

## ‘Barbell’ strategy boosts Stewardship International performance, says Coles



A ‘barbell’ investment strategy has helped F&C’s Stewardship International fund to achieve a relatively strong start to 2009, according to manager Terry Coles.

The strategy combines an overweight to defensive consumer staples and healthcare stocks whilst maintaining exposure to cyclical sectors such as oil & gas and industrials. The Fund has significantly outperformed against its MSCI World Index benchmark by 6.4% so far in 2009.

“Over the past few months we have reduced our underweight to the US, and significantly lowered the fund’s exposure to emerging markets which have performed very strongly so far this year.” Coles explained. “Having led the world into recession, we expect the US to be the first to emerge from the current economic and financial crisis but this will take some time to play out.” A major contributor to the fund’s performance this year has been its position in FTI Consulting, a US based consultant that provides corporate restructuring services. The challenging financial environment continues to drive demand for the company’s services, as highly leveraged companies seek advice on how to repair their balance sheets and as others file for bankruptcy. An underweight exposure to financials was also a driver of performance, as the sector has remained under pressure so far in 2009. Financials fell by around 19% in February, following news that the US government would take a larger equity stake in Citigroup. Coles believes that areas such as alternative energy will also continue to face headwinds amidst the current economic turmoil, and that industry sales growth is likely to be constrained over the near term due to a lack of credit availability. To reflect this view, the fund has decreased its exposure to the solar sector, and now only holds two stocks, SunPower and SMA

Solar which both have better than average visibility.

Regarding the outlook Coles concludes, “Although consensus earnings estimates for some sectors such as energy and materials have become more realistic, earnings growth expectations for the market as a whole appear too high and we expect forecasts particularly within financials to be revised lower throughout 2009.”

“We remain cautious on global markets for the time being, but continue to monitor leading economic indicators for signs of improvement that would prompt us to reduce our defensive positioning and increase the cyclical part of the barbell strategy.”

### Combined Code review ‘timely’

Today’s announcement by the UK’s Financial Reporting Council (FRC) of the review of the Combined Code of Corporate Governance is timely in light of the ongoing financial crisis, which in many ways can be regarded as a failure of corporate governance.

George Dallas, Director of Governance at F&C said: “We support this general review of the Combined Code to complement the specific Walker Review of governance in the UK banking sector. While we believe that the Combined Code has established a positive framework for corporate governance in the UK, it is important to take stock at periodic intervals and to reassess the effectiveness of the Code, particularly in light of lessons learned from the recent financial crisis.”

Specifically, F&C believes there may be scope for greater scrutiny of how boards oversee the process of risk management – encompassing not just financial risks, but also relevant operational risks, including environmental, social and governance risks.

This also offers the opportunity to review executive remuneration, with a view towards ensuring that incentive structures support long-term value creation. F&C also believes that a review of director elections, which might call for more frequent director elections or the annual election of board chairman and board committee chairmen might be an area that stands to enhance board and management accountability.

“F&C also welcome a review of the role of shareholders in the corporate governance process and how shareholders might play a more effective role in engaging with companies on matters of corporate governance, risk assessment, remuneration and strategy,” Dallas concluded.

### US regulators act on climate change

Under the new administration, US regulatory bodies are taking important steps towards the introduction of new policies to flight climate

change.

This week, the National Association of Insurance Commissioners (NAIC) approved a mandatory requirement for insurance companies to disclose the financial risks they face from climate change. The new requirements would mean all insurance companies with annual premiums over \$500m will be asked to fill out an Insurance Climate Risk Disclosure Survey every year, with the first reporting deadline being May next year. F&C, which has been actively encouraging companies and regulators to take action in the fight against climate change, welcomes this step. Alexis Krajeski, Associate Director at F&C’s Governance & Sustainable Investment (GSI) team, explained: “We have been engaging with the NAIC in the US and broader industry bodies such as ClimateWise and the Association of British Insurers in the UK, with the aim to improve not only corporate behaviour but the overall business landscape. We have asked insurance regulators to improve information disclosure on climate-risk to the market, while allowing insurance pricing flexibility that reflects growing climate risk, and collaboration with local planning commissions to invest in adaptation plans to reduce the physical impacts of climate change and associated losses to insurers.”

The move from the NAIC follows last week’s proposal by the US Environmental Protection Agency (EPA) to introduce the first comprehensive national system for reporting emissions of carbon dioxide and other greenhouse gases produced by major sources across the country.

The new reporting requirements would apply to companies supplying fossil fuel and industrial chemicals as well as manufacturers of motor vehicles and engines. It would also apply to emitters of greenhouse gases with emissions equal or greater than a threshold of 25,000 metric tons per year. Most small businesses whose emissions fall below that threshold would not be required to report their emissions.

“The scheme will allow the collection of data in preparation for a possible emissions trading scheme,” said Vicki Bakhshi, Associate Director at F&C’s Governance & Sustainable Investment (GSI) team. “For some time F&C has been pressing companies to measure, monitor and disclose emissions, and to prepare themselves for regulations ahead. As expected with the election of the new President, policies are evolving rapidly and companies cannot afford to ignore the issue any longer.”

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