Investment update

25 October 2011

Stephen Message, manager of the Old Mutual Equity Income Fund

Stephen Message took over management of this fund in November 2009. Stephen joined OMAM in October 2008 from US private wealth manager Bessemer Trust, where he worked for two years, firstly as an analyst covering Asia ex Japan and UK equities and then as manager of the UK component of Bessemer's international equity fund. Prior to this he was a business analyst at technology consultancy Detica. Stephen has a masters degree in engineering from Imperial College London and is a CFA Charterholder.

Exciting yield opportunities

In a volatile, macro-driven market, yield and growth opportunities continue to stand out, sometimes in surprising places

The market is being driven by macro issues. What are company managements telling you?

It's going to be important what companies tell us in the next few weeks, in the third quarter reporting season. So far it has been company specific - Mothercare has struggled but Tesco and Sainsbury have been all right. The reporting season will give us a sense of the degree to which the volatility markets is feeding into company spending patterns and business behaviour.

Companies are cash-rich. What do you want them to do with that money in this environment?

Companies have strong balance sheets because they haven't aggressively hired or invested in the last couple of years, as we've evolved from the credit crunch. In the earlier part of this year, when confidence was a bit higher, we were seeing increasing dividends, share buybacks, some M&A, and I'd like to see that continue should confidence start to improve.

One of the stocks in the portfolio, Tullow Oil, had a good third quarter. What do you like about it?

Tullow Oil is a core growth investment in the portfolio. It does not have a significant dividend yield. It has been successful in exploration and production, principally in Africa, in Uganda and then latterly in Ghana. Recently the company announced some early success in some exploration in French Guiana in Latin America, which has had investors excited about some of the potential prospects there going forward. As a result, the shares performed well. We're still confident for their growth prospects. It's early days in terms of the Latin America opportunity but there is some exploration potential there for the business.

Filtrona is a recent addition to the portfolio. What does it do? What's its story?

Filtrona is an internal change opportunity. It was demerged a few years ago out of Bunzl. What it essentially does is manufacture fibre and plastic products for a range of industrial and consumer end markets. I don't think the business has been run as aggressively as it could have been over the past few years, but there is a new management team who have had some success improving returns in the business, growing sales and raising margins. I believe that can continue. It has a healthy dividend yield, around 3½% at present.

Is there a lot of yield opportunity in the UK market?

Quite significant at present, I believe. The UK equity market is currently yielding around 3.8% on a trading basis. I expect dividends in aggregate to grow at the market level and I think there is a range of interesting dividend opportunities across the market, including in areas that you would not traditionally think to find income stocks. In the core income part of my portfolio I've got investments in BSkyB, the pay-TV broadcaster. It has a healthy dividend yield with good prospects going forward. Restaurant Group, the UK restaurant operator, is another example. Then there are companies such as Melrose, in the industrial engineering space, which offer premium yields. So there is a lot to be excited about.

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What is the split in the portfolio between UK and international earnings?

At present, around 30% of the revenues from the investments in the portfolio derive their income from the UK, which means around 70% are from international earnings. In the businesses that we have in the UK, I'm focusing on strong, domestic franchises. We talked about Restaurant Group, others are Booker Group, a cash-and-carry operator, or Barclay Group, the house builder. But overall we have a broad range of diversification in terms of our global revenues.

What is your outlook for the equity market and the fund?

I think equity markets are cheaply rated at present on a long-term view, given that markets have derated quite aggressively in anticipation that profits will go backwards. I am not sure that will happen. Looking at the macro economic data, it is not consistently pointing to a downturn. Company finances, as we mentioned, are strong and management remain broadly confident. That suggests a positive outlook for equities.

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