Intelligent Investor
IDEAS AND INSIGHTS FROM THE BEST INVESTMENT MINDS

INTERVIEW SERIES: **John Chatfeild-Roberts (Jupiter Asset Management)**

The truth about fund of funds

John Chatfeild-Roberts

John Chatfeild-Roberts recently recorded his third anniversary as head of the fund of funds team at Jupiter Asset Management. With his colleagues Algy Smith-Maxwell and Peter Lawery, he joined Jupiter from Lazards in 2001. The team's range of fund of funds, marketed under the Jupiter Merlin label, are proving increasingly popular with advisers. In this in-depth interview Chatfeild-Roberts and Smith-Maxwell explain their philosophy and how they go about picking the best fund managers from the hundreds they could choose.

Why did you decide to come to Jupiter?

JCR We realised, correctly as it turned out, that the idea of multi-manager funds was coming of age and that we needed to be able to leverage off a big UK retail brand name to bring our fund of funds proposition to a wider audience. We also jumped at the chance to work alongside the team of exceptional fund managers at Jupiter. Working in that environment has been very stimulating and helpful.

ASM It was also important that we had the chance to move as a team. The team hasn't changed since we moved. We continue to do what we did at our previous house and we do it in very much the same way. The three of us have been working together now for nearly five years. Before we all teamed up together in 1999, John and I originally worked at Henderson together for a short while in 1995. It means we know our strengths and weaknesses pretty well by now.

What was the initial appeal of fund of funds to you?

JCR On my side it came from dealing with private clients at Henderson. It seemed clear to me that individual investors could do much better by having the chance to put their money with all the best fund managers around, not just the in-house ones.

ASM From my perspective, I simply thought that fund of funds was the most scaleable way of managing monies on a fair basis for clients. No matter how big or small they are they get exactly the same performance as everyone else. That has to be a more effective way of managing money than running individual or segregated portfolios.

PL In the early days Henderson didn't actively market a fund of funds as such, although they managed one; it wasn't deemed to be saleable at the time. They did market a portfolio service however, which was the same thing in a different tax environment. But it was very labour intensive from an administration point of view and the proposition was definitely a concept sale first and foremost.

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The Jupiter fund of funds team at an industry awards presentation

What do you mean by that?

PL That it was the idea that was being sold, not the end results. We feel strongly that fund of funds is more than just a good concept. It has to stand or fall by how successfully it delivers results for the client – and fortunately our results have been good. At the beginning, it was more of a niche product than it is today, but our belief is that fund of funds on our model is going to become a much more mainstream way of investing over the next 3-4 years. We are likely to see a lot of growth.

Why are you so sure that will happen?

ASM I think that the bear market of 2000 onwards brought a lot of people up short. It made them realise that it wasn't as easy to manage money as they all thought. Both investors and fund managers have learnt some salutary lessons. In particular, people have come to recognise how important it is to switch from one investment style to another at different times.

PL There are occasions, for example, when you want to be heavily into growth and others when you want to be heavily into value. It is the same with large cap and small cap, and so on. With fund of funds, you have a mechanism for making those changes in a tax efficient way – you can switch around within the fund without incurring capital gains tax. It's an obvious, common sense thing to do once you think about it.

JCR That is right. In essence what we're trying to do is form a view of the future and then make a portfolio to fit that view. By and large, we think that individual fund managers are the primary generators of fund out-performance. But it is vital to understand in what environment they will be good and in what environment they will do less well. Our portfolios are made up of individual fund managers whom we think are going to do well in the particular investment environment that we're predicting.

How do you decide what the environment is likely to be?

JCR Well, that is one of the skills we think we bring to the party. The great advantage of working at Jupiter is that you've got a lot of very bright individuals here, so getting a handle on the environment – though it's never easy – is not quite as difficult as it might be. You've got plenty of people to bounce ideas off. It is not as if everybody here believes the same thing. You have to defend your ideas. Nobody gets upset if they are told "that's a stupid thing to say".

