Money Makers Weekly Investment Trust Podcast

Q&A with Ian Lance of Temple Bar - Interview Transcript
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Jonathan

So earlier this week I had the chance to speak to Ian Lance, who is co-manager of the Temple Bar Investment Trust, which sits in the UK equity income sector. You put out some results this week, interim results, which have been, I think, pretty encouraging on your side. You've outperformed again in this period. Let's start off then by just asking you what did you do right and what did you do wrong in this particular period?

Ian

I think what was pleasing actually about what went right in the first half was that it was two themes that I think we were talking about actually last time we spoke. So we've been talking about the fact that there's lots of value in the UK and the question was always “what's the catalyst?”. And two of the catalysts I think we spoke about last time were UK corporate takeovers and share buybacks. And it was both those things that actually came through the first six months.

So on the corporate takeover side, we actually had four companies bid for the first six months of the year. So that was Direct Line, Curry’s, Anglo American and IDS, all bid for. Their share prices went up quite significantly. And then on the buyback side, we've been encouraging UK companies with very low valuations to exploit that low valuation by buying back their own shares. And some of the biggest repurchases would have been the banks, for instance. So, a company like NatWest and Barclays. And their share prices have been very strong year to date. So, those share prices have gone up fifty percent year to date. So, a combination of those two things.

Jonathan
One of the interesting things about that is you made the point that actually of those bids, none of them have yet gone through. In fact, some of them failed. So it sort of underlies the fact that the value is there, but it also underlines the fact that the market perhaps has failed to appreciate that, as you pointed out before. So you can still gain even if those bids don't actually come to fruition.

Ian
Yes, I think so. I think these takeovers are a double-edged sword because obviously, it's great that some of the companies bid for the company and the share price goes up 30% on the day or whatever. But what you don't want is to be giving the companies away for less than they're worth. And I would describe some of these takeovers as opportunistic. So Elliot came in for Curry's and offered 68p, I think, at the start of the year.

And we've been quite public. We've gone to the press saying that we thought a lot of these offers materially undervalued the company. And so actually, the fact that those takeovers have gone away doesn't trouble us too much. I think in all cases, the share prices are significantly higher than they were before the offer. So what it has done, I think it has helped to demonstrate the value that there are in some of these businesses.

Jonathan
Indeed, because if we look at fund flows, we're still seeing flows out of UK equities. And that's been going on for at least three years. So it needed some sort of catalyst to put value back in there. But would you be in the camp that says that it's obviously very pleasing that the UK market is doing better, and you're gaining from that process, but you would still argue there's more to go from here?

Ian
Absolutely. We've got some quite good charts in our presentation at the moment that shows the valuation of the UK market relative to world stock markets, basically trading at the biggest discount that they've been at for 50 years, because the UK market is at a 45% discount to world stock markets. And that's partly because the UK is cheap, but it's partly because obviously the US stock market is so expensive at the moment. You know, because we don't think the entire UK market is cheap, but certainly the big pockets are.

And if you look at the valuation of the trust, we think that the average price earnings ratio is still about 8 or 9 times at the most, despite the fact that share prices are quite significantly in the first half. And Nick and I think they're pretty much the lowest that we've seen in the 30 odd years that we've been running money today. We're still very much in the camp that believes there's a lot of value in the UK market.

Jonathan
One of the issues that people have begun to talk about again, I think, is the role of passive funds. They are getting a very large part of the market. And therefore, in terms of fund flows, you can get these situations where the valuations are very cheap, but nothing still happens. You still need some real demand at the margin to make these prices move. So you're still fighting that kind of trend, if you like.

Let me ask you about, there's been a lot of talk about reforming the UK market and making it more attractive and so on. So if this is happening already, do you think that that slightly undermines those arguments about the need for reform in the UK stock market? I mean, will it not sort itself out eventually?

Ian
No, I don't think so. Again, we look at, for instance, the figures that show the percentage of domestic equity markets held by pension funds in those countries. If you look at countries like Australia, their pension

funds would typically hold 35, 40% something like that of their equity exposure in Australian equity. And the figure over here is three. I mean, we're pretty much the lowest of any country that I've ever seen.

So I do think that there are certainly things that the government can do to try to make it more attractive for investors to hold their own domestic equities. Because at the moment it appears that the low valuations on their own are not enough. The low valuations on their own do not appear to be changing the flows out of the UK equity market. So I think it probably is going to require a bit more *green* spending.

Jonathan
You're managing a UK equity income trust. You have one of the lower yields in the sector, I think it's fair to say. What is your outlook for the dividend? I mean, you'd hope obviously you can manage for a total return and you can get a better total return if conditions are right and you invest the right way. But what do you think is the outlook for the dividend of your particular trust, given that it is somewhat lower than some of your competitors, your peer group anyway?

