

Resolution Asset Management



FUND MANAGER
David Stevenson

Resolution breaks into a smile of satisfaction

Cartesian UK Opportunities' first anniversary marks job well done



FUND MANAGER
Andrew Kelly

When David Stevenson and Andrew Kelly celebrate the first anniversary of the Resolution Cartesian UK Opportunities fund's launch in December, they will be able to afford themselves a smile of satisfaction for a job well done.

Not only has the portfolio managed to deliver impressive returns – despite the fall back in global markets earlier this year – but it's also been externally recognised with the award of an A-rating from Forsyth-OBSR.

"We're delighted with how everything has gone so far and it's been even better than we could have anticipated," says Stevenson. "The fund has also continued to receive daily inflows and is now up to around £45m."

The fund, which is benchmarked against the FTSE All Share index and sits in the competitive UK All Companies sector, has the ability to invest in companies across the UK market, regardless of either size or sector.

It is principally suited to the more experienced investor who is looking to invest part of their overall portfolio in a higher risk product in the hope of achieving a better return in exchange.

"We run a fairly concentrated 50-stock fund and like the idea of having more ideas than room in the portfolio," adds Stevenson. "The aim is to exploit inefficiencies in the market and we

want our portfolio to look different from those run by our peers."

Investment process

The greatest source of ideas for the portfolio is the experience that Stevenson and Kelly boast after 10 years of working together. Prior to setting up the high alpha boutique, the pair had forged an enviable reputation at SVM.

"Over this time we have met and analysed a large proportion of the companies in our investment universe," says

Examples include Aberdeen Asset Management, which was bought by the duo in the wake of the split cap problems. Adhering to this investment process means a 1,000 potential stock universe can quickly be whittled down to size.

A business template featuring lists of good and bad points will be applied to every potential holding in order to understand the dynamics of the business model. The areas to be examined include: levels of demand for the product or service; the market backdrop; the company's growth profile and its market positioning.

"Once we're comfortable with those areas we will look at a company's earnings quality," explains Stevenson. "It's important to make sure it has the right financial dynamics - such as an ability to generate turnover – as well as decent profit margins and cash available to fund ongoing growth."

Portfolio construction

"We've got a combination of good long-term growth stories and good recovery situations in the portfolio," says Stevenson. "Some of the best investment performance can come from spotting a company which historically hasn't done very well, but has tidied up its act and improved the quality of its earnings stream."

Although the fund will always be underweight the FTSE 100 because Stevenson and Kelly feel this is a very well researched part of the market, the number of large-cap holdings has actually increased over recent months.

"This has very much been on a stock-by-stock basis," adds Stevenson. "The large-cap exposure is up from 25% to almost 40%, while the small-caps are down to about 15%. The rest of the holdings are made up of mid-cap companies."

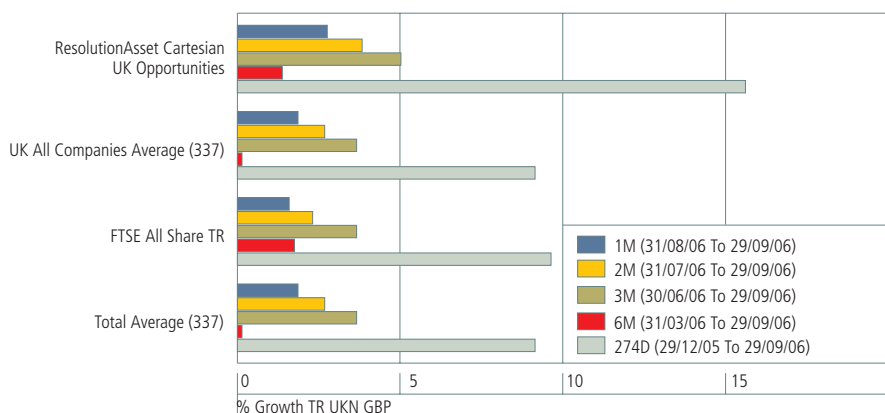
Current themes

"We try to cut the investment universe up into three broad areas of spending – consumer, corporate and government – which we see as driving overall economic growth," says Stevenson.

