Majedie Investments

MAJE has seen a complete overhaul of its strategy under a new manager...

Update
27 March 2023

Overview

The board of Majedie Investments (MAJE) undertook a review of the investment management arrangements, assisted by an external advisor, that resulted in the appointment of Marylebone Partners as the Investment Manager in January 2023. The strategy is focussed on offering investors a liquid endowment-like investment solution, which is unique in the investment trust universe and follows MAJE's long-term fundamental investment focus.

As discussed in **Portfolio**, the strategy remains focussed on equities. However, the unrestricted approach allows the lead portfolio manager, Dan Higgins, to invest across multiple asset classes at his discretion. The approach remains focussed on the bottom-up, fundamental characteristics of each investment and the attractiveness of its valuations, rather than being driven by any macro-outlook or stylistic biases. Portfolio construction is centred around the team's unique long-term target allocations to special investments, specialist external fund managers and public equities.

As discussed in **Management**, Dan works alongside fellow partners at Marylebone, Robert Elliott and Olivia Macdonald, whose combined experiences equip them with the required skill sets and access to an ideas network. This should offer a solution that has, historically, been hard to access for mass market investors. The trust has moved from the AIC Global Equity Income sector to the AIC Flexible Investment sector.

The long-term **Performance** of an equivalent strategy run by Marylebone Partners compares well to other multi-asset trusts within the sector. The evolution of the strategy will see MAJE target annualised total returns of CPI +4% over five-year rolling periods, which includes an annual **Dividend** calculated at 3% of NAV. As discussed in **Charges**, there is a management fee holiday for the first six months, with a new tiered management fee calculated in relation to MAJE's market cap to align the managers' interests with the trust's shareholders, thereafter.

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Analyst's View

We believe that Marylebone Partners' historical **Performance** track record suggests the strategy is likely to appeal to longer-term investors. The strategy's diversified nature is expected to offer greater consistency throughout the market cycle, which is similar to what is provided by certain alternative multi-asset trusts within the Flexible sector. The **Management** team's unrestricted approach and significant experience managing such strategies provides them with a unique network of ideas, which we believe should provide investors with confidence around their unrestricted multi-asset approach and tactical allocation to special investments and boutique external fund managers, which we discuss in **Portfolio**. We believe that this strategic evolution means MAJE should offer unique and complementary exposure to the typically generic core equity solutions.

We believe the 3% of NAV annual **Dividend** payment and substantive revenue reserves may provide a useful and dependable source of income during periods of elevated market uncertainty or lacklustre growth. However, it is likely to be lower than under the previous strategy, with income making up less of the trust's total return. In our view, the new real return target of CPI+4% is an attractive objective and we believe that, if the managers can deliver good performance in line with their objectives, there is scope for the current **Discount** of 15.5% to narrow closer to that of other multi-asset strategies within the sector that trade close to par. We also believe that the new management fee, being charged on market capitalisation, creates an incentive for the manager to see the discount narrow.

BULL
Liquid endowment-like model, offering a genuinely differentiated portfolio
Wide discount to NAV
Competitive long-term performance track record of the investment manager

BEAR
Allocations to special investments and external fund managers may make KID RIY high versus peers'
Income likely to be lower in the future
Fundamentally new strategy yet to demonstrate a track record of performance in this vehicle

Portfolio

On 25 January 2023, the board of Majedie Investments PLC (MAJE) appointed Marylebone Partners LLP as the trust's investment manager, following the acquisition of Majedie Asset Management by Liontrust. This appointment was the result of a formal review of the trust's investment management arrangements with MAJE's external advisor, JPM Cazenove, which determined that Marylebone Partners' long-term, fundamental approach was the most closely aligned with Majedie's ethos amongst a competitive group of 25 alternative candidates.

Dan Higgins is Marylebone's CIO and takes on the responsibility of being MAJE's lead portfolio manager. However, as we discuss in **Management**, Dan's fellow partners, Robert Elliott and Olivia Macdonald, work closely alongside him. Considering the trio's specialist experience of running liquid endowment-like strategies since 2013, we believe they are well-placed to deliver a truly differentiated investment proposition within the investment trust universe. The trust's underlying long-term, fundamental investment philosophy remains the same. However, the Marylebone Partners team will be able to bring their proven, distinctive and unrestricted proposition to shareholders. The formal investment policy was amended during the annual general meeting to allow the trust to pursue a high-conviction, long-term approach that is unconstrained by geographical limitations or any formal benchmark. As a result, MAJE will now target an annualised total return of at least 4% above the UK Consumer Price Index (CPI). The focus is less on income generation, specifically; however, the trust's annual dividend, which will equate to 3% of NAV, will remain a core part of MAJE's total returns. Further details are discussed in the **Dividend section**.

Rather than being driven by any top-down macro view or stylistic biases, the team are focussed on bottom-up, fundamental analysis of investment opportunities. This is combined with the use of well-honed and sophisticated portfolio construction techniques and a series of proprietary tools to reduce the risk of permanent capital loss. Research conducted in-house is central to the process, with every potential investment assigned a lead coverage analyst. A central factor to Marylebone being awarded the mandate was the team's ability to source differentiated investment opportunities that have originated through their substantial ideas network. This includes the specialist industry connections the team have made over their careers, which can deliver strong performance across market cycles and which are less correlated to the alternative strategies currently available in the investment trust universe. One way the team achieve this is by ensuring that the cross-correlation between the underlying assets is low, with the current average sitting at 0.33.

For this bespoke mandate, the team have constructed MAJE's portfolio using three distinctive fundamental strategies, which include allocations to hard-to-access special investments, specialist external fund managers and exposure to direct equity investments. Firstly, special investments offer investors exposure to more eclectic areas of the market which can generate higher levels of alpha, with a target IRR of 20% or more. This allocation is expected to make up 20% of the portfolio by January 2024, depending on available opportunities, with the ability to increase this to 30% over time. Although this is an inherently riskier allocation, over their 30-year combined history, the team at Marylebone have developed an established proprietary ideas network through which they hope to identify exceptional opportunities. Importantly, they apply a 'one degree of separation' rule and will only consider an opportunity if it has come through a source which is connected to a member of the team. Within this bucket, there are co-investments, thematic funds, capital market transactions and special purpose vehicles. It is important to note that these opportunities are scarce, with access typically capacity constrained, however they provide a unique opportunity to gain exposure to areas of the market that are not typically found in existing investment trusts or accessible to the average investor.

Importantly, the special investment opportunities are liquid. The investment horizon for these is between 24 and 36 months, which means that unlisted pre-IPO situations, venture capital and private equity funds are excluded from consideration. Additionally, investors can have greater confidence in the underlying value of these investments, as valuations are updated either on a monthly or quarterly basis, rather than based on a formulaic approach. Instead, the focus is on credit instruments, public equity investments, activist positions or fund investments. An example of such a special investment is a co-investment in an activist campