Gresham House UK Multi Cap Income

UK Equity Income

Introduction

Launched in June 2017, this is a high conviction UK equity income fund that invests across the market cap spectrum, primarily focussing on high quality small and mid-cap companies. A maximum of 30% of assets can be held in large cap companies, defined as those with a market cap greater than £5bn, although the allocation to such stocks is typically much lower than this. Stocks are selected based on bottom-up fundamental research, leveraging in-house resources and an external network of specialist consultants, and the investment process takes into account macro-economic conditions but is not driven by them.

Click here to read the Gresham House approach to ESG investing.

Why RSMR Rate this Fund

- Strong track record of consistent and attractive risk-adjusted returns
- Stable and resilient dividend stream from a diverse range of underlying companies
- Differentiated approach with low relative correlation to peers
- Well resourced team with access to an extensive external network of specialists

Fund Process

The process begins with idea generation from several sources, including brokers, the external network of specialists, other investment teams at Gresham House and an investment screening process. The screen excludes companies where the primary determinant for success is dependent upon an external factor, such as commodity prices, and this includes the majority of companies in the Real Estate, Banking, Oil & Gas and Mining sectors. Listed investment funds are also typically excluded unless they can add exposure to a specialist niche area. Companies that do not pay a dividend or are not expected to pay a dividend in the next 12 months, as well as companies that are not profitable, are also excluded. This reduces the size of the investment universe from around 1,500 companies to around 600.

Stock ideas are then analysed using a proprietary financial model, as well as third party research tools, to calculate financial metrics looking at things such as valuation, profitability, balance sheet strength, and dividend cover. Stocks are then ranked and those that do not meet the criteria for quality are discarded. This reduces the list to around 20-30 stocks and is run on a bi-monthly basis. In-depth research is then carried out on each idea to understand the market dynamics of the industry in which it operates, the business model, ESG factors and their materiality to the business, and the competitive landscape. Company meetings are also a core component of the investment process and the team carry out around 400 company meetings per year, allowing for an assessment of the company management and their long-term strategy as well as an in-depth evaluation of the company. All these factors are combined to form a proprietary Conviction Score which is used to rank the quality of each company.

The portfolio is constructed from companies that pass through the rigorous fundamental research and allocated to one of four categories, depending on the characteristics of the company. Developing companies are those with higher chance for capital growth and an acceptable level of yield, Emerging companies are expected to have a lower yield but high capital and dividend growth potential, Established companies have a strong yield and scope for some capital growth, and Mature companies are those with a high yield but little expectation of capital growth. Developing and Established categories having a target weight of 35% each in the portfolio and Emerging and Mature make up around 15% each. The weighting of each stock within a category is dependent upon several factors such as liquidity, valuation, and the proprietary Conviction Score. This blended approach ensures the fund has diversification across its underlying businesses and sources of yield, enabling it to navigate market volatility.

Risk management is a core component of the fund, and the managers employ internal limits that individual companies should be no more than 5% of the total portfolio (and typically range between 2 – 4%), the fund is to be invested in only UK-based assets apart from exceptional circumstances, and the fund will maintain a cash balance of 5 – 10%. Liquidity management is particularly important when investing in stocks with a lower market capitalisation and these measures reduce the inherent risk of doing so. The fund is also monitored by, and accountable to, an Investment Committee that includes both external consultants and internal members of staff outside of the fund management team. ESG risks are identified using the Sustainable Investment Framework that applies across investment products at Gresham House. This allows for a structured assessment of the underlying risks of each investee business.

Evaluation

This fund has a bias towards small and mid-cap companies that are profitable and generate high levels of cash. The underlying income stream is well diversified across industries and the dividend of the fund is stable and resilient.

Application

This fund can be used to diversify a UK equity allocation, particularly for clients seeking income. It works well alongside funds that are focussed on large-cap stocks or are heavily biased towards value or growth, thanks to its lower relative correlation and differentiated approach.

Our Opinion

The fund has established a strong track record with attractive levels of long-term returns utilising a differentiated approach compared to peers. Income generation has been stable and less prone to volatility than others in the sector. The under-researched nature of small and mid-cap companies offers a long-term driver for outperformance through anomalies in valuation.