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MFS Investment Management

Preservation or creation: Why not both?

In the often black and white world of investing, MFS is adding colour.

Typically, when people think about investing they think in terms of winning or losing - it's always one or the other.

But things aren't always so black and white and, according to MFS, it's thinking like this that can very well cost you.

MFS Prudent Capital aims to avoid this by investing in a diversified portfolio of global equity securities, cash, cash equivalents and short-term government bonds with exposure to fixed income securities.

This is done with the aim of achieving a total return over a full market cycle, without the distraction of constantly tracking a benchmark.

And it's done by investing in great companies at cheap prices - identified through extensive bottom-up, fundamental research - that meet the strategy's deliberately steep criteria.

Benefiting from more than 60 years' combined experience in funds management, the strategy is co-managed by portfolio managers Edward Dearing[01], Barnaby Wiener[02] and David Cole.

Here, Dearing and Wiener provide insight as to how their disciplined, yet flexible approach to stock-picking has fared in its 3 years since inception* and why they're confident it can stand the test of time.

Why do you believe in taking a prudent approach to investing?

ED: We believe one of the safest ways to generate long-term returns is to seek to avoid losses. By adhering to this focus, we aim to deliver equity-like returns with less volatility over a full market cycle. Our approach has always been a preference to lag the market in periods of frenzied excitement than risk material losses during abrupt market declines.

BW: In our view, minimising downside risk is critical to preserving capital in the long term. We take a very long-term approach when thinking about security selection and put capital to work only when the risk/return profile warrants it.

How do you decide what to invest in?

BW: Our aim is to navigate the investment path whilst aiming to deliver capital appreciation. We have an absolute return mind-set and our philosophy is reflected in two components.

The first is at the core of the strategy; finding long-term opportunities in equities and credit that we believe have the potential to compound value over time (closer to 10 years than one year), while maintaining the option of not committing if it's not the right time.

The second is that we invest our clients' money just as we would invest our own. We are very focused on downside risk both in terms of the portfolio's position – we have a lot of flexibility to manage market exposure – and secondly, in terms of the types of investments we make. We spend more time thinking about what can go wrong with an investment than we do thinking about what could go right.

We put capital at risk only when we believe the potential return warrants it. As we do not think of relative risk versus an index, it frees us to do things differently, namely reduce market exposure when opportunities are not attractive and build an investment portfolio that bears no resemblance to the index.

What does the perfect stock for you look like?

ED: Valuation is a major determinant of our market positioning but there are other factors. We follow a highly disciplined investment approach and only look to own individual securities where we see a compelling fundamental reason to own a stake in the underlying business. We tend to focus on companies we believe have a genuinely durable franchise, sustainable competitive advantage, strong balance sheet, a management team running the company with a long-term future in mind and, above all, companies trading at a reasonable valuation.

Why has the portfolio been so defensive?

ED: Our approach is a blend of both bottom-up and top-down observations. We are more influenced by what we find at an individual security level. Asset allocation will stem from finding or not finding sufficient investment ideas in which to invest and an overall judgment of the risk/reward in the market as a whole.

Over the last couple of years, the portfolio was defensively positioned and continues to be so. This is because we had a number of concerns which informed our positioning. The greatest concern is a deep misgiving about this essentially 40-year monetary experiment of accumulating ever greater debt system wide. We see this as a source of instability and an impediment to growth. Other general concerns include inflated profit margins and disruption risk in a number of industries.

Has the strategy performed as you expected in the market downturn?

BW: Yes, there have been two significant downturns since the strategy was launched. The last quarter of 2018 and the first quarter of 2020.

The quote

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The strategy outperformed the MSCI World Index in both instances by 9.1% in Q4 2018 and 23.3% in Q1 2020 delivering on our main goal of protecting client's capital during these market events. However, we do not want to declare victory yet as we probably have a long way to run still.

One thing that we have always been quite conscious of is that there will come a time where we think it is prudent to be much more constructive in terms of our positioning. We are acutely conscious that our clients entrust us with their capital because they want to preserve it and not speculate with it.

We reserve judgement, and wait to see how we perform over an extended period of time and through a range of different market conditions because that is the only way of really evaluating whether we are doing a good job or not.

To this point, we always like to think of things in the long term, if we look back to the life of Prudent Capital, over the last three years to 30 June 2020 it has generated an annualised return of 12.7% vs the MSCI World Index of 10.6% despite only holding approx. 50% in equity through his period.

How do you look into the near future and prepare your portfolio?

BW: While it is difficult to predict the future, we continue to believe that taking a long-term view, investing in resilient businesses, in companies that have the ability to adapt and thrive, which are trading at attractive valuations – and importantly, with great balance sheets – is the most appropriate strategy for our clients.

It is sometimes tempting to do more when volatility picks up; however, it is precisely at times like this that a disciplined approach to investment is absolutely key and has served our clients well historically.

We believe taking a long-term view with judicious security selection will determine the difference between success and failure, bringing opportunity for the prepared and those with skill and patience. **FS**

Watch the video on www.fsitv.com