ASM The timing of our investment decisions has certainly improved a lot since we started working around the likes of Philip Gibbs, Edward Bonham Carter and Tony Nutt. We are also in a very different market now. It was easy to sell fund of funds or a portfolio service, as a concept in the 1990s when the bull market was raging and large caps were outperforming small caps most of the time. Now we're in an environment which might turn out to be a secular bear market, fund managers need to be much more fleet of foot to do well.

Isn't picking fund managers the job of financial advisers?

PL Our experience is that more and more advisors are happy these days to hand over the responsibility for day-to-day management of investment decisions to us. Many have enough on their plate already, and keeping tabs on the best managers in the universe is a full-time job – or it is if you do it properly. Also, five years ago there were no investors I'm aware of who bought products such as ours directly. Now we have individuals, individuals using advisers, and institutions all buying them directly. They all have different reasons for doing so, of course. But it comes down to the fact that this is an investment product that both makes sense intuitively and also, we have found, delivers performance.

JCR I would think we're pretty close to being the market leader: Sales of our funds have been running recently at over £16m a month. There are a couple of other houses that are doing good work in this area, but in terms of sales, we are certainly ahead of the pack at the moment. Some people also see us as a target to be shot at, which is rather flattering, as it means we must have got something that they'd like to have.

How do you structure your fund range?

JCR We have three onshore fund of funds unit trusts. They are Jupiter Merlin Growth Portfolio Trust, Jupiter Merlin Income Portfolio Trust and Jupiter Merlin Worldwide Portfolio Trust. Offshore we also have the Jupiter Offshore Portfolio Fund Ltd and a fund of hedge funds called Jupiter Astral Limited. The three onshore unit trusts are funds that invest in other unit trusts, Oeics and mutual funds, but have different investment objectives.

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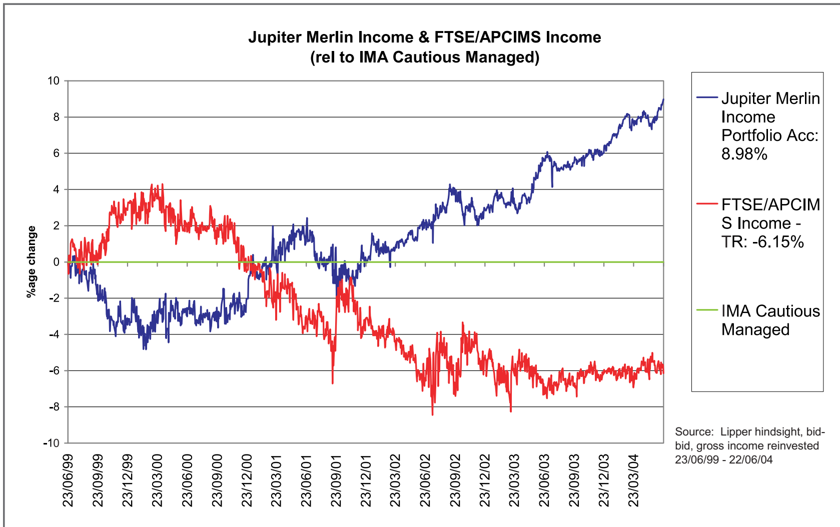
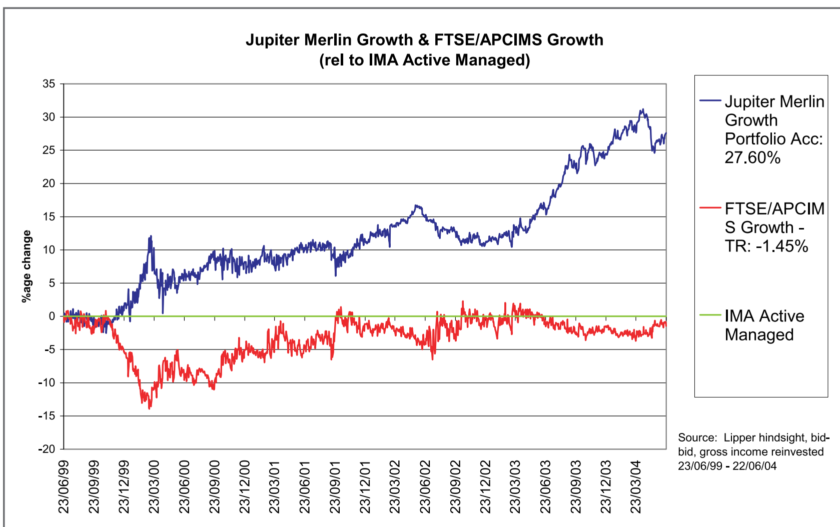


