# Phoenix Pension Fund

## Investment Strategist: Raffaele Mugno – Spring 2001

- *Phoenix  Investment Ltd*

# Introduction

- Goal: The Fund's investment objective is to seek long-term capital appreciation
  - by investing primarily in equity securities of issuers throughout the world

# Global Gloom

- **E**xpected growth in 2001: UK  2.3%. - US 1.5%. - EU 2.4% Source: World bank

- Economic growth is slowing in Continental Europe in line with the rest of the world

|  | 2000 | 2001 forecasts % made in | |
|---|---|---|---|
|  |  | Oct 2000 | Apr 2001 |
| United States | 5.0 | 3.2 | 1.5 |
| Euro Area | 3.4 | 3.4 | 2.4 |
| Japan | 1.7 | 1.8 | 0.6 |
| Developing Asia | 6.9 | 6.6 | 5.9 |
| Asian tigers* | 8.2 | 6.1 | 3.8 |
| Africa | 3.0 | 4.4 | 4.2 |
| Latin America | 4.1 | 4.5 | 3.7 |
| Russia and Eastern Europe | 5.8 | 4.1 | 4.0 |

- Source: IMF   * Hong Kong, Singapore, South Korea and Taiwan

- UK and US  best potential employment rate Source:OEDC

- Approach: Sector movements & Stock selection

# Adagio

- Non-Cyclical Consumer Goods & Services: Food/Drug Retailer - Beverages - Telecom services

- Resources: Oil and Gas - Two trends are reshaping the energy industry:

   *the rise in natural-gas demand*

   *convergence between the gas and electricity markets in America and Europe*

- General Industries: Publishing

- Basic Industries: Construction

- Beta lower than 1: in bear markets lower downside than the indices

- P/E ratios lower than industry average: avoiding bubbles, share valuations more attractive

- *How plausible are forecasts based on High p/e ratios? Not very:*
  *empirical evidence by Louis Chan, Jason Karceski and Josef Lakonishok.*

- The Level and Persistence of Growth Rates". University of Illinois working paper, March 2001

# Adagio

- Buy and Hold

- Not change the risk profile in the short period

- Avoid transaction costs

- Confidence in our analysis

- Our Shares, overall, are outperforming the relative sectors

# Looking Ahead

- Macro & Micro Changes:
- Monetary and Fiscal Policies
- Political and Regulation Reforms
- Shares performance & companies strategies

- Exposure Changes
- Defensive stocks expensive?
- Going for growth

- The Fund will continue to invest in the UK and US, and may also invest up to 10% in Continental European Countries within Pharmaceutical, Financials and Media companies. Undervalued opportunities can be identified outside the market leaders as these companies are less well-researched by the broader investment community

# Stock Selection

- In selecting securities for investment,the Fund emphasises a "value" style of investing focusing on companies with strong fundamentals,promising growth prospects and attractive valuations

# Fundamentals

- The Fund invests in businesses whose future earnings are predictable
    - Profit margins
    - Return on equity
    - High liquidity
    - Brand-name loyalty for its products
    - The presence of multiple products

    - Models:
    - DCF & DDM Multistage

# Portfolio Characteristics

- Total Assets                         £100,000,000
- Number of Securities            30
- Beta                                0.64
- Benchmark                    FTSE 100
- Current Value                 £102,000,000

