Bright Talk - Artemis

Presenters: Richard Turpin, MD Artemis
Jacob de Tusch-Lec, End Manager

Operator: Thank you for standing by, and welcome to the Artemis Capital Fund Conference call. At this time, all participants are in a listen-only mode, to eliminate any background noise. I must advise you that this conference is being recorded today. I would now like to hand the call over to your host today, Richard Turpin, Managing Director of Artemis. Please go ahead, Mr. Turpin.

Richard Turpin: Thank you very much. Ladies and gentlemen, good morning. Welcome to the continuing series of our webcast conference calls. And may I thank you very much for the time you've been waiting while we got all the participants online. Today we have with us Jacob de Tusch-Lec, who with Mark Tyndall, is the co-manager of the Artemis Capital Fund. Jacob joined Artemis last year as a member of our SmartGARP team, and specifically to be a UK specialist, and manage the Capital Fund. Now as many of you will recall, SmartGARP is our investment process, has a large-cap bias, and is the investment process that sits behind the Capital Fund, as well as driving our European and our Global Fund.

Now just a quick recap on the Fund, the Artemis Capital Fund has been managed by Mark Tyndall, originally from September 2002, when you may recall the ABN AMRO UK business was merged with the Artemis business. Now the Fund is currently some £760 million in size, is top quartile over six months, 1, 3 and 5 years, and over the last twelve months, has delivered a return of some 36.3%, versus a FTSE 100 of some 26%.

Now before I hand over to Jacob, who's going to have a look at what is going on inside the Capital Fund, and also reflect on some thoughts on the UK market, if I just may for a second, touch on some housekeeping points? On the screen in front of you, if you look to the left, you will see a box with a picture of Jacob sort of in the top left-hand corner. Below the picture there is a question tab and a box where you can actually type in some questions and we – please don't hesitate to send us any questions online, and we'll attempt to answer them as we go through the conference call. If you could just simply type in your question into the box, and then click on the send button which is at the bottom right-hand corner, and we'll do everything we can to answer your questions as we go through.

So without further ado, I'll hand over to Jacob. Jacob, thank you very much for joining us, and the floor is yours.

Jacob de Tusch-Lec: Thank you Dick, and thanks to those who have called in today. What I wanted to touch upon today is basically three things; I'd like to talk about the Artemis Capital Fund, how it looks today, and what drives the process behind it, the SmartGARP process behind the Fund, and lastly, I'd like to talk about some of the themes that we're seeing in the UK market right now, and what that means for the composition of the Fund.

We kick off on slide number two. The UK– the Artemis Capital Fund is the UK large-cap offering from Artemis that is using the SmartGARP process. Some of you might know the process in more or less detail, I'll touch upon it a little bit later. But what I'd like to say here is that the SmartGARP process that the Capital Fund uses is the same that Philip Wolstencroft and Peter Saacke use in the European and the Global Funds. And the way that we apply it in the Capital Fund is very much the same way, we use the same methodology, we respond to news flow the same way. And in that respect, the Capital Fund is sort of the third offering in a suite of SmartGARP funds from Artemis.

The Capital Fund is not benchmark-driven but we're definitely benchmark-aware, and we're benchmarked against the All-Share. That means that we usually don't have more than a 10% active bet on a sector, much more often it's much less than that, and we usually don't have holdings that are more than 5%, in order to minimise idiosyncratic company risk. But in many ways, it is a SmartGARP-driven fund, so we take some big bets on smaller companies, if that's what the Fund is saying, or we go large-cap, if that's what the model is saying.

We also have the ability to have up to 20% non-UK stocks in the portfolio, and currently we're actually using that quite a lot, as continental Europe looks quite a bit better within a SmartGARP context than the UK. The key point here is that we're using the same yardstick to compare UK and non-UK companies, that's a very efficient way of using our 20% allowance. Basically, we want to put in good stocks in the Capital Fund, stocks that have very high SmartGARP scores, and sometimes in the UK market, it's tough to find stocks that have high SmartGARP scores within certain sectors where you have very few companies, for example telcos, where you basically have three companies to choose from. And in order not to have a big sector bet, we like to take foreign stocks.