JUPITER MERLIN INCOME PORTFOLIO

(IMA Cautious Managed Sector)

The chart shows the track record of the Merlin Income Fund run by John Chatfeild-Roberts at Lazards from 1999-2001 and at Jupiter from 2001 to 2004. The fund, which is rated AA by Standard & Poors, is compared with a benchmark, the FTSE/APCIMS private client income index. The fund has outperformed the average fund in the "cautious managed" sector by a total of 9.0% over five years. In absolute terms it has returned 15.9%, as follows:

June 03 June 04	June 02 June 03	June 01 June 02	June 00 June01	June 99 June 00
+9.2	+3.6	-2.4	+3.5	+1.4

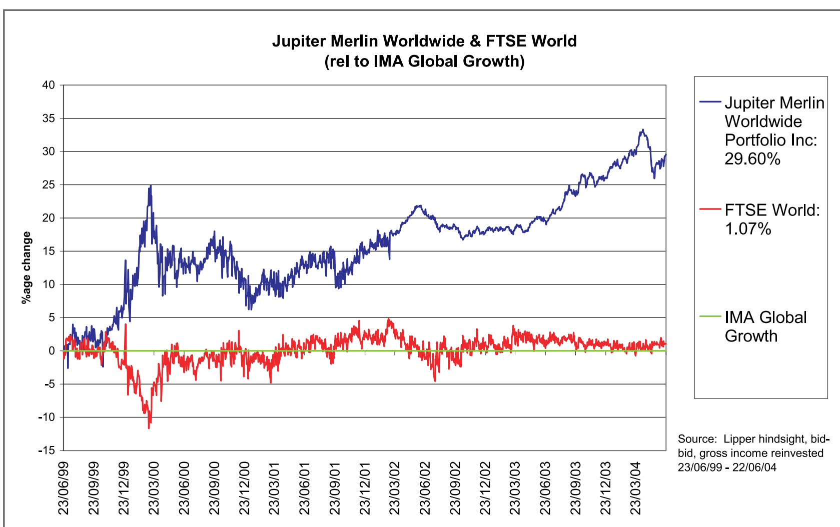


JUPITER MERLIN GROWTH PORTFOLIO

(IMA Active Managed Sector)

The UK growth fund has outperformed the FTSE/APCIMS private client growth index by a cumulative 27.6% over the past five years. In absolute terms the fund has produced a total return of 24.2% over the five years June 1999 to June 2002, made up as follows:

June 03 June 04	June 02 June 03	June 01 June 02	June 00 June01	June 99 June 00
+24.3	-7.1	-9.0	-7.7	+24.2



JUPITER MERLIN WORLDWIDE PORTFOLIO

(IMA Global Growth Sector)

The global growth fund has also outperformed its benchmark, the FTSE World Index, by 29.6% since June 1999. In absolute terms the fund has returned 13.3% over the period June 1999 to June 2004.

June 03 June 04	June 02 June 03	June 01 June 02	June 00 June01	June 99 June 00
+22.2	-11.3	-10.1	-14.0	+35.1

NOTE: The Jupiter Merlin Portfolio Trusts were managed by John Chatfeild-Roberts and his team at Lazard from 1st May 1997 until 1st March 2001. On 1st March 2002, the management of these funds was fully transferred to Jupiter Unit Trust Managers Limited under the same management team.

