



Martin Cholwill

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Fund

## Q&A with Martin Cholwill

**Martin Cholwill, manager of the Royal London UK Equity Income Fund, gives an update on the fund in light of recent global developments**

**This is a UK fund; how focused are you on the global macro environment?**

Overall my focus is more on stock picking than on big macroeconomic tilts and this is where I would expect the majority of returns to come from. Having said that, in the last couple of years the global economy has panned out very much as I expected in terms of trends and themes and as a result we have enjoyed consistently good investment performance.

**How are current global events affecting portfolio positioning?**

The situations in the Middle East and Japan are developing very quickly and need to be watched carefully. At the time of writing I expect these events to take some of the shine off global growth, rather than derailing it completely, and to lead to more upward pressure on commodity prices, including oil and gas. We are still a long way from being tipped into global recession and I have not changed the portfolio as a result of recent events. The current situation only reinforces my view that inflation risks remain to the upside and that there will be a huge variation in the extent to which companies are able to pass on these cost pressures.

**What do you currently perceive to be the greatest threat?**

The biggest threat is that the global economy experiences a double-dip recession, although I think the likelihood of that happening is remote and that the overall growth trend remains intact. The UK economy is likely to muddle though, whereas growth from emerging markets will be more robust and this is the scenario for which the fund is currently positioned.

**How do you see the outlook for inflation?**

I have thought for a while that the risk to UK inflation is to the upside, given the scale of quantitative easing from the UK authorities and the policy imperative of avoiding a Japanese-style deflationary scenario. This view has been reinforced by ongoing economic recovery and rising oil, food and commodity prices, as well as monthly inflation data releases that have consistently been ahead of expectations.

**Your top ten holdings are very FTSE 100-focused. How do you diversify?**

The fund is a conviction portfolio and holds just 50 stocks. There are plenty of opportunities outside the FTSE100 Index and currently around 35% of the portfolio is in midcap shares. I believe that the issue with concentration is more relevant to

'mega cap' shares rather than the FTSE100 Index as a whole. Overall I am agnostic as to size and am instead concerned with seeking out value. If there is an increase in merger & acquisition activity in 2011, it is not the mega cap companies that will be taken over; they are more likely to be the ones doing the taking over. With strong corporate cashflow and healthy balance sheets suggesting that this will be the case, it is the potential bid targets that make the more attractive investments, rather than the buyers making acquisitions at a premium.

**Which sectors currently offer the best opportunities?**

The fund is broadly based in terms of sectors although I am currently finding plenty of opportunities in industrials and non-bank financials. The portfolio is also well represented in regulated utilities, which are cheap inflation hedges and potential M&A candidates, as well as being attractively valued on a standalone basis. A key focus for me is identifying survivors – in other words those companies whose competitors have been seriously weakened by the recession that are able to exploit this advantage as the economic upturn gathers pace.

**Finally, what are the prospects for dividend growth?**

Although we face an extended period of anaemic economic growth in the UK, that does not mean that the equity market can't do well. Having planned for a full-blown depression, companies were generally able to cope very well with what turned out to be 'only' a recession. Having taken difficult cost-cutting decisions at the low point of the cycle, companies are now reaping the benefits and in some cases profit margins will exceed previous peaks. Consequently underlying corporate cashflow is strong and balance sheets are repaired and this combination of robust cashflow and balance sheet strength means that prospects for dividend growth are rosy for the next couple of years, even if it still feels like a recession to the man in the street. Dividends will therefore look very attractive relative to savings rates that look set to remain low for an extended period.

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