [to run the firm]."

For example, Potter mentions the £792m Prusik Asian Equity Income fund, which is closed to new investors and has been one of the longest lasting holdings in the portfolio.

Potter says: "The preservation of income won't increase the size of the fund, it is one of the best Asian funds by a country mile which we have owned since 2011 and the manager is currently up 120 per cent. We [have] got to find the specialists when we can."

Emerging markets and Asian equities offer value for the managers despite the disappointing performance compared with developed markets over the past five years. The managers believe the risks posed to the region by US President Donald Trump and his potential protectionist policies are already priced in by the market. Elsewhere, changes in the portfolio have been relatively minimal, Potter says, as the team tends to stick with its managers.

Value plays

The team has recently bought the Global High Income Bond fund from newly-launched boutique 1167 Capital, which was co-founded by former Liontrust manager Michael Mabbutt.

However, Potter has cut back a slice of the fixed income in his fund, given the very low yield environment, preferring floating rate exposure. Given interest rates are expected to rise this year, the 29.4 per cent exposure to



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fixed interest in the fund should prove beneficial, however.

Potter has increased exposure to the value-driven Schroders Income Maximiser fund, currently a 6 per cent allocation and second biggest holding of the fund.

Potter explains the team is betting on more value-oriented funds, believing the strategy is making a comeback compared with growth investing.

The team gained exposure to student accommodation through the GCP Student Living investment trust, which has a yield of around 4 per cent and a return of 11.4 per cent over the past year. Within property, Potter also invests in caravan parks and UK camping.

Elsewhere, Potter points out the fund is "almost" fully invested, with only 2 per cent allocated to cash and the rest in over 14 per cent of futures margin positions.

'Take more risks'

Potter recognises the market has been challenging for fund managers globally but as equity investing regains traction, he would not mind investors taking more risks.

He says: "In the past five years, there were fewer bullish fund managers than before. There is room for equities now but managers need to take more risks.

"We look at fund managers, not just one, and blend them together with their ideas when they don't look at macro events. Most of them will be right anyway on markets, but they're not always right."

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