Slide number 3 is a very schematic way of showing how the SmartGARP process works, and I don't want to spend too much time on this, but in essence, what the SmartGARP process is, is a way of filtering a lot of data for a lot of companies every day, and drilling down to stocks that have some good characteristics. Basically, we want companies that have good growth, good value, good earnings revisions, etc. And what we use is, we use a lot of economics forecasts, we use a lot of fund manager forecasts in the market, and we use up to 2000 analysts at different brokerages, in order to get estimate revisions and EPS numbers, etc. We have 75 filters that go through all this vast amount of data, and it filters the data with respect to six categories: growth, value, earnings revisions, price momentum, economic variables and fund manager sentiment. And in the end, we get down to a ranking of all the stocks in our universe.

It is a quite complicated process, from a data point of view, but in reality, it's a very simple philosophy that lies behind it. Basically, we're trying to find stocks that are growing faster than the average UK market, that are less highly-valued than the UK market, and where earnings forecasts are going up faster than that of the UK market. And basically, we avoid anything else. So what we're trying to do is basically find 50, 60 stocks that have these characteristics, and you won't be wrong for long, if you have that mix of stocks.

This very sort of agnostic way of approaching the market also means that we don't pick stocks that fit a theme of top-down beliefs, we don't come in and say, "Now we want to be large-cap, and now we want to have exposure to a certain macro-economic theme." Rather, we run the model every night, trawling through hundreds and often thousands of stocks, and the stocks that have been picked by the model tells us what the macro-themes are in the economy and in the market. And from that, we try to filter out what the market is telling us, and how we're positioning ourselves.

In the UK market right now, I think there are four themes that I'd like to mention. The one is that large-caps are looking relatively better than mid-caps. Mid-caps, as all of you know, have done very well over the last six, seven years, and that has meant a re-rating of mid-caps and small-caps. Large-caps now have quite good value scores in the model, and just increasingly look interesting.

Another theme that I'm going to touch upon later in the presentation, is that mining and industrials are still seeing significant earning upgrades, and we are seeing leadership amongst cyclical factors and among especially mining and sort of industrials, with a large degree of export component to Asia and other countries.

Another theme we are seeing is that UK banks and also European banks are scoring very highly in SmartGARP, so that – it tells us that the credit cycle is actually picking up in the UK, where UK banks are scoring better today than they have three months ago, for example. And in Continental Europe, banks are looking very good; house prices are still going up, so that is a theme that we like to play.

The fourth theme is corporate spending and capex, and that's a global theme that we both see in our Global Fund and our European Fund. That companies, after a couple of years of not investing very much, but

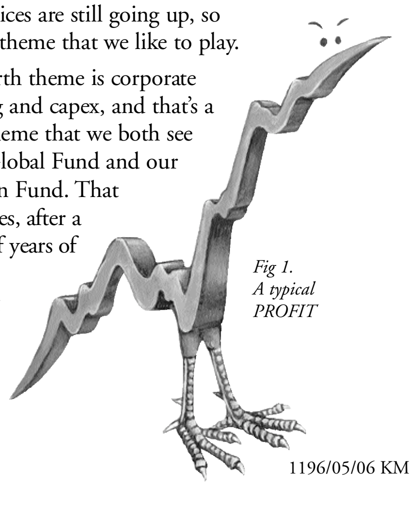

Fig 1. A typical PROFIT

having very strong cash flows, have a lot of cash on the balance sheet and as we are seeing a global recovery and a global pickup in growth, companies have started to invest again. And we're seeing corporate spending pick up, and that is showing in a lot of different areas; staffing agencies look very good, airlines look very good, anything that benefits from corporate spending looks much better today than half a year ago or a year ago.

So what does it mean for the Capital Fund? It means that we're overweight mining, we're overweight industrials and we're overweight banks, those are our three biggest sector bets. Our biggest underweights are in food and beverages, in healthcare, and insurance, and you'll obviously say that shows that there is a bit of a cyclical tilt in the portfolio right now. But that's not surprising, as we're still in a global – recovering a global synchronised pickup.

The first theme I mentioned before was the mid-cap/large-cap theme, and what we're showing on page 6 is a red line, showing the earning dynamics for the FTSE 100 versus the FTSE 250. And as you can see, the red line from sort of end of last year, started picking up quite dramatically. The blue line is the performance of FTSE 100 versus FTSE 250, so as the blue line floats downwards, it means that mid-caps are outperforming large-caps and we've seen that for quite a lot of years now.

The gap has started to open, and what it tells us is that you are seeing large-caps actually having earnings being upgraded faster than those for mid-caps, but the price line has not yet started to reflect that. We've taken the choice in the Capital Fund that we have started to increase our weighting towards large-caps. There's a lot of reasons why the price line hasn't started moving yet, I think one of the strongest is that mid-caps are basically being bid for, and you open the paper and every morning another FTSE 250 company is about to be taken over, a private equity company has started some rumours, and that is being thrust into the mid-cap space more than the large-cap space, but we are starting to position ourselves in the large-cap space, because we do think that there is more, increasing amount of value there.

So as SmartGARP is telling us to go more large-cap, what does that mean for the composition of the Fund? Well, on page 7, you can see that the large-cap component of the Fund has gone from sort of the low 60's percent back in April '03, to the high 70's – right now we are around 77%, and that is the highest number in quite a while. And we're quite comfortable with that. A lot of the mega-caps and a lot of the large-caps in the UK are now yielding 3, 4, 5%, with single-digit P/E's, and the re-rating of mid-caps have gone quite far.

The other theme I touched upon was the cyclicality of the Fund and where we're seeing the highest amount of earning upgrades. What I've done on page 8, is just basically take the 25 stocks in our UK universe that have the highest scores in SmartGARP. So we don't necessarily hold all of these names, but we just took the 25 names that have the highest scores. And you can see the lowest scoring name here is 93, so it's in the 93rd percentile. And as you can see, basically, you have a lot of industrial goods and services – ten industrials. You've got nine stocks from the basic resources sector. And then you have a couple from other sectors – you have two banks, and one gaming company, and one utility, but no real other themes. And obviously, if you want to follow SmartGARP sort of hard-core, you'd really load up on these mining stocks and industrials, but we're obviously aware of the fact that these are cyclical stocks, and that the cycle can turn etc, so we are monitoring risk very carefully, and we don't have maybe, let's say, as large overweights as one could have, if one really wanted to go completely overweight, because there is that certain amount of correlation between these names.

But obviously, within the industrial goods and services, you're also seeing the fourth theme that I mentioned before, which is the corporate spending theme. You have Michael Page and Hays in there, which are staffing agencies, companies are sort of hiring temps and are looking for more people. You have Charter in there, which is selling welding equipment all over the world. And as you have the energy – industrial energy cycle in China growing very strongly, Charter is taking advantage of that. You have the Ashtead, which is a rental equipment business with large exposure to the US. And you've got Chemring, which is a defence company.

So, although these companies are quite different, they're all really playing on the theme of corporate spending, and that theme we think can continue for quite a while, as global growth seems to be above trend globally. Most regions in the world are growing very strongly; Japan is picking up, Germany is recovering, and companies have started to invest in their business again, rather than just pay out big dividends or buy back shares.

Richard Turpin: If I could just remind people, please don't hesitate to send us through any questions, by just filling in the dialogue box and clicking the send button, and we'll happily answer them as we go along. Sorry Jacob, thanks.

Jacob de Tusch-Lec: That's ok. On page 9, I've just shown some of the stock clusters that we are playing with, because often SmartGARP more than just highlights one name within a sector, sort of tells us, "Here is a theme that you want to play", and shows a number of stocks. And mining is definitely one of those sector clusters that we're seeing right now in the UK.

