

WEALTH ADVISER PROFILE

Getting under the bonnet of portfolios at Saunderson House

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If anyone used coats of arms nowadays, Chris Sexton could adopt a worse motto than 'caveat emptor'. A basic axiom that seems to be often forgotten in professional investment, it has informed his career from an early stage, and his relationship with his clients.

Now investment director at Saunderson House following a career running institutional funds, and ultimately responsible for around £2 billion in assets, Sexton has taken a lead in restructuring and formalising both the investment process and client communications at the firm.

Within the six years he has been in the post, the principle of 'buyer beware' has informed some pretty punchy asset allocation decisions – 'our necks were on the line,' he reflects now – but which have been ultimately vindicated by the past three years.

Now heavily back in equities he has, as you would expect, a long-term and cogent view of why he sees solid support to pricing despite an air of malaise settling in over the global economy. But as an adviser required to bring his clients with him, the principle of caveat emptor extends to ensuring that clients are able to buy into his expertise.

'When I turned up here I helped develop the investment process, including the ideas of simplicity and transparency. During 2005/06 we would still regularly be asked "where is my exposure to hedge?" – not even hedge funds, just hedge – "where is my exposure to structured products?";' says Sexton.

'There was a sense that "you are not sophisticated, you just don't understand these things". Over the last two years many people have come round to the point of view that you want to be able to look at anything [in a portfolio], understand it, and sell it the next day if you need to.'

Born in 1965 in Chadwell Heath, Essex, Sexton grew up in Chelmsford, near the Suffolk border, where his father

was an engineer in Ford's research and development department and his mother a teacher.

With what he now describes as the 'arrogance of youth' he left education to begin a career in the City after completing his A levels, joining insurer General Accident as a specialist underwriter on the Lloyds markets.

'At that point, leading up to the Big Bang, everyone wanted to be a broker: there was this idea that you could go into the City and make your own way. But of course, all anyone would ask you would be what degree you had.'

Suitably chastened, he headed to university to obtain a degree in economics. Having begun with the sense that he was 'just out to get a piece of paper', he discovered his calling however, achieving a first-class degree and inadvertently stumbling on his future career.

'One of my tutors told me that I was not aggressive enough to be a broker, but that I was a natural born fund manager. And that was it.'

Having spent his work placement at the Family Assurance Friendly Society, Sexton

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joined the company after graduation in 1990, on its trainee equity analyst team, as one of six people handling the company's insurance capital.

'I had a fantastic time. I remember being there when Thatcher was forced out and the market responded and all the screens went blue and the feeling of being right there in the middle of things. It was the same thing with the exit from the exchange rate mechanism when [then chancellor Norman] Lamont kept on coming out during the day and interest rates went from 10% to 15% before coming all the way back down again, the sense of being where things were happening.'

It was also the beginning of his understanding that not everyone in the City trying to sell things to you had your best interests at heart. 'I remember doing the derivative overlays during the [1992] election: I made money but more by fortune than skill. It was an important lesson, realising that there were a lot of clever brokers out there who will sell you anything. The City is a very dog-eat-dog place.'

He spent five years at the company up to 1995. After it consolidated its operations in Brighton, it became clear that the dedicated in-house investment team had a limited future.

'That's the great thing about being an economist – you can see a slow train coming from a long way off. [The company] was growing well but it was not clear how sustainable it was or how long they would continue to have a fund management team,' he says.

Expanding his experience from the broad but shallow research and management remit of a small investment

team he moved on to the British Steel Pension fund. From a role in which he was expected to make a wide range of investment decisions rapidly he had to adapt to making a limited number of decisions slowly, but with authority.

'The atmosphere was like a library. [It was] a very different environment. We would spend days, sometimes weeks, trying to get to grips with the finances of individual companies, modelling cash flow and revenues and deciding whether or not we wanted to own the shares. It was very rigorous research.'

He says the discipline was hugely valuable and an important component of a well-rounded manager's skill set, providing the courage that comes with an authoritative grasp of a subject. 'It was definitely useful in providing conviction to your calls so you can haul the senior fund manager up by his lapels and say "you need to sell these things".'