# Main 10 Sectors
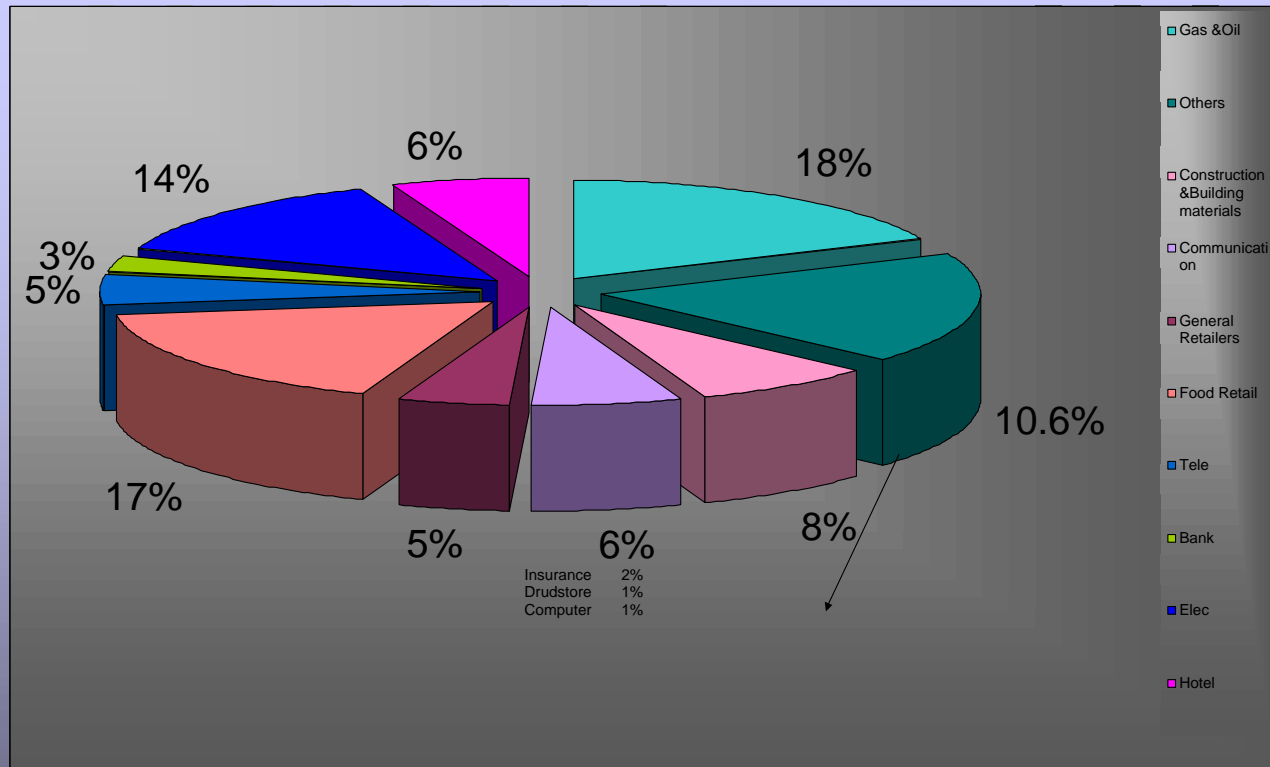
# Top 5 Holdings

- Shell Trnspt&Trdg          15%
- Electrocomponents          7.89%
- Reed International         7.04%
- Tesco                      6.96%
- Cvs Corp                   6.88%

# Risk Management

- Market Risk
- Specific Risk
- Foreign Risk

# Market Risk

- Market risk is the possibility that the market values of the securities that you invested will decline

- The fund's investment process is value- driven
- Diversification among sectors is used to reduce risk

# Specific Risk

- Aim to identify mis-priced securities offer opportunities to achieve abnormal returns


- Trade-off between
  - achieving abnormal returns
  - reducing risk via diversification

# Foreign Risk

- Since The fund owns securities of foreign issuers,it is subject to risks outside of the UK



**Country Distribution**
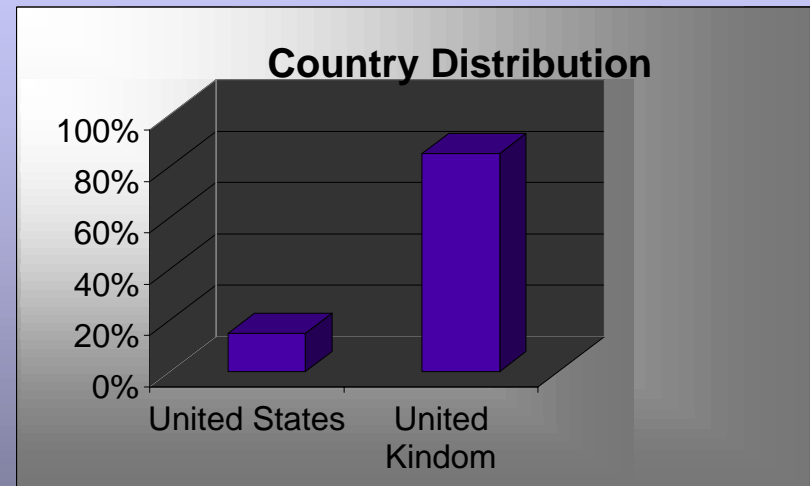
# Foreign Risk

- The fund faces less credit risk from US companies

- Transaction cost in the US is lower

- The main source of risk is foreign currency exchange risk

# Performance Measurement

- Jensen' alpha
- Modified Jensen' alpha
- Appraisal ratio
- Market timing

# Jensen's alpha

- $J_p = r_p - r_f - \beta_p \, [r_M - r_f]$
- same systematic risk
- measures our portfolio's excess returns
- our portfolio's Jensen's alpha is *0.00984*
- This positive number shows we have outperformed the market
- But Jensen' alpha does not measure specific risk , we need to modify it

# Modified Jensen's alpha

- cost of carrying specific risk

- $J_p - (\sigma_p / \sigma_M - \beta_p)\, \mathbf{E}[r_M - r_f]$

- Modified Jensen's alpha is *0.00973*. Our portfolio still outperformed the market after we modified our Jensen's alpha