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Left to right:
Peter Lawery, John Chatfeild-Roberts and Algy Smith-Maxwell

The Growth Trust, for example, has an objective of long-term capital growth with a bias to the UK market. The Income Trust also has a UK bias, but can't have more than 60% in equity funds. It has a high and rising income requirement as its first aim, together with some capital growth. The Worldwide Trust has a capital growth aim but a global rather than a UK centric remit. The offshore fund, Jupiter Offshore Portfolio Fund, has a similar remit to the onshore growth fund, but can also have up to 20% in long-short equity funds.

What are the main differences between them?

ASM Essentially they have different risk profiles. The Worldwide Fund has higher volatility than the Income Fund, and usually also more volatility than the Growth Fund. All the funds are aimed at people who want a one-stop solution and don't want to manage money themselves – they are the same type of investor in that sense - but we recognise that they will also have different propensities to accept volatility and risk.

Where does the fund of hedge funds fit into this picture?

PL In our view fund of funds hedge funds should be competing directly against the with profit bond market. Why? Because in our eyes, they have the same focus on absolute returns and a low risk profile. We will have to wait until such a time as that product is authorised by the FSA before we can expect to have large fund inflows from the sort of people who have been with profit bond investors to date. But if that happens, my expectation is that you will see a lot of demand. There is a lot of confusion and misunderstanding of what this kind of fund can do for you.

You think that the current fashion for absolute return funds is here to stay?

JCR Yes. We think that most investors are interested in absolute returns first and foremost, and we would like to provide a product that addresses that. Of course funds of hedge funds are aimed at this area, but the regulation makes them more difficult to sell to retail investors, so we are looking at other ways of fulfilling the need, using the flexibility that the new rules for UK funds allow. In general, we believe that simplicity in investment management is a great virtue.

Can you quantify the amount of money you have under management now?

JCR When we arrived at Jupiter, we had no funds under management at all. Currently we're running just over £500 million. That's a reasonable rate of growth over three years. We did buy our old business back from Lazard, but that wouldn't account for more than 40% of what we currently have. Sales are up by 100% in the last 12 months. Strangely, I had no real idea what would happen when we arrived here. All you can do is set out your stall, perform to the best of your ability and hope that the sales and marketing teams are going to come up trumps, which fortunately they have done.

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ASM In some ways, having to start again from scratch after leaving Lazard has been extremely hard work, but in other ways, it has been good news. It means we have had an opportunity to prove ourselves again through our performance. Hopefully being here has made us better investors. The industry tends to start following managers when they have put together a strong track record over a three-year period. So it is no surprise to me that, now we have been going for three years, inflows into the funds have gained a lot more momentum.

How do you go about selecting the funds in your portfolios?

JCR As I said, we think that it has to start with a market view, because that's the canvas you're working on. Once we have formed our view, we move on to picking the managers who are most likely to perform on that canvas. It sounds simple, but there is a lot of research and experience behind the process.

ASM It is important to be comparing apples with apples. There is a structure to how the team works; every six months we do a full review of the managers in a particular sector. Currently it is Japanese fund managers. We therefore have an up-to-date view on how managers perceive their particular market at roughly the same point in time, as well as allowing us to compare their performance. This is the bedrock on which we build our universe of potential individual managers.

On what basis do you compare different managers?

ASM Before we have our meetings with fund managers, we do a lot of other preparatory work. We prefer not to look at calendar year performance, but at discrete periods when investment conditions are different – ones in which we would expect managers to either out or under-perform each other, based on our knowledge of their style. In practice that often means we will use key market inflection points. A good recent example would be looking at how Japanese fund managers performed from the turning point in March 2003 to the end of last year. Doing that gives you a much better feeling for who had the greatest cyclical bias than if you simply looked at the 12 months Jan-Dec 2003.

How many funds in practice do you have in your universe?

JCR In the long-only universe, we look seriously at around 100, but we hold no more than 30 funds at the moment across our range of funds. In the long-short universe, there are about a dozen. A lot of our work comes down to experience. We simply don't bother to look at the huge swathe of fund managers who, when you look at the numbers, don't ever seem to have made a difference. The good news is that with just three people on our desk, what we're doing is very scaleable. You could multiply the amount of money we've got tenfold and you probably wouldn't need more than the three of us to manage it.

