



VT Downing European Unconstrained Income Fund

In November 2020 Downing Fund Managers added a new fund to its specialist line-up, launching the VT Downing European Unconstrained Income Fund.

Fund launched
November
2020

by Fund Managers
Mike Clements
and Pras
Jeyanandhan

Managed by Mike Clements and Pras Jeyanandhan (formerly of Syz Asset Management), the fund follows a similar approach to that used on the Oyster European range of funds, which they had joint-managed over the previous five years.

We talked to Mike and Pras about what unconstrained means and investing under the radar, but opened with why Europe is home to good income-producing companies.

An untapped opportunity

With interest rates at all-time lows, investors are finding it hard to secure decent returns and may need to widen their search to find consistent, high-quality income. Can European equities help plug this gap?



“Despite a pandemic-impacted 2020, European (ex. UK) companies still paid out approximately £126 billion in dividends, c2.7x the amount distributed by their UK peers” says Pras. “Furthermore the second quarter of 2021 saw the sharpest dividend growth coming out of Europe compared to other major regions. We believe this makes it an attractive market for clients seeking income.”

Pras notes that a number of leading global dividend payers are European, with Nestlé currently topping the ranks worldwide. “Not only are there quality companies in the large-cap space, there are strong small and mid-cap income producers that many UK investors are not getting exposure to.

“Europe has changed structurally over the last decade, shifting away from ‘old economy’ exposure towards being more of a growth region,” Pras continues. “With this fund we are trying to offer a solution that allows UK investors to diversify their portfolio, giving them something different.”

Unconstrained investing

With an ‘active share ratio’** in excess of 90%, the make-up of the fund looks very different to the European benchmarks. And due to its ‘all-cap’ approach, it also has very little overlap with other funds in its peer group.

“Our fund is about identifying different sources of alpha (returns that beat the index) and different ideas for the portfolio,” Mike says. “We construct a portfolio of high-quality, undervalued companies across a range of industries not typically included in large-cap dividend paying sectors.”

This ‘unconstrained’ method mirrors that used by the managers in their previous fund and it’s one Mike has adopted for over a decade. It boils down to looking for two types of companies across all market capitalisations: ‘contrarian opportunities’ and businesses operating ‘under the radar’.

“Contrarian opportunities involve well-known companies that operate in a sector or country that, for one reason or another, the market has fallen out of love with,” Mike explains. “As long-term investors, we have a behavioural edge because we have the confidence and patience to hold positions for the time it takes an investment thesis to play out.”

With roughly 2,000 stocks to choose from and the ability to invest up and down the market cap spectrum, Mike says the fund can access stocks unfamiliar to many UK investors. “This is what we call ‘under the radar’ stocks and it’s where we think we have an informational edge, simply because we can do extensive in-house research.”

* This isn’t a constraint of the fund

**This measures the % the fund’s portfolio differs from the benchmark index

All cap
portfolio with
typically 30-40*
holdings





The perfect fit

According to Mike, Downing's venture capital and micro-cap ethos are what drew him to join the boutique investment manager.

"When Downing invest in a company, they treat it as if they are the owners of the business, which is exactly what we do - just in the public equity space. We do in-depth, fundamental, bottom-up research on a company before we bring it into the portfolio. That way, we end up with a relatively compact portfolio of around 30-40 thoroughly researched stocks that we strongly believe will bring returns for our investors."

"Given the amount of time and work this process takes, the trade-off is that we can't own 100+ stocks: we wouldn't have time to ensure all of them had the right profile for achieving the returns we want them to."

For Pras, culture is everything. He describes Downing as the "perfect fit" for himself and Mike: "When we met Judith MacKenzie and the team, we quickly appreciated the similarities in our philosophy and style of investing," he says. "There's no pressure to move towards the consensus - in fact, just the opposite. Downing Fund Managers have a distinct culture and investment style that appealed to both of us. We slot in perfectly."

For more information about VT Downing European Unconstrained Income Fund:

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Key themes:

Untapped opportunity for income investors
Long term investors with an all cap approach
Informational edge with 'under the radar' stocks
Behavioural edge with contrarian stocks

Downing

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