Let me just briefly explain what the charts are showing, the two lines, the red and black. The black line is the price relative between the stock and the FTSE All-Share Index. So when the black line goes up, basically means that the stock is outperforming. And as you can see, most of these mining stocks have outperformed the market quite dramatically since 2003, when we had the market turnaround. The red line is the EPS relative between the specific stock and the UK market. So similarly, when the red line goes up, it means that earnings growth of the particular company is higher than that of the market.

For a lot of these mining stocks, if you didn't have the red line, but you just looked at the price line, you'd wonder, "Hey, is it time to take profits, because the outperformance has been quite amazing." And often, you know, we have the discussion internally as well; How long can this go on? When will leadership change? Etc. But what the red line tells us, is that although prices have outperformed the market quite significantly, all they're doing is really keeping up with earnings. The red line has been going up just as fast as the black line, which is the price relative.

So, what charts like this do, is induce a certain amount of discipline on us, because all we are saying is that actually, mining stocks have not been re-rated over the last three years. If anything, they've been de-rated versus the market, despite having shown tremendous earnings growth. And we think that it's not really about whether you believe in a super-cycle or not, because we don't really have strategy views like that. What we are just saying is that as long as analysts are upgrading earnings estimates for these companies, price will have to go up and follow up with these earnings estimates. And we are in that environment. So we are quite happy to play that. And there are – the first stock is Vedanta, for example, a stock that's trading at 12 times earnings with cash flow growth of a staggering 65%. And this is a stock that at the IPO a couple of years ago was £1 billion, now it's a £4.5 billion stock, and in a couple of years it's sort of quadrupled.

And I also just want to mention that the mining sector, a lot of people are talking about it. And it is a quite interesting sector. At the peak of the bubble, mining was 1% of the European market, today it's 7% of the European market. The telco sector, at the peak of the bubble, was 23% of the UK market, today it's only 5% of the market. And actually, the UK mining sector is 25% larger than the telco sector, with giants such as Vodafone and BT. So it is really a big sector, and it's a quite volatile sector, but it's no wonder people are talking so much about it.

We still have an overweight here, it is a risky sector, and if the cycle was to roll over, obviously we'd see some price moves here, but for now we're still seeing very robust earnings growth.

Richard Turpin: Jacob, we have the first question from Chris Haig. Chris, thank you very much indeed. We're just reflecting back on your comments about capital spending, Chris is saying with the requirement of capital spending driving sort of stocks at the moment, have you any thoughts on sort of consumer spending going forwards? And has really, sort of, capital spending taken over from the consumer spending boom we've seen over the last few years?

Jacob de Tusch-Lec: Well, I definitely think so. I mean, capex is growing, and as I've said before, it's a global theme, it's not just in the UK. I think basically, what you had was that consumers, they were driving – maybe not the tech bubble, because that was also corporate capex – but in the bear market, consumers were leveraging up their balance sheets, and you can see globally – both in the US and in the UK – consumer balance sheets are definitely much more level than we've seen historically. People have really been riding the housing bubble and have been borrowing and taking out mortgages against their real estate, whereas corporates in the post-bubble days were very good at sinking their pension deficits, paying down debt, and accumulating as much cash as they could on the balance sheet, because what investors wanted were strong and healthy balance sheets.

So, what companies have been doing for years now, is that they've been running themselves for cash. But as we're seeing global growth remaining robust globally, and as we're seeing capacity utilisation being very high in many regions of the world, the Chinese economy is arguably over-heating, capacity utilisation in the US was very high, companies had to make the decision: "Do I want to buy back shares or give out a special dividend? Or do I actually want to invest in my business?" And I think that companies increasingly are making that decision. So, I think, if I had to make sort of a bet on either corporates or consumers over the next year, I'd continue to belong corporates, rather than consumers.

Richard Turpin: Thank you Jacob.