Over this time we have met and analysed a large proportion of the companies in our investment universe

Stevenson. "Our focus is on those which have either been through a restructuring or have superior growth which is being overlooked by the market."

CARTESIAN UK OPPORTUNITIES FUND PERFORMANCE



As at 29 September 2006. Source: Lipper, bid to bid, net income reinvested, excluding initial charge.

"The mix of these can change during the cycle."

The consumer, he points out, has enjoyed a relatively soft landing. "Growth has slowed, but we're playing sectors such as food and drink because people will carry on eating and drinking," he explains. "We also have exposure to asset and wealth managers who are benefiting from the rising savings ratio."

Government spending includes exposure to the main PFI areas of schools, hospitals and the roads. On a stock basis, this has led Stevenson and Kelly to names such as Balfour Beatty, as well as companies working in outsourcing.

As far as corporate spending is concerned, Stevenson believes that fund managers need to choose their investments carefully.

While aware this area goes hand-in-hand with the economic cycle, he believes names such as Rolls-Royce in the commercial aerospace sector, as well as construction companies, are set to benefit further. "We're very focused stock pickers in this area," he adds.

Benefits of boutiques

Stevenson believes the boutique environment is conducive to delivering out-performance for investors.

"This fund is a truly unconstrained product and we haven't got people breathing down our necks with their views," he says. "We obviously want to grow, but there are no outside influences on our stock picking. Our interests are clearly aligned with the underlying clients as the better we perform the more money we make too."

While accepting the UK Opportunities Fund may have to eventually be capped if it continues being so popular with investors, Stevenson believes it still has plenty of room for growth before that becomes a burning issue.

"We don't really see any issue between where we are now and funds worth half a billion pounds," he insists. "Given the way we have oper-

ated over the last 10 years, I don't think that growing to that sort of size would present too many problems."

Examples

Stevenson cites supermarket Tesco as a prime example of the type of company he likes. "It has consistently produced double digit earnings growth, has high cash conversion and a decent growing dividend yield, as well as freehold properties," he explains. "Tesco is

portfolio within the first nine or 10 months then that suggests you haven't got much of a process," says Stevenson. "The portfolio we initially picked is essentially the same, although we have made a few tweaks."

Even so, all positions in the portfolio are subject to constant review. "We try to avoid falling in love with stocks, although we have had positions in some companies for many years," says Stevenson. "However, you don't always get it right and where the

The trend towards bid activity is likely to continue and that provides underpinning to the market

going to be a very significant all-round retailer in the future and we bought it because we felt it just looked at the wrong price for its prospects."

Performance

"The performance that has been achieved so far has been better than we hoped so we're delighted," says Stevenson. "The year can be divided in two but we've managed to hold on to a decent amount of the out-performance enjoyed during the first quarter. The recent market rally means we've also improved the performance so the numbers are back up again."

Since launch the fund has delivered a bid-to-bid return of 17.28%, according to figures compiled by Standard & Poor's up to 9 October 2006. This is well above the 10.18% average achieved by the UK All Companies sector over the same period and enough to place the fund in 12th position out of over 300 rivals.

Sell discipline

Turnover has been relatively low so far and that's mainly due to the fact that the fund only launched last December.

"If you feel the need to churn your

analysis turns out to be wrong, it's got to be an automatic sell."

Market outlook

Although Stevenson and Kelly proclaim themselves to be nervous about levels of growth, they remain confident in their ability to deliver returns for investors by focusing on long-term stories and the structural drivers in spending.

"We can still find more than 50 companies that offer the prospect of sustained earnings growth over the next few years, aligned to compelling valuations," says Stevenson. "The trend towards bid activity is likely to continue and that provides underpinning to the market."

Goals

As far as the Resolution Cartesian UK Opportunities fund is concerned, the aim is to continue delivering decent outperformance for their investors.

"We feel that all the building blocks are now in place," says Stevenson. "Although we've only been running this fund for a year, people need to realise that we have a long track record and are using the same process. We're not new kids on the block."