



Hold or Fold: Aberdeen UK Mid Cap vs Schroder UK Mid

250

By Tim Cooper | 00:01:00 | 08 October 2008

Aberdeen UK Mid Cap

What Citywire says:

The Aberdeen UK Mid Cap fund was relaunched in April 2006 and has assets totalling £80 million. It invests predominantly in the companies of the FTSE 250 index. James Laing heads Aberdeen's London-based Pan European equities team, which manages this fund.

What Aberdeen says:

'We avoid businesses we don't understand and place emphasis on the strength of balance sheets and cash flows,' says Laing. 'The fund's performance has been volatile, achieving top-quartile performance in 2004 and 2006, only to underperform in 2007 and during the first half of 2008. Much of the underperformance was due to increasing our exposure to the housing market far too early, in hindsight. Also some of the food manufacturers we own – for example Premier Foods – were hit by higher soft commodity prices. But it is encouraging that more recently the fund's performance is improving.'

'Sentiment is likely to remain fragile and market volatility will continue for the foreseeable future. However, to a large extent valuations have already priced in a sharp slowdown for domestic economies. Indeed, we believe the current market weakness has presented interesting opportunities in well-financed companies for patient, longer-term investors. We expect merger and acquisition activity to return as sovereign wealth funds and private equity funds look to deploy capital.'

What the advisers say:

Matthew Clark, Chartered financial planner, Cathedral Financial Management

This fund's performance has been patchy and disappointing. In the year to date the fund is down 24%, compared with the FTSE 250 index, which is down 18%. Over three years, it has delivered a return of -8%, compared with 16% from the FTSE 250.

The fund's good performance in 2004 and 2006 has been hurt by not controlling downside risk in the recent bear market. The maximum loss of the fund over the past three years is 31%, compared with 24% for the index.

I am concerned that it is not positioned defensively enough in the current climate. About 50% is invested in consumer goods and services, which are likely to face severe headwinds as the UK economy slows.

The mid-cap arena is potentially a profitable market in which to invest, where a

good active manager can add value. But with significant underperformance and more compelling propositions elsewhere, this fund is a **fold**.

Ian Creswick, Investment manager, Thesis Asset Management

It surprised me that this Aberdeen fund dates back to 1982, but has only reached £80m in size, which is about the size of the Schroder fund's largest holding. Marketing and a high profile are not everything, but performance has been nothing to shout about over the short and longer terms.

The investment process emphasises a bottom-up approach with little regard to sector weights. The fund is relatively concentrated with the largest holding, Venture Production, being around 4%. The result of Aberdeen's stock picking is quite different from Schroder's, being overweight in consumer goods and services and underweight in industrials. This has led to underperformance, since it is the industrial sectors, such as defence, specialist engineers and support services – largely exporting companies – that have benefited from a weak sterling.

Other better funds specialise in the mid-cap area or can move between large cap and mid cap as conditions dictate. On either count this fund is a **fold**.

Philip Pearson, Partner, P&P Invest

The fund was created from the UK Mid Cap unit trust launched in February 1982 and reconstructed in April 2006. The underlying investment strategy has remained consistent. Long-term performance looks good, but closer analysis indicates poor returns compared with the index over the past five years.

The fund manager has been unable to sustain above-average performance year on year. The portfolio is made up of around 49 stocks, with consumer services and industrial companies accounting for around 65%. The investment style is therefore to run a concentrated portfolio, highly influenced by stock selection.

The investment strategy is not achieving returns greater than that offered by the market when considering the performance of the FTSE 250 index. The risk-adjusted returns from the fund therefore offer poor value. Should stockmarkets continue to experience a high level of volatility over the coming months, investors will see continued above-average risk. I advise a **fold**.

Schroder UK Mid 250

What Citywire says:

Andy Brough has managed the Schroder Mid 250 fund since its launch in November 1999. Its objective is to achieve long-term capital growth by investing in the medium-sized companies listed in the FTSE 250. Assets total £1,935 million.