Jacob de Tusch-Lec: Just flipping to slide number 10. I talked about – and it's actually quite good, because we just talked about the capex story. Just two companies that have benefited from this industrial story and this capex story: the company on the left is Rolls-Royce, a staggering restructuring story. I mean, over the past 12 months alone, the stock is up 100%. Yesterday, it hit a 52-week high, followed the rest of the market in nominal terms. We are happy holders of this stock, because as the chart shows again, the red and the black line are really following each other. It's not as if the stock has been re-rated and is trading at a multiple to the market. It's trading in line with the market, and we still se that there is very strong demand for transmission distribution systems, gas pumps, airplane engines, and any kind of gas turbines, etc, all the kind of stuff that Rolls-Royce is producing. And the order book is plus €20 billion. So, we still see that there is a robust demand for these products.

Another stock that we are using to play this theme – and it's sort of an energy/mining theme – is a French stock, Vallourec, which maybe not everyone has heard of, but it's actually a €10 billion stock. It's a company that produces steel tubes for the mining and oil industry. And, of course, this is a derivative play on the resources cycle and higher commodity prices, but also the fact that companies today have to drill deeper for oil. I mean, a funny or an interesting fact, I think, is that as companies are looking for oil in every single corner of the world, they have to drill deeper for it, and a 10 000 feet well uses 12 times more tubes than a 5 000 feet well, on average. So you double the amount of feet you drill down in the ground, and actually you almost triple the amount of tube that you use, and companies like Vallourec, that is one of the world's largest producers of steel tubes, obviously have taken advantage of that, and as you can see, price has gone up quite dramatically, and so has earnings. It's hovering about – it's sort of gone up ten times faster than the market in the last two and a half years. So it's quite a good story.

Richard Turpin: Jacob, I've got another question, just relating to the sort of super-cycle you were talking about in mining. Ian, in Scotland, has kindly sent in a question saying that "What sort of lead indicators are you looking for as a catalyst for change, in terms of exposure to mining? And is it really driven by SmartGARP scores, that catalyst?"

Jacob de Tusch-Lec: Yes, well I think to some extent, it is driven by SmartGARP, but we obviously look at a lot of other indicators that also feed into SmartGARP. And one of those indicators that I look at every morning, because I'm worried about this cycle as everyone else, and having an overweight in mining, you have to worry. And one of the things I look at every morning are inventory levels, LME for example, and that is one of the indicators actually, it does feed into SmartGARP. So whenever inventory levels go down, and we've actually seen inventories go down over the past sixth months, that is positive for the mining sector. Whenever inventories are going up, that's negative, and that gives a negative score to the sector.

So, on the one hand, definitely SmartGARP has a macro component, where we look at what are inventory levels doing, what are metal prices doing, what are commodity prices doing, more widely. And we're also looking at investor sentiment. I mean, there's no doubt and that's one thing that worries me right now – that every investor, his uncle and his dog is on mining right now. And you don't want to be in a place in the market where everybody already is.

So you are seeing, sort of, I would say, a struggle between, right now, the contrarians in the market, which are taking a bet against mining, because they think that everybody is already there, and I have sympathy for that. On the other hand, you have to look at the actual fundamentals driving these stocks, and you're seeing earnings upgrades that are faster than at any other segment of the market. You're seeing stocks that are still trading at single or low double-digit P/E's with high cash flows, and where analysts are actually pricing in quite conservative metal prices. I mean, if you used spot prices today in your models of mining companies, you know, CSFB for example, had an interesting note out hypothetically saying if we just model spot prices today ten years out, it's not going to happen, but just as an example, while these stocks should be trading 100% higher.

I'm not saying that's going to happen. I'm just saying we're not really in a blue sky scenario, like in the tech days where people pricing in the very, very most positive scenario. I think analysts are being quite conservative, and therefore we do see some upgrade. But it is a struggle between positioning and earnings growth.

Richard Turpin: Thank you.

Jacob de Tusch-Lec: I mentioned before how the Capital Fund is allowed to invest in non-UK companies. And one example of when we do that is shown on page 11. And we are basically going abroad whenever we can find stocks that are scoring much better in SmartGARP than the UK alternative, and where we could get exposure to a certain sector without having to put in mediocre stocks.