Ian
Yes, I mean, I suppose we've got a nice problem. The dividend is low-ish because obviously the price has gone up quite significantly. We're up 18% year to date. But to answer your question, we think the outlook is good. And the reason we say that, I suppose, is I mentioned earlier on, we think the price-earnings ratio on average across the trust is about eight times. If you flip that upside down, convert it from a price-earnings ratio into an earnings yield, then that's an earnings yield of probably sort of 12%, 13%, something like that. And then if you divide that by the current dividend yield of the trust, it's about 4%. So that's telling you that on average, the dividends in the funds are covered probably sort of two, three times. So that should be quite good for the dividend growth prospect in the future.

And I think the other thing is you've got to remember when we talk about the share buybacks, when companies are buying back their shares, they're quite a substantial clip. And a lot of them are buying back at a very substantial clip. Of course, what that does is that reduces the number of shares in issue. And therefore, all other things being equal the dividends per share are going to go up as a result of those share buybacks. So hopefully those do for the growth in each company pretty good.

Jonathan
But of course, what is good for the goose is also good for the gander. So in terms of your own discount, you have been doing some share buybacks. But what's been the trend as far as the trust is concerned? And how do you assess where the discount is at the moment?

Ian
Yeah, so you're right, we were buying shares back at the start of the year. But actually, I'm not sure whether it's a Temple Bar thing or whether it's an investment trust thing. But actually, we haven't bought shares back, I think, for a couple of months or so now. So it sort of feels like the selling pressure to a certain extent has gone away. And interestingly, the discount has come in as well. I think the discount got out to probably 9%, something like that, at the start of the year. That was certainly when we were buying shares back. And it's come in to today, I think it's around 3% or 4%, something like that. So the backdrop feels a little bit better now, actually. It does feel like some of that selling pressure has dissipated.

Jonathan
Just looking ahead, obviously, we've got a lot of political uncertainty out there, a lot of geopolitical uncertainty. We know interest rates have been cut in the UK and it looks like they'll probably be cut in the US. Is a lower interest rate environment - obviously, it's been priced in already to some extent, or perhaps a considerable extent - is that broadly speaking, positive or negative for you as manager of Temple Bar?

Ian
I suppose it depends how far they go down. So if we went back to the environment where interest rates were zero, then that isn't good for, for instance, our banks. We have quite a significant percentage of the portfolio in banks. I personally don't see that happening. I don't think we're ever going back to those days of zero percent interest rates. I think interest rates are normalising back at their long-run averages, which is, to my mind, 4-ish percent, something like that. So yes, I think interest rates might come down a little bit, but I don't see them coming down very significantly. And therefore, at the margin, that's probably a good thing because we have quite a cyclical orientation to the fund. So we own, as I said, quite a lot of banks, we own quite a lot of consumer cyclicals, retailers, things like that, and that should be supportive for those types of businesses at large.

Jonathan
Now just remind me perhaps - I don't have the data in front of me, but I am familiar with it - remind me what your policy is about investing outside the UK market, and to what extent have you been taking advantage of any flexibility you have there?

Ian
Yes. Temple Bar can invest up to 30% outside of the UK. And I think at the moment we're about 28%. So we are utilising that flexibility, which I know raises the obvious question of, hang on, you say that the UK is very cheap, why are you investing 28% outside of the UK? Two reasons, really. Number one is, I suppose, where there are sectors that we think are cheap that you just basically can't access in the UK. So we think autos, for example, there just aren't many quoted UK auto manufacturers. So that would be one reason. And the other reason is where we want to access the sector but lower the stock specific risk. So we own 7% of Shell, about 6% in BP, and then we also own Total. So we get our access to the sector without taking really massive

positions in the underlying companies by basically going outside of the UK.

Jonathan
Is that kind of percentage likely to stay that way for the foreseeable future?

Ian
I think so. The turnover has been pretty low actually. We've not been up too much. We tend to be [...] started running the trust in 2020. That was right in the middle of the Pandemic, so there was quite a bit of activity then. And then since then, having bought what we thought were still quite cheap companies, the level of turnover has gone down quite substantially.

Jonathan
So final question has to be about gearing. If you think the market is this cheap, you have been putting on gearing. How are you in terms of the range, and what are your expectations around gearing?

Ian
The gearing at the moment is 6, 7 percent, something like that sort of order. And Nick and I are quite conservative. I think we always are cognisant of the fact that despite the fact that we might think cheap, that doesn't necessarily mean that they can't go down if other people decide to sell them, as we saw, I suppose, a couple of weeks ago. And what we absolutely don't want to be in the position is where we own companies, the NAV goes down, the gearing goes up, and exactly at the time that you want to be buying things, you're being forced to sell them because you think you're bumping up against your gearing limit. So we always want to take a reasonably cautious stance with regard to gearing, whilst at the same time, I suppose, utilising the benefits of having a bit of gearing. So I think we're in a really comfortable situation where we are today.

Jonathan
So That was Ian Lance, the co-manager of the Temple Bar Investment Trust, talking to me this week about his trust's latest interim figures, which showed a 13% NAV total return for the six months to June, nicely ahead of the benchmark FTSE All-Share index's 7% return. The shares are up 14% year to date.