- To make it more clear, we also used Appraisal ratio
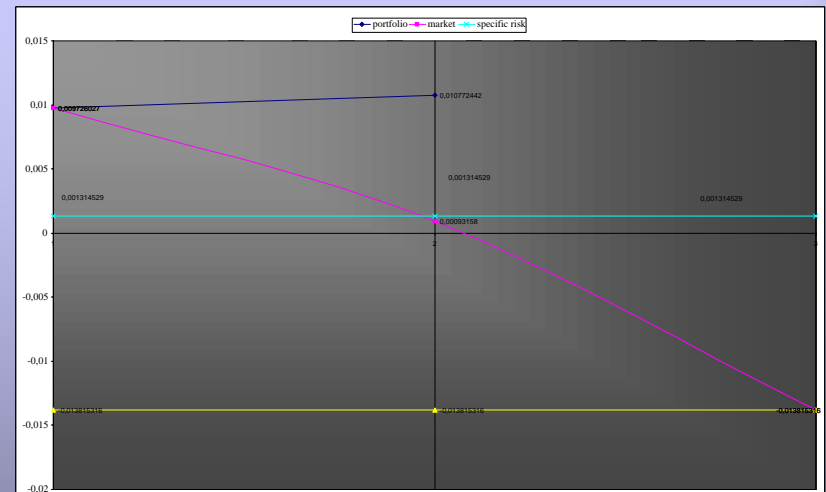
# Appraisal ratio

- the excess return per unit of specific risk

- $A_p(t) = J_p(t) / \mathbf{\grave{O}}_{\varepsilon\,p}(t)$

- the specific risk of our portfolio is 0.003278

- our portfolio' s appraisal ratio is 3.00

- In fact,our portfolio is less volatile than the index

# Performance
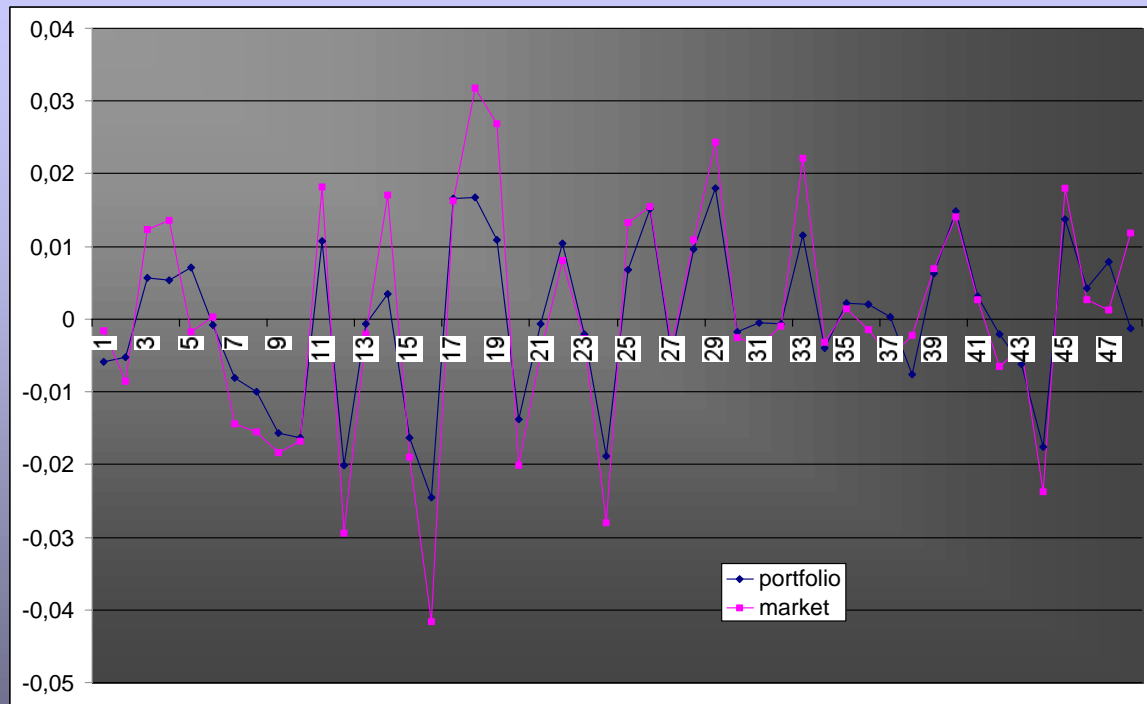
# Market timing

- We are bearish about the market — lower beta

  Market timing= $(\beta_p - \beta_t)\ [r_M - r_F] = 0.0015$

- Our portfolio outperformed the market 35 out of 48 days, which is 70% over this period

- So the overall abnormal performance of our portfolio is $J_p + (\beta_p - \beta_t)\ [r_M - r_F] = 0.01133$

- Moreover, we had a good forecast about foreign exchange rate

- The return on foreign exchange is

  81000/100000000=0.00081=0.081%

# Conclusion

- Good performance
- Sound strategy
- Selective stock picking
- Careful consideration of risk
- Confidence for the future