One sector where we're having trouble right now is oil and gas, because the UK stocks within the sector – BP, Shell – are not scoring very strongly, and it's basically hard to find companies that score very well in SmartGARP. But we don't want to have a big underweight in the sector, because SmartGARP tells us to be equal weight.

So what we've done is we've invested in a US drilling company called Patterson, it's an onshore drilling company. And what you can see here is that this is a company where earnings, the red line, has run ahead of price. What earnings, I mean, price could easily double from this level, just to catch up with the way that analysts have been upgrading earnings. It's a company that now trades at nine times and has 23% earnings growth, and a market cap of $6 billion.

Why do we hold Patterson, and not sort of a UK equivalent, or let's say, a company within the same space in the UK? Well, one example is John Wood Group, for example. This is a UK services company, oil and gas services company. The stock is trading at 24 times, so sort of two, three times the US company, has the same kind of growth, but it's half the size. So what we're basically saying is that when we have the opportunity to put a foreign stock with a significantly higher SmartGARP score and much better underlying dynamics, we tend to do that. And that obviously means that we are able to have a much better fund within a SmartGARP context.

So, in conclusion, what does this all mean for the composition of the SmartGARP Fund right now? Well, as mentioned before, it is a large-cap fund. We currently have 76%, or hovering between 75% and 80% large-cap within the Fund. And that's at the high end, historical high end for the fund, and is a testament to how strong these large-cap stocks are scoring right now in SmartGARP. And it does show a bit of a sort of regime change, where we are already positioning ourselves in the large-cap space. We are also using our 20% overseas holding to the max right now. We have 19% primarily within, I would say, oil and within banks. European banks are scoring very highly, and we have a lot of drillers in the US that are scoring in the 99 and 100's. So we are really positioning ourselves there. And I can tell you that currently, the SmartGARP score for the Fund is above 75, so we've basically been able to pick stocks that all are in the best 25th percentile of the Fund, and we're quite happy about that. I'm pretty sure that that's an all-time high for the Fund. And it's quite a good sign, and also indicates to me that the UK market has started to score better than, for example, three months ago, within a global context.

Richard Turpin: We've got one question from Steve Jordan. Steve, thank you very much. He's asking: "Percentage-wise, how much of the Fund is actually you and Mark, and how much has Mark got?" which is a very interesting question, and we have encountered that before, over the course of the last few years. And also, he's asking if you run the model which is 100% SmartGARP, to see how much value the Fund Manager actually adds. And if you'd like to sort of pick up a little bit on that, Jacob?

Jacob de Tusch-Lec: Yeah, no problem. I would say that we have a couple of stocks in the portfolio that aren't SmartGARP. And one example could, for example, be Vodafone. Vodafone doesn't score very well in SmartGARP. But the reason that we have the 2% holding in Vodafone is that some things, SmartGARP can't really anticipate. For example, if Vodafone were to dispose of their US holding, and make an agreement with Verizon, we know that there would be 10-15% EPS upgrade to Vodafone, and the Vodafone SmartGARP score would go up quite a lot. So what we're doing sometimes is to avoid having a big underweight in a sector, and it's not as if we have many other telco's in the UK to choose from. We sometimes have a bit of a holding, in order to anticipate things that SmartGARP basically cannot incorporate. But I would say that currently – and to give you a sort of rule thumb – we have three stocks that are scoring below 40 with SmartGARP. Most of the stocks are scoring above 80. So I would say – well, we usually say that 75% of the stocks in the Capital Fund are purely SmartGARP stocks. Where we both like the story, we do our due diligence, we like the quality of the story, and at the same time, we have the quantity story with us as well. And then once in a while, you have situations where SmartGARP isn't able to anticipate potential events, and for big stocks, it can be quite risky to not have some kind of insurance, and that's what we're having here.

