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Star struck

Star culture presents siginficant problems for asset management companies when top managers jump ship. We examine the steps some groups take to avoid them...

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The star fund manager culture and its effect on open-ended fund industry has been the subject of debate for many years, frequently making headlines when a high profile manager leaves for pastures new.

To try and address the problems associated with key man risk, many fund management groups have pushed the 'team-based' approach more in recent years in an effort to soften the blow if a lead manager does change fund management houses The idea being if a manager does depart, investors won't feel the need to sell out of a fund because they know the team taking over will run it in a similar way.

Given their structure of being closed-ended, investment trusts have traditionally been shielded by the effects of key-man risk. However a recent example of a high profile departure at River & Mercantile shows they are not immune.

Rather than being swamped with outflows, the **River & Mercantile UK Micro Cap** Trust saw is share price fall 14.6% and its discount to net asset value (NAV) move from 16.2% premium to a 0.6% as investors hit the panic button after the announcement its lead manager, Philip Rodrigs, had left the group.

For Nick Greenwood, manager of the **Miton Global Opportunities** trust, the large drops the trust has faced since Rodrigs' departure, represent the risks that investment trusts with key managers can face when those managers leave.

"If you have a key manager following, the price that the trusts trades at can be very different to its peers, meaning that if the manager leaves, the price can quickly fall either back into line or below the peer group," he says.

In its 2018 rebalancing of its model portfolio, Winterflood replaced the R&M UK Micro Cap Trust with the JP Morgan-managed **Mercantile Investment Trust** in the UK equities section of its portfolio for its mid and small cap exposure. Trading at a 9% discount at the time, it felt the Mercantile Investment Trust, which is managed by Guy Anderson, represented a better value opportunity (versus the premium the R&M UK Micro Cap was trading at the time).

However after the events that unfolded since Rodrig's departure, Simon Elliott, a research analyst at Winterflood Investment Trust, says the micro cap fund does offer value versus its nearest peers. He also believes there is a large opportunity in the micro cap segment of the UK market for a genuinely active manager to add considerable value through stock picking.

"The fund's assets of £102m are nearly only 10% below where the board has deemed it appropriate in the past to return capital at NAV," he says. "It is feasible that the portfolio could generate sufficient growth within the next 12 months to warrant a third return of capital and we would expect this to act as a catalyst in narrowing the discount."

At the same time, while many in the past may have invested in the fund because of the previous manager, its new manager, George Ensor, knows the trust having been involved with its running since launch in December 2014.

"As a key member of River and Mercantile's equity team, Ensor has gained the respect of the team's leadership and we were impressed with his knowledge of the stocks in the portfolio at a recent meeting," says Elliott. "Whether this will translate into strong returns, both absolute and relative, will only be proven in time.

"However he has a head start given his current knowledge of the portfolio and this is an important, high profile mandate for River and Mercantile, not least as its only listed collective to date."

Meanwhile Greenwood, who never held the fund, says things can work in the opposite way. Namely a badly performing trust can see its discount narrow if it gets taken over by new management.

A most recent example of this would be the **Aurora Investment Trust**. Having been a serial underperformer in the IT UK All Companies sector, since Phoenix Asset Management took over the trust in January 2016 it has undergone a complete transformation under new manager Gary Channon. As such it has moved from a 17% discount in April to 2015 to currently trading at parity, with the trust ranked second article over one and three years.

So the movements in discounts can work for and against investment trusts when a high profile manager departs. However what they are not subject to is large outflows thanks to their closed-ended structure meaning any incoming manager does not have to deal with a firesale of assets on day one.

In the case of the R&M UK Micro Cap Trust, it would seem after all the negative headlines, many are realising the strength of the team that lay behind the key man and at its current 11.9% discount to NAV could be sensing a buying opportunity.

Important information