What Schroder says:

'The UK equity market continues to experience considerable volatility, with share prices moving in huge volumes and significant shifts in direction,' says Brough. 'Sentiment towards equities in general remains poor, with investors factoring in a collapse in earnings regardless of fundamentals.'

'Although we predicted a tough year for consumer names (and cut our exposure last year), we have still been surprised by the sheer speed and scale of recent share price movements. We didn't anticipate that contagion from one or two of the weakest companies would engulf the whole sector.'

'Takeovers play a vital role in highlighting value in companies and their share

prices, so the dearth of M&A activity has been a major reason for the recent mid-cap troubles. All it takes to turn sentiment around, however, is for someone to say, "Yes, that share is cheap" – as highlighted by the fact that any whiff of corporate activity currently prompts a significant rebound.

'We continue to look to the bombed-out sectors for opportunities. If merit exists in the individual companies, going against the trend is the best way to make money in the long term. This approach has put the fund under pressure recently, but we feel it will be more than justified in the long run.'

What the advisers say:

Matthew Clark, Chartered financial planner, Cathedral Financial Management

Brough is a strong advocate for UK mid-cap investment, but sadly this fund's size has made it increasingly hard to manage effectively in the mid-cap space. Liquidity is much more of a constraint here than with large-cap FTSE 100 companies.

The fund has to focus on the larger, more liquid companies in the FTSE 250 index and hold for longer periods since it is difficult to exit a large position quickly. As a result, it has tended to move closer to the make-up of the FTSE 250 index, with a tracking error of just 3.3 over the past three years. The portfolio turnover of the past 12 months has been 45%, while peers have managed their portfolios more actively to reflect market dynamics.

Past performance reflects challenges Brough faces piloting a tanker, while smaller competitors' funds are more like speed boats, better able to exploit changing market conditions. The strong performance of 2004 to 2006 has been undone by disappointing returns in 2007 and 2008. There are more attractive UK mid-cap options around, so this is a **fold**.

Ian Creswick, Investment manager, Thesis Asset Management

Brough is the face of the Mid 250 index as an ambassador for this evolving area of the market, which he calls a 'Heineken index that is constantly being refreshed'.

The fund has been managed on a bottom-up basis since launch. Sector positioning is largely a secondary consideration, although the fund is overweight in industrials, oil and gas, the main underweight being in financials.

We have invested in the fund since its launch and have mostly enjoyed good returns above the index and competition, especially when M&As were booming. But as this dried up last year, performance has lagged due to poor stock selection and missing out on some large rises in newer entrants to the index.

Brough has tried to revise his tactics by having fewer, more concentrated holdings and by trying to trade more, making stock selection even more vital and fund returns more erratic.

Despite having great respect for Brough and his achievements, I now rate this fund as a **fold**.

Philip Pearson, Partner, P&P Invest

Brough adopts a bottom-up investment strategy, targeting firms with quality management and effective business models. This sector of the market has the potential for performance above that expected from the FTSE 100 index.

However, this comes with the added risk of higher volatility associated with

medium-sized companies. In the past the fund achieved a period of success, but it has underperformed significantly over the past three years against the benchmark of the FTSE 250.

It is difficult for any fund manager to outperform an index consistently. This is particularly true in the FTSE 250 where companies are diverse in size and potential for growth.

This fund has had a higher level of volatility and investment risk to that of the FTSE 250 index, while being run at a higher cost than that normally associated with a tracker fund. There is little to suggest that Brough's investment style will change, and performance may continue to be volatile. I would **fold**.

Citywire verdict:

Aberdeen UK Mid Cap

The fund used to be a top-quartile performer, but has not been able to replicate this success recently.

FOLD

Schroder UK Mid 250

The manager has achieved a lot, but also struggled in the tougher market conditions.

FOLD

Twist

Citywire AA-rated Ashton Bradbury has achieved efficient stock selection consistently and his Old Mutual UK Select Mid Cap fund has outperformed its peers over the past five years.

“
I am concerned that the fund is not positioned
defensively enough in the current climate.”

Matthew Clark