ASM Well, you might need a few more people to write reports, but in terms of interviewing and building relationships with potential fund managers, I don't see a need for more capacity. As we speak to them twice a year in our regular sector reviews, and also hold conversations on the telephone in between, each of us carries a huge bank of knowledge around in our heads. We also keep a comprehensive integrated electronic filing system on what people have said to us in the past. So we can easily look back and say "Well, five years ago they said X and actually Y turned out to be the case, so perhaps their macro calls aren't that good but their stock picking is great".

You don't include quant-based fund managers in your universe?

JCR No. Our view is that investment is a people business, and it really isn't rocket science. Anything to do with quantitative data is of necessity backward looking. Alchemists tried to turn base metal into gold and they never found out how to do that. Similarly quant people are always looking for the one magic formula that will tell them what's going to outperform next. My experience is that there isn't one of those either.

How often do you turn over the number of funds you own?

JCR That depends on the environment. In the last three years we have seen some pretty big swings in style and sentiment, so our turnover has been higher than usual. September 11th and the Gulf War are just two of the obvious turning points. In general, from March 2000 onwards, with the odd blip, it was right to have had a largely defensive portfolio, while in the long/short universe, you had to be short of technology. That trend lasted for three years.

Then, from March 2003 until very recently, you had to have an aggressive portfolio to do well. As it happens, over the last 12 months, our turnover in the growth fund has been around 100%, which is high for us. We were defensive in the run-up to the Gulf War but had a very strong view on what was going to happen once it started. In fact we changed all the portfolios pretty substantially on the 12th and 13th of March 2003, in order to move them from being defensive to offensive. That has turned out to be the right thing to do.

ASM Last year was particularly interesting because you then had the backwash from the SARs epidemic, which meant that the Asian and Japanese markets had not kept up with the leading Western markets following the Gulf War. That meant there was an opportunity there to rotate and add value by upping your exposure to Asian markets, which we also managed to do.

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THE FUNDS THAT JUPITER OWNS
As of May 31st 2004

MERLIN INCOME TRUST	
UK Equities	55.3%
Artemis Income	
BWD Microcap	
Cazenove Growth &Income	
Framlington Equity Income	
INVESCO Perpetual Income	
Jupiter Income Trust	
Rathbone Income	
UK Fixed Interest	23.5%
Fidelity Moneybuilder Income	
Framlington High Income	
INVESCO Perpetual Monthly Income Plus	
Old Mutual Corporate Bond	
Japanese Equities	4.0%
CF Morant Wright Japan B	
Other Fixed Interest	7.2%
Thames River High Income	
Cash	10.0%
TOTAL	100.0%

MERLIN GROWTH PORTFOLIO TRUST	
UK Equities	30.7%
Artemis UK Special Situations	
Fidelity Special Situations	
Framlington UK Smaller Companies	
GAM UK Diversified	
Gartmore UK Focus	
US Equities	12.8%
Findlay Park US Smaller Companies	
European Equities	4.1%
Artemis European Growth	
Jupiter European	
Japanese Equities	18.1%
CF Morant Wright Japan B	
Framlington Japan	
Thames River Japan	
Far East Equities	6.3%
Solus Eastern Enterprise Inc	
Specialist/Emerging/Other	25.5%
JPMF Natural Resources A	
Jupiter Emerging European Opportunities	
Jupiter Financial Opportunities	
Cash	2.5%
TOTAL	100.0%

MERLIN WORLDWIDE PORTFOLIO TRUST	
US Equities	19.1%
Findlay Park US Smaller Companies	
European Equities	10.6%
Artemis European Growth	
Jupiter European	
Japanese Equities	28.0%
CF Morant Wright Japan B	
Framlington Japan	
Thames River Japan	
Far East Equities	7.7%
Solus Eastern Enterprise Inc	
Specialist/Emerging/Other	33.7%
JPMF Natural Resources A	
Jupiter Emerging European Opportunities	
Jupiter Financial Opportunities	
Cash	0.9%
TOTAL	100.0%

PL Another key turning point will probably turn out to be the change in the direction of UK interest rates that is now under way. Historically, that has been a time when you should be reducing your exposure to small cap stocks. For the last five years or so, the smaller 15% of the UK market has outperformed the larger cap stocks. This may well turn out to be a turning point after which that no longer happens with such certainty.