In other instances, if a whole sector scores poorly, which is what we're seeing in pharma right now – Glaxo is scoring poorly, Astra is scoring poorly – but again, you don't want to have too much of a sector bet, you sometimes have to lower your – let's say 'your score' a little bit, for the stocks you want to have in. But it is a portfolio construction question, and obviously, if a sector isn't consolidated – for example, mining is not a consolidated sector – you have a lot of players, and they tend to move together. If you did that, and you picked all the miners, you would always either be very long in the sector or very short in the sector, and your sector bets would be all over the place. And we try to be less volatile than the model.

The second question – I think – you asked, is much more interesting, because that's actually about the value add from the Fund Manager. And I'll be completely honest, and say that as long as the market is moving on a trend, and where there is no leadership of sector, the model will – I think – beat the Fund Manager, and to some extent, the value add that Mark and myself have might be negative. We are in the market right now where the same sector resources, and especially mining and industrials, have been market leaders since March '03. And as that continues, then basically, as long as you'd just been on these sectors since March '03, you would have made a lot of money. And to some extent, that is what SmartGARP has been telling you. But you would have had a lot of volatility, and a lot of risk for inflection points, so obviously, we haven't just put 100% into mining and industrials, although that is what SmartGARP has been telling you. So it's a question of how much risk you want to have, but obviously, we run from dummy models, where we just basically take, let's say, the 40 highest-scoring SmartGARP scores. I don't know if that's a portfolio you want to own, and especially not in inflection points, but it is a portfolio that has done very, very, very well.

Richard Turpin: Thank you for picking up on that. Almost the last slide, I don't know if there's anything you'd like to mention, in terms of performance, where it just gives a reflection of – on the left-hand side – clearly, the Artemis Capital Fund versus the All-Share, and on the right-hand side, the Fund itself against the All-Share performance.

Jacob de Tusch-Lec: Yes. Well, I thought there's maybe one thing to touch upon, it's a question that hasn't been asked today, but I get it from a lot of clients, is: "How does SmartGARP work in an environment where M&A is driving the market?" And I think it's a quite interesting question, because it's no secret that SmartGARP is a very poor picker of M&A targets. I mean usually, private equity houses, they go for poorly-managed stocks with a lot of cash on the balance sheet, a little growth, and that they can turn into a turnaround story. And SmartGARP is looking for the exact opposite. So one would think that in an environment where M&A is driving the market, SmartGARP would do very poorly, and I'm actually quite pleased to see that SmartGARP has done very well over the past year, where M&A has been one of the big drivers in the market, and of course, the risk of moving from the mid-cap space into the large-cap space is that – again, as I said before – every single FTSE 250 stocks is up for grabs, and one could be a little bit worried that we would lose a lot of performance there, by not being overweight in that space, but we can't see that in the poor performance numbers, so obviously, we've just picked up on some other trends, although we haven't been long, a lot of the targets in the M&A trends over the past six to twelve months.

Richard Turpin: And Jacob, your feeling is that there's still a lot of pipeline activity out there, in terms of talking to sort of corporate financiers, or investment bankers?

Jacob de Tusch-Lec: I think definitely. I think that a lot of – basically, I think there are two things driving the market right now. The one thing is sort of true behaviour of economics, which is that a lot of the private equity houses have collected a lot of cash over the past 12, 24 months. There's a lot of funds out there that haven't been used yet, and these people will get paid when they invest. They're not going to return it back to the investor and say, "We couldn't find anything to invest in." They can lever up their assets seven times, so they've collected experience, they can invest seven times as much, and they are – I think they're starting to struggle to find targets. The other thing is that the market has been bidding up the targets, so it's going to be harder and harder and get a good exit price for the private equity guys.

So I think from the one hand, there is a lot of pipeline activity, just because there's a lot of liquidity in the space; whether it creates economic value or not is another question. However, I would say that we are still in an environment where, for a lot of companies, the dividend yield that they're paying is actually higher than the interest that they're paying on the debt, if you look at it after tax. So if I was a CFO of a company, what I would do is I would say, "Ok, why not issue debt?" You get the tax deduction, you get the PEP shield, and your interest payments you can deduct from the income statement, and you buy back equity. And you make that CFO trade, and you might make 25 basis points.

In most countries, that's actually not legal. You can't just issue debt to buy back equity. But you can do it in the form of M&A, in the form of debt-financed M&A. And that's what companies are doing. They're buying other people's equities by issuing high-yield debt, which is quite cheap in this environment, because corporate spreads are still very tight. And I think as long as that's the case, again, it's not so much a question about economic value add behind that M&A transaction, it's just simply a financial engineering exercise. And we're seeing that in the UK.

Richard Turpin: Now, we've also been seeing there's an overall reduction in the issuance of – well, there's lack of issuance in paper in the market.

Jacob de Tusch-Lec: Yeah, I mean companies of course, they have very little interest in issuing equity right now, because it's so much cheaper to issue debt. So what you're seeing is that there is what we call the 'de-equitisation' of the UK market, where companies are buying back equity at a faster pace than other companies are being listed. And although we have a lot of AIM in these things, the market caps of those are very small. I think just the fact that '02 was bought – taken out of the market – would probably offset that many times. So as people are receiving dividends in the scale of 3% and have to reinvest that in the market, there is basically a supply/demand issue going on. And thirdly, the UK is a great M&A market, because it's very easy to take out companies who don't have a lot of political clout – more of the same as you have on the continent. So I think that we're going to continue to see Continental European companies go to the UK, where companies are quite cheap. I mean, the UK market is trading on a sort of 13, 14 times trading earning, which is bang in line with a 25-year average. So I wouldn't say the UK market is cheap, but it's not necessarily expensive. And again, compared to a lot of other asset classes, equities don't look particularly expensive.

Richard Turpin: No, in fact there's a question I was going to ask, maybe just coming towards the end. I know a lot of our listeners would appreciate a couple of thoughts on the market as a whole. Now you touched on the sort of long-term earnings trend in the market, and there are other indicators that imply that the market is well-positioned and well-balanced. Do you have any thoughts, generally, or maybe just a couple of slides that we might be able to look at, so…

Jacob de Tusch-Lec: Yeah, I mean, if we jump to page 19, I mean firstly, I'd say we don't really, in the SmartGARP team, have sort of a macro strategy, where we're either bullish or bearish. I mean, we very much use SmartGARP to tell us that. But we obviously do look at macro trends to check against the SmartGARP system, whether we are on the same page. And what chart number 19 shows, is just that the dividend growth in the UK market. And as we are seeing here, I mean, dividend per share growth in the UK market is hovering around 20%. I mean, these are levels that we laughed for, back in the late 80's, where if you'd entered the market back then, you would have made great money for the next ten years. So I mean, I don't know. I mean, it could be that we're going to get either a geo-political event in Iran, we can get a new oil crisis, it could be China slows down, and mining could come under pressure – it's always tough to say. But I think that if the market comes under pressure, the equity market, it's not going to be because growth is going to disappear. It's not going to be – I think – because companies are going to do something wrong, the same way they did during the takeover. I think it's going to be either a liquidity event – i.e. we're going to have higher interest rates globally, that are going to go too high; i.e. a policy mistake is going to tilt growth – or is going to be a geo-political event. And it's very, very tough to calculate probabilities of that, so as long as we're seeing earnings being upgraded, and the UK market trading at healthy multiples, and having dividend growth of 20%, I wouldn't be overly concerned.

Richard Turpin: Jacob, that's absolutely excellent. Thank you very much indeed. I think we must, ladies and gentlemen, draw it to a close now, I'm conscious of the time. Thank you very much indeed for listening today, I hope you've found it useful and interesting, and indeed thought-provoking. Thank you also, those of you who sent in questions, it's most helpful, it sort of helps move the whole process along. If there are any further questions, please don't hesitate to send them through to us. You can email them to us at broker.support@artemisfunds.com, or indeed phone us on our broker line, 0800 092 20 90. So thank you very much indeed, again, for your time, I look forward to a future conference call with you all, and Jacob, thank you very much indeed for the time you've given us. Thank you very much indeed.

Operator: That does conclude our conference for today. Thank you for participating, you may all disconnect.

Risk Warning