Even so, by the end of his time with the fund, Sexton began to wonder whether he was painting himself into a corner. Working on a fund that was in an inevitable period of long-term decline was also not a great position to be in, he adds.

'For example [I] spent most of 2003 analysing the Safeway takeover bid by WM Morrison. Sainsbury, Tesco and Asda all signalled their interest in bidding. We took the view that a bid by any of the big three would be blocked by the competition authorities and so positioned the fund with an underweight in Safeway.'

'This turned out to be correct but Morrison, with no competition, came up with a very generous bid.

I phoned Ken Morrison directly and expressed my disappointment. Unsurprisingly, he didn't change the bid but we felt fully vindicated when Morrisons suffered a series of profit warnings as it tried to integrate Safeway into its chain. At the end of the year, I had to ask myself how marketable my skills were.'

One thing he had never considered was private client work. But after an approach by head-hunters who filled in the Saunderson House back story, he says the change appealed on a number of levels. The company has a continuous history stretching back more than 40 years but its modern period dates from the arrival of former *Citywire Wealth Manager* coverstar Nick Fletcher in the early 1990s, and his mission to create a modern fee-based advisory.

The company now manages the best part of £2 billion on behalf of around 1,000 clients, primarily City professionals, and made £16.3 million in the financial year 2009. The most recent set of filed accounts for the business showed it made £14.39 million in 2008 with profit before tax of £2.62 million – a healthy rate of growth from £3.2 million revenue and £851,000 in pre-tax profit in 2001.

Recent years have shown a fairly consistent rate of on-target client growth running at 11%, with economies of scale delivering profit and revenue growth a little bit above this. The company now employs 92 people, and is still recruiting, compared with 23 in 2001.

'Nick has a very clear vision of what he wants to do, enabling me to come in with a very clear sense of what I needed to do. I had a much broader canvas

than before, and [the company] is growing. British Steel had £9 billion but it wasn't growing – this is a story that I can go out with to clients and prospective clients.'

Since joining, Sexton's investment research team has grown from two to six, with a 12-strong investment committee – including external members Jonathan Hagger, chief financial officer to the Duke of Westminster's estate, and Tom Wacker, founder of Belmont investment partnership and a former chair of Royal Trust International – meeting monthly.

Sexton shook up client communications, establishing in-depth monthly investment commentaries, twice-yearly investment reports, and one-off investment bulletins on major asset allocation calls, all written by himself. After some initial grumbles about his investment methodology (which focuses on a pure blend of traditional equity, fixed interest, cash and property), clients saw results through the credit crunch and emerged with their faith strengthened. He estimates his allocation calls have a 95% client participation rate.

In addition to sprucing up the company's communication, he also fundamentally redrew its investment methodology in line with his sceptical, value-based approach. 'We came up with a seven-point philosophy, of which the key three points were transparency, analysis and value. If an investment product, fund or proposition is not transparent – if we can't pull it apart to see how it works, we are

not interested. If it is transparent we do full diligence. Finally, value: we are focused on whether what we are buying is attractively priced rather than performance or other criteria.'

The nature of the company's business, which requires securing client approval for each portfolio change, loads the asset allocation towards big one-off moves rather than incremental change. Saunderson House's decision to cut property exposure in 2006, and then all small-cap exposure the following year was significant in winning the support of clients initially unconvinced by Sexton's back-to-basics management.

At the time, the decisions proved an uphill battle however, as was the decision to cut commodity exposure in the lead up the collapse of the resource bubble in 2008.

'All our [equity] funds were underperforming like stink. We were getting a lot of stick but had a lot of very good meetings with managers who were saying it makes no sense to buy these companies and were being consistent with their methodology: they were saying copper would have to be at £100 a pound to justify these valuations. Then the market corrected, and all our funds went from fourth to first quartile.'

Having shifted heavily into gilts ahead of the credit crunch, the company was able to provide significant downside protection, before shifting heavily into corporate debt last year. The last significant move was back into

property in time for the yield compression of the last quarter of 2009.