How do you decide how many funds to include in each of your funds?

JCR The FSA rules within which we work are that you can't have more than 20% in any one fund, so that's the starting point. The Merlin Worldwide fund tends to have fewer funds than the Merlin Growth fund. Its content mimics the Growth fund in terms of its overseas holdings, but it doesn't need most of the UK funds.

ASM We have found that it is difficult to tell who in the income sector is going to perform best in the short term. So to have a cluster of top quality income fund managers is a sensible approach. The other factor is that the dividend flow to the client is important for income funds, and you don't want to have all your funds paying out their dividends at exactly the same point during the year. You need a spread of funds to provide a consistent dividend flow.

How do you monitor the overall risk of the fund?

PL At a philosophical level, we see risk as the likelihood of losing absolute money for clients, rather than against an index. Most clients would agree with that as a standpoint. However, we do use industry standard software to give us information about portfolios, which comes out relative to indices. I do most of the analysis. Once we have made our initial choice of fund managers, I'll run their portfolios through the BARRA system, combined with market data, so that we are fully up to speed on the sector and stock weightings, and also the liquidity, of the portfolios.

JCR It can be interesting what comes out of this analysis. For instance, you can look at two funds invested in the UK, both in the same sector, and discover that they are as different as chalk and cheese. One could be wholly invested in FTSE 100 companies, whereas the other has 50% in mid and small caps; you may not be able to see that from their top ten holdings but the way they behave and perform will be completely different as a result. And looking at the PEs of the underlying holdings in a fund will confirm (or not) the answers a fund manager has given you about the price they are prepared to pay for companies. It is certainly worth knowing if a fund manager is prepared to buy stocks on PEs over 100 for example. One has always to remember, however, that all number crunching is based on backward looking data, and therefore should not be relied upon as "the truth", but rather as a rough guide.

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PL I also run the combination of the funds that we hold through BARRA software in order to give us a guide to the style biases of our fund. I have to say we view the output purely as interesting information rather than as a tool for running the portfolio. It does draw your attention to anomalies however - for example, if you want to add a fund for a particular reason and it doesn't make the change to the portfolio that you thought it was going to. It is a useful adjunct to the process, but that is all it is.

How do you deal with the business issues involved in changing managers in the fund?

JCR You have to recognise that fund management is a people business and you need to keep the managers you are using onside. If you're going to give them money or if you're going to take the money away from them, you need to make sure that they understand what you're going to do and the timeframe in which you're going to do it in. People don't like nasty surprises. Managing the expectations of the people you invest with is part of the process.

ASM Obviously you don't buy a fund expecting to sell it, because you had a reason for buying it. The reality is that some things you do will be right and some things will be wrong. You may have to sell a fund because you were wrong, and you have to make sure that people understand what you're doing and that you're doing it for the best reasons. They tend to be understanding. Their job is to make money out of buying and selling shares and they know that we have to do the same out of buying funds.

JCR It's important to highlight the fact that the vast majority of the managers in our portfolios are ones we've had money with for 10 or 12 years. We're not short-term investors. When we identify real, genuine investment talent, we want to back it. It is not as if there is too much of it around. There's no point in having just 2% in Anthony Bolton's fund, in our view. You want to have a much larger proportion of your clients' funds with a top quality manager at a time when style is on his side.

Don't funds of funds involve double charging?

JCR We try very hard to minimise the cost to the client, because it's self-evidently in our own interest to do so - every penny we can take off the cost of the fund is a percentage point added to the performance. I can't think of any fund group that we pay front-end loads today, though that is a change from 10 years ago. In terms of annual management fees, where we own Jupiter funds (and we have a self imposed limit of 25%) there is a full rebate of the extra annual management fee. On the other funds, our experience is that we can usually halve the annual management fee we're paying to a fund group. As we get larger, we can probably squeeze those costs down further.

