Investment update

30 November 2011

Daniel Nickols, Head of the Old Mutual UK Mid & Small Cap team

Daniel has been the manager of the Old Mutual UK Select Smaller Companies Fund since 2004. He was appointed head of OMAM's highly successful UK Mid & Small Cap team and manager of the Old Mutual (Dublin) UK Select Smaller Companies Fund in January 2009.

Daniel was previously a smaller companies manager at Gerrard Investment Funds, which merged with OMAM in 2001. Daniel has over 13 years' investment experience of UK smaller companies. He is IIMR qualified

Domestic opportunity

The emphasis of UK equities has been companies accessing global growth, but there are still many interesting domestic stories

If we think of the main sectors that give exposure to the UK economy, they are areas such as retail, travel & leisure, support services. Those are industries that are oriented to the consumer or to the public sector, areas of the economy that are facing cutbacks and declining spending power. As a result, in most cases we have been materially underweight for a long time and we expect to remain that way.

But being cautious from a macro perspective does not mean we are closed to ideas either at the sector or the stock levels. A range of factors, including changes in policy and regulation, can affect the outlook for an industry. At a more stock specific angle, 'structural growth' has been an important and largely successful theme for us, in many cases helping us to identify growth stories in the UK domestic economy.

House-building has been in the news recently with the government's plan to help first-time buyers looking to move into new-built homes. We are underweight the sector as a whole, but it makes up a material proportion of out investment universe and, from a risk control perspective, we are unlikely to close down our exposure entirely.

When you start to look closely, you see it is a sector where the perception and the reality are not identical. The headlines will tell you that the UK housing market is in a dire state, but in my view the reality on the ground is that it's bumping along the bottom with largely static prices. Mortgage availability and indeed transaction levels, however, are gradually improving. It is an environment in which a lot of the smaller competitors have fallen by the wayside, leaving the larger players, the quoted house-builders, in a relatively strong position to improve their margins and their net asset values.

The sector is likely to benefit from the government initiative. In the meantime, when we look at the opportunity set, Bellway Homes has been one of our favoured stocks. It seems to have, to our mind, that combination of being exceptionally well managed and still at the cheaper end of the pack.

What structural growth as theme means to us is companies with a distinctive market niche which enables them to grow almost irrespective of what's happening in the wider economy. It is about identifying pockets of growth not correlated to either the UK or the global economy. Some of the strongest examples are in the media and technology sectors. Examples include stocks such as Rightmove, Aveva or TeleCity. But there is any number of characteristics that might be relevant, such as changes to management or business strategy, regulatory change, a merger or acquisition.

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Unsurprisingly in the current environment, it's rare to find a stock which clearly exhibits structural growth characteristics and which is exceptionally cheap as well. In essence, they tend to be more expensive than the average stock and in some cases considerably more so. As an investor, the judgment is to balance the benefits of exposure to significantly above average growth against the price you have to pay.

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