With the carrying cost of cash now unjustifiable in all but the most apocalyptic of investment environments, Sexton's value approach suggests that upgrading equity exposure will now be the next significant move.

'It comes back to value. Value is not currently in cash or gilts, but equity looks cheap enough, if we don't get a prolonged recession. The data has been getting worse but what will they do if it comes to the worst? Hose it down with quantitative easing, which will prevent deflation, in which case you don't want cash or gilts.'

'We think there are a lot more arms in the armoury. People say that will result in inflation, but once again, in that case equity and property will be the best places to be. We have to paint with a big Rolf Harris brush – we can't go to our clients and say we recommend a 0.5% move.'

'We moved back into property because cash looked expensive – we moved equity exposure overseas at the start of the year, with the exception of Europe, although I would like to start buying Europe,' he adds.

'I suspect the eurozone will be restructured but the EU and IMF's £750 billion was a fireblanket over it that said [they] are not going to be bounced out of it by speculators. Core Europe is actually doing well now because the euro's value has come down. Time and a modicum of growth will help things out.' ■

CHRIS SEXTON'S TOP FIVE PICKS

1

JO Hambro UK Opportunities

'John Wood, lead manager on JO Hambro UK Opportunities, believes equity markets often underestimate the long-term value created by strong, well-managed businesses that reinvest their cash flows to earn returns in excess of their cost of capital. He therefore concentrates his research efforts on identifying companies that exhibit these characteristics. Research always begins with fundamental analysis of a company's financials, with Wood discarding those with distressed balance sheets. Rigorously deriving valuations from first principles frees him from the temptation to follow momentum or relative value. Although these factors drive the market at certain points in the cycle, they are unlikely to lead to sustained outperformance.'

2

Schroder Recovery

'Joint managers Nick Kirrage and Kevin Murphy adopt a contrarian approach, investing in companies that have suffered setbacks and are trading at significant discounts to their assessed intrinsic or fair value, but where the long-term business remains intact. To do this effectively they must look beyond short-term news flows, which they see as the main driver of market sentiment, and focus on an assessment of a company's long-term business economics. The duo recognises the behavioural biases of investors means many potentially attractive investments occasionally become very cheap. As long as the financial metrics indicate the company will survive, this is often a very attractive entry point.'

3

GAM North American Growth

'Gordon Grender, manager of GAM North American Growth, is a hugely experienced investor with a highly individual investment style based on low turnover and very long holding periods. He is refreshingly honest about what an investor can and cannot hope to achieve and he refuses to be swayed by benchmark considerations or to invest in any business he feels he doesn't fully understand. His portfolios tend to be quite concentrated and are skewed towards areas where he believes he has analytical strength. He seeks to make money over a market cycle and his fund has a very low correlation of returns with the index. He is not averse to running high cash positions if he doesn't like the outlook for the economy or market.'

4

BlackRock European Dynamic

'Alister Hibbert's approach centres on a belief that equity markets are not efficient, and disciplined fundamental research plus sophisticated risk management tools will enable him to produce consistent long-term outperformance. Research is done using a bottom-up approach, though the process also incorporates top-down macroeconomic and thematic analysis. Each stock idea starts with an investment thesis built around analysis of 30 to 40 spending streams that make up an economy. Hibbert and his team factor in assumptions about how these will develop into their forecasts for each stock. Risk is taken primarily at the individual stock level, and he describes the fund as largely unconstrained but benchmark aware.'

5

First State Asia Pacific Leaders

'Joint managers Angus Tulloch and Alistair Thompson believe that emerging and Asian markets are among the most inefficient in the world. Their focus is primarily on identifying high quality businesses, and they adopt an absolute return mindset, resisting any temptation to let momentum drive investment decisions. They are of the opinion that, although a company may have good underlying fundamentals, if it is overpriced it is not suitable for investment. They aim to find companies that are attractively priced, that can deliver sustainable long-term earnings growth, and have strong capital discipline, quality management and financial strength.'