That said, we don't have any strict rules on costs, and by that I mean we don't say "we will not pay any more than X% for a fund". The reason for this is that we want to make sure that our investors are exposed to the best, not the cheapest, talent. If you've got one fund run by Andrew Green and another run by AN Other, does it matter if Andrew Green's fund is X% more expensive? It only matters if he isn't a very good fund manager, but as he is, our view is that he is likely to generate significant outperformance over and above the extra cost.

PL I have always thought that buying the best possible talent wherever it happens to be is a good idea – that is the fund of funds concept. But we know there is an extra cost attached and that is why we say that running a fund of funds means you need to be able to generate performance over and above the extra cost. Otherwise it isn't worth doing. If all it is a nice idea, you can't live off nice ideas.

ASM In making comparisons on charges, most people don't measure their own performance as precisely as we do. If you have ten funds in your portfolio, what you should be doing is comparing our performance with the performance of all your 10 funds, not just one. And you should be counting in both the cost of the fund switches you make and the charges you incur. It's actually quite a difficult thing to do. Most people can't do it. The real beauty of fund of funds from a performance perspective is that it is utterly transparent. We don't do the institutional thing of quoting performance before fees. With us, what you see is what you get.

What does it cost to buy your funds?

JCR Our funds are priced identically to the vast majority of those in the Jupiter range. There is a 5.25% front end load and a 1.5% annual management fee. These are the same charges as most other Jupiter funds. Our total expense ratio is around 2.5%.

Why do you think fund of funds is a superior method to manager of manager of funds?

PL Manager of manager funds come from the institutional environment. They're much more hung up on benchmark risk and low tracking errors. They do usually have a clear advantage over us on the cost side, though we think it's no more than 0.5%. They tend to be style neutral and in our view that means they are sitting on the fence, not actually taking a view of what's going to happen next. If you've got three different managers, one is value, one is growth, and the third has a different style, when you put the three together, all you've got is the market index – so what is the point?

JCR It's fair enough if you haven't got a view, but if you set your stall out on that basis, I think investors would do better to go elsewhere. With our portfolios you know that we are expressing our views on the direction of the market. The other thing is that if you are using managers with low tracking error, you inevitably will end up with institutional

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type portfolios where the scope for out-performance will be significantly reduced. In a number of well known cases, I'm afraid to say the performance just isn't there at all.

What in your view makes a good fund manager?

JCR I'd put the ability to think for themselves as absolutely top of the tree. There's a lot of "noise" out there. Supposedly everybody has the same information – though I'm not entirely convinced about that - but it's very easy to get sucked along having your opinions formed for you by the noise. The best people use their brains to think about what's going on and make up their own minds about how they should be positioned. And if they see that they are wrong in a particular instance, they have the humility to admit that to themselves (which is psychologically difficult), do something about it (i.e. reverse direction) and move on.

ASM I also think that their character needs to be ultra-competitive. They also need to be workaholics. There is no substitute for hard work, and fund management is not a 9-5 job, it is with you every moment of every day. They need to be bright and have a burning desire to make money; and ultimately, they will probably be proven to have been a better seller than buyer.

Who outside Jupiter do you admire most as fund managers?

JCR In the UK growth arena, Anthony Bolton at Fidelity has a wonderful track record; in global growth funds we are longstanding admirers of Andrew Green at GAM; and on the income fund side Neil Woodford at Invesco. We are fortunate that the UK still has some outstanding fund managers. That makes our job a lot easier.

How do you assess the current market environment?

JCR Overall, we think that people are probably still being over-pessimistic, are underestimating operational gearing and overestimating how much interest rates will go up. Markets have to climb a wall of worry. There are some longer-term trends that interest us; small domestically orientated companies in Japan can be found on single digit PEs with good prospects, and we think that we will continue to make money in that area. And on anything other than a two-month view we think the oil price may continue to move higher than the consensus expects. ■

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