

GAM UK Equity Income – On the lookout for the next opportunity

Marketing Material

GAM UK Equity Income¹ has just celebrated its one-year anniversary. The year has been a challenging one, with macro issues adding to market volatility, however the fund has outperformed its benchmark over the period². Looking ahead, the team believes that despite short-term headwinds, there are interesting opportunities in the longer term; new idea generation continues at pace and can be seen across the market cap spectrum.

While market volatility is unwelcome in the short term, for the GAM UK Equity Income fund we believe it presents opportunity. As an active manager we believe we have the ability to position the portfolio to benefit from market turbulence but also, due to the fund's AUM of GBP 150 million, this should enable us to complete such repositioning in a timely fashion. This can be most clearly seen in sectors such as telecoms, utilities and tobacco, as shown in the chart below.

There are several investments in our top 10 holdings that did not exist in the portfolio 12 months ago. BT is a case in point. It is an investment that is out of favour with the market but we believe a good deal of uncertainty has been removed since Jan Du Plessis joined as chairman. Most notably he has added clarity over the company's dividend, pension fund contributions and capex plans.

New idea generation continues at pace and can be seen across the market cap spectrum. In October, British American Tobacco was added to the portfolio as a 2% position at a price of GBP 32.70. When we launched the fund in October 2017, BATS was priced at GBP 50.22 but has subsequently suffered from FDA pronouncements of investigations into cigarette nicotine levels and marketing practises with regard to vaping. A decline in emerging market currencies has also hampered debt reduction. With a free cash flow yield of 8% and a dividend yield of 6.0%, we believe these recent concerns are now reflected in the share price.

Past performance is not an indicator of future performance and current or future trends. The performance is net of commissions, fees and other charges.

¹ Refers to GAM Funds (OEIC) – GAM UK Equity Income

² Performance data refers to Z share class.

The mentioned financial instruments are provided for illustrative purposes only and shall not be considered as a direct offering, investment recommendation or investment advice. Allocations and holdings are subject to change.

Highlights from our first year (to 27 Oct 2018)

6th out of 87 funds

in the IA UK Equity Income sector –
-1.7% versus -4.1% (FTSE All Share)

GBP 150 million

fund assets under management
(as at 30 October 2018)

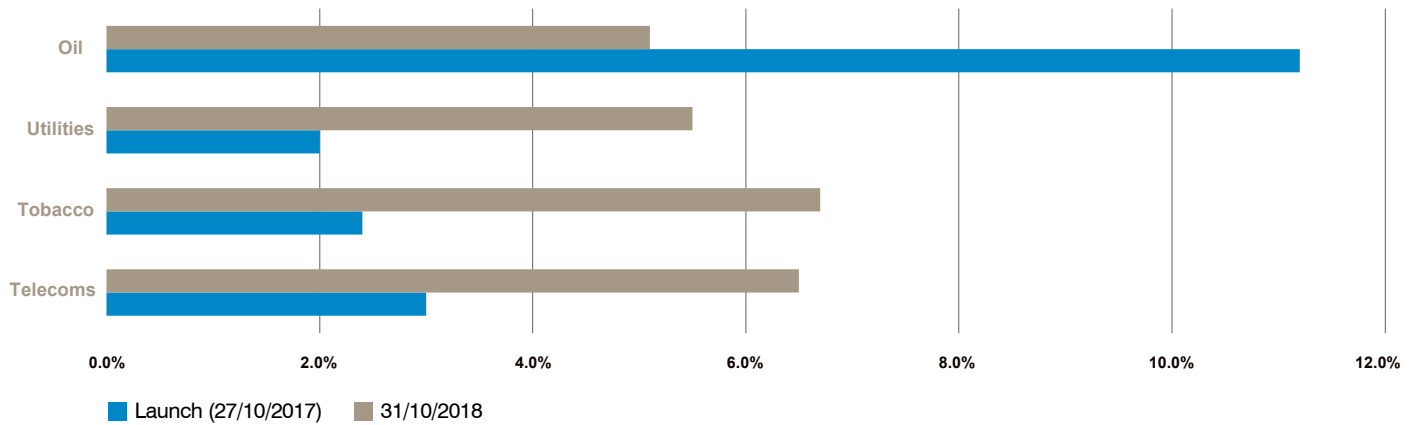
50 stocks

active share 80%+, progressive dividend
with yield in excess of FTSE All Share Index

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The fund has shown its capabilities across the market cap spectrum and has done so with agility. We are looking forward to the second year with confidence.”

Chart 1: Evolving sector positioning



Source: GAM Investments

From the below GBP 1 billion market cap universe, we have added OneSavings Bank. This domestic bank, aimed at the buy-to-let market, has struggled to gain support from investors during Brexit negotiations, as well as concerns around falling house prices. However, on 6.5x price to earnings (P/E) for 2019 we believe the shares appear to already price these issues in.

Throughout this first year, we have rigidly stuck to our sell discipline. When the fund was launched, Royal Mail was a top 10 holding. Trading on 9x prospective earnings, we felt the valuation reflected uncertainties over union action and the structural decline of letter volumes. Our confidence to invest in the company came from meeting Moya Greene (CEO at that time) and further work with preferred analysts on possible scenarios. The stock delivered strong gains in a short space of time, but this meant there was little left in terms of the valuation based on our estimates. The announcement that Moya Greene would retire also came into our thinking and resulted in the sale of the complete holding at GBP 6.17 on 11 May 2018.

Northgate was another holding sold during the period. The business is well run and the new management had shown ability to capture growth in the UK van rental market. However, a change in the policy towards vehicle disposals meant there would be no cash flow from the business for the next two years. As we have often articulated, cash flow is at the heart of our process and we hold it sacrosanct. For this reason we sold the position at a small profit for the fund.

With the flexibility to invest in mid and small-cap shares we are cognisant of the possibility of corporate activity. During the last year, the fund has experienced four such outcomes; in each case we sold our entire holdings in the stocks following takeover approaches and realised a healthy gain on our initial investments.

We are continually on the lookout for the next opportunity and to that end are busy meeting companies. We have sought to construct a fund with an aggregate valuation that looks both interesting and distinct from the peer group. We have some domestically-orientated names that are growing both revenues and profits, have strong balance sheets and are trading on single digit P/E multiples. They may not be at their absolute lows, but in our view such attractive valuations stack the odds of a decent outcome in the portfolio's favour. When the uncertainty clouding the UK market lifts, we hope to look back and see how obvious an opportunity this was.

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Please, read the legal information on the following pages

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Equity: Investments in equities (directly or indirectly via derivatives) may be subject to significant fluctuations in value.

Investment Positions: Positions may increase in size relative to the size of the Fund. The risk is monitored by regularly adapting positions.

Brexit Risk: The regulatory regime to which certain of the Investment Managers are subject to in the UK could be materially and adversely affected. The decision to leave the EU could also result in substantial volatility in foreign exchange markets and a sustained period of uncertainty for the UK, the EU and the global markets in general.

Source: GAM, unless otherwise stated. (Where applicable and, unless otherwise noted, performance is shown net of fees, on a NAV to NAV basis).

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