VT Garraway UK Equity Market Fund Investment Process

"VT Garraway UK Equity Market Fund is a highly concentrated and actively managed portfolio of quality companies aiming to achieve attractive long-term returns with lower risk. It is a fund with defensive characteristics and should achieve consistent returns and alpha generation over the long-term."
Malcolm Schembri, Fund Manager

Our Focus

We focus on investing in companies with strong sustainable growth potential to which market influences have limited impact.

Our strategy is to invest in companies that have high-quality characteristics in terms of their business models, financials, competitive advantage and their management. We believe that this will provide resilience during periods of market uncertainty.

In order to generate superior long-term risk adjusted returns we need to be invested in the right companies and at the right price. With the current continuous multiple expansion, we are mindful that it is more important than ever to stick to this discipline.

Investment is subject to trends and cycles. We do not invest in companies simply because they are fashionable and might rise in the short term. For example, during the Dotcom boom valuations of many Tech companies' share prices and valuations rocketed without a rational basis. We avoid these kind of situations as they pose high risks. We do not speculate or use leverage to enhance our returns.

We aim to diverge from benchmarks in a positive way, managing a more concentrated portfolio than is typical for the sector.

We aim to achieve this by adhering strictly to our investment philosophy.

Our investment philosophy: the 3Ms

Moat

What do we mean by moat? A moat is a deep, wide ditch surrounding a castle, typically filled with water. It is intended as a defence against an attack. A crucial part of our investment philosophy is to focus on those companies which have an economic moat; some sort of competitive advantage over others in their field. As these companies tend to dominate the market, it is extremely difficult for their competitors to take market share away from them.

Crucially for our investment philosophy, these are the businesses that, thanks to their competitive advantages, have high sustainable profitability margins and the ability to create long-term shareholder value by compounding high returns on capital employed over time.

Management

We recognise that the quality of management is a crucial input to the long-term success of our strategy.

As such, we make sure that the companies we are invested in are managed by individuals with a proven track record; managers who are good allocators of capital. Notable examples include JD Sports, Halma & Diploma. Additionally, we invest in companies that appropriately align management and shareholder interests. It is not surprising to note that the share prices of companies with high insider ownership in aggregate outperform those with low or no insider ownership.

We are also interested in the way the management treats its employees, as well as the overall corporate culture.

Margin of Safety

We believe the free cash flow yield allows us to see the world through the eyes of the business owner and as such it is our preferred valuation metric.

We only invest in high quality companies with clear understandable business models.

The FTSE-All share index has an allocation of nearly 11% in Basic Materials, over 16% in Financials and 7% in Energy companies. We avoid many types of businesses within these sectors because we do not want to own cyclical companies which are highly dependable on external factors.

We also avoid banks and insurance companies, as the economic reality vs what is presented in the financial statements could diverge over time. We strive to avoid any nasty surprises.

By avoiding such companies we are able to more reliably value the companies we are investing in, and therefore ensure that we do have a margin of safety.

Value or Growth Strategy? Growth at Reasonable Price (GARP)

We look for companies that are somewhat undervalued (a feature of value investing) with solid sustainable growth potential (a feature of growth investing). We identify stocks on an individual basis and select those that have neither purely value nor purely growth characteristics, but a combination of the two.

We will not overpay for a stock. Even if we like a company, we will not invest if we feel it is overpriced. Similarly we seek companies which are able to redeploy capital at attractive rates of return. i.e. compounders from whom we seek growth.

Buy & Hold

Our turnover is lower than is typical for the sector. Companies we buy are held for the longer term. We focus on our best company ideas; and unlike most UK equity funds, we will hold no more than 40 stocks, typically 25-35.

Invest in High Quality Businesses

We define high quality companies as those which can sustain a high return on capital employed. While a high rate of return is important to us, we prioritise the sustainability of such a return. Repeat business and recurring revenues are characteristics found throughout our holdings.

Our holdings tend to be market leaders, companies which have experienced and survived a number of boom and bust cycles, and that have solid fundamentals in place. These companies have a good pulse of the market they are in. Market leaders tend to be the ones who would be the ‘last man standing’ in challenging market conditions.

Their intangible assets such as brand name, dominant market share, patents, distribution networks and client relationships / partnerships are difficult for competitors to replicate.

Responsible Investing

We have factored in many ESG considerations in our investment process since the inception of the Fund and have implemented a formal RI policy in line with Garraway’s firm-wide ESG policy. As buy and hold investors we take a long-term view and aim to be invested in companies which can generate long term shareholder value. We believe that strong corporate governance is key and that this tends to lead to companies implementing long term social and environmental initiatives.

When considering key risk factors as part of any investment decision making process, we recognise that some companies’ strong ESG initiatives will lower risk (for example litigation risk) and this has increased our overall conviction for a number of our holdings.

Avoid companies with high-leverage

We do not want to take the unnecessary risks associated with leveraging as we are looking for capital preservation and consistent returns. We only invest in companies that earn a high return on capital on an unleveraged basis. This does not mean that the companies we invest in do not have any leverage, but they should not need to borrow money to be able to function.

For instance, financial companies, such as banks, generally earn low unleveraged returns on capital so they need to borrow money to further increase their returns. This is one reason why these types of companies do not fit into our investment strategy. During times when the supply of credit is withdrawn, the consequences for those companies dependant on borrowing money would be disastrous due to the illiquidity of their asset base.

Invest in businesses with growth potential

We define companies with growth potential as those that have not only the ability to earn high unlevered rates of returns, but also the ability to reinvest a portion of their excess cash flow back into the business to grow and generate high returns on cash and also improve their margins. This will create exceptional results and value for investors, due to the compounding effect.

Therefore, we are biased towards high quality businesses which benefit from long-term favourable secular trends such as digitisation, genomics, urbanisation, aging population and, in the case of emerging markets, the emergence of the middle class.

Seek resilient businesses

We aim to invest in companies with resilient products or services, those which are unlikely to become obsolete. We seek to benefit from product development in long established products and industries, rather than investing in industries that are subject to rapid technological innovation; as we do not have the appetite to ride the initial waves of enthusiasm in the short term**.**

No market timing

Studies illustrate that most fund managers who try to time the market are less successful. We do not try to predict the unpredictable.

Strict bottom-up strategy; No closet benchmarking

Unlike most other UK equity funds we are not constrained by a benchmark. We apply a very strict bottom-up strategy; we are not constrained by sector or geographical exposure limits, rather we analyse companies' financial statements and only invest in those which fit in our strict investment criteria and philosophy.

We expect the Fund to the less correlated to UK equity indices than the sector average as a result of a more concentrated portfolio.

Avoiding over-diversification

Whilst we do seek diversification, the strictness of our investment criteria typically leaves us with a concentrated portfolio of 25-35 companies, and concentration in certain sectors. This does not concern us as research has shown that optimal diversification can be achieved with 30 stocks. As Warren Buffet said "Wide diversification is only required when investors do not understand what they are doing".

As an example, our rigorous investment criteria tend to favour companies in the consumer staples sector and our Fund's exposure to this is higher than the average UK equity fund. This sector is historically (1) a leader in long-term of returns, (2) offers downside protection in volatile markets, and (3) generally provides higher income and dividend growth rates**.**

Risk Management

Risk management is conducted throughout the entire investment process. We apply a conservative allocation of capital among high quality securities, together with the selection of excellent businesses when they are available at reasonable prices. We avoid speculative buys and paying excessive premiums.

Conclusion

We only invest in companies that we thoroughly understand and that we believe have durable qualities:

- Highly profitable and above-average margins;
- Generate and maintain high returns on capital but also successfully compound returns at high rates of return over the long-term;
- Financially sound and have consistent, reoccurring revenue streams;
- Highly cash generative and distribute excess cash-flow to shareholders;
- Low levels of debt;
- Benefit from long-term structural tailwinds;
- Leaders in their niche and have dominant market positions, thus having sustainable competitive advantages that are difficult to replicate; and
- Run by superior management teams whose interests are aligned with long-term shareholders and thus focus on a long-term approach.

Important Information

This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. It is not a personal recommendation and it should not be regarded as a solicitation or an offer to buy or sell any shares in the VT Garraway UK Equity Market Fund (the 'Fund'). It should not be construed as investment advice. Any person interested in investing in the Fund should conduct their own investigation and analysis of the Fund and should consult their own professional tax, accounting or other advisers as to the risks involved in making such an investment. Full details of the Fund's investment objective, investment policy and risks are published in the Key Investor Information Document ("KIID") and the Prospectus, all available from www.valu-trac.com/garraway. Any offering of the Fund is only made on the terms of the current Prospectus and KIID. A subscription in the Fund can only be made after the provision of the KIID and should be made solely upon the information contained in the Prospectus and KIID.

Valu-Trac Investment Management Limited ("Valu-Trac") is the Authorised Corporate Director of the Fund, responsible for its management and administration. Valu-Trac has appointed Garraway Capital Management LLP ("Garraway" or "we") as delegated investment manager to Valu-Trac in respect of the Fund.

This document has been approved in the UK by Garraway Capital Management LLP, which is a limited liability partnership incorporated and registered in England and Wales under partnership number OC303626 with its registered office at 200 Aldersgate Street, London EC1A 4HD. Garraway Capital Management LLP is regulated by the Financial Conduct Authority. Distribution of this material and the offer of the Fund are specifically restricted in certain jurisdictions. In particular, but without limitation, neither this material nor shares in the Fund are available to US persons.

An investment in the Fund is not suitable for an investor who cannot sustain a loss on their investment. There is no guarantee of the Fund's future performance and past performance is not a reliable indicator of future performance. The value of your investment and the income derived from it can go down as well as up, and you may not get back the money you invested.

Investment risks

The risks associated with making an investment in the Fund are described in the Prospectus but investors should note, in particular, the following: 1) The Fund is subject to the risk of the insolvency of its counterparties; 2) As the Fund invests primarily in UK listed shares, the Fund will have a greater exposure to UK market, political and economic risks than a fund which diversifies across a number of countries; 3) Foreign currency denominated investments are subject to fluctuations in exchange rates that could have a positive or an adverse effect on the value of an investor's investment; and, 4) The Fund invests in one or more financial derivative instruments, which may result in gains or losses for the Fund that are greater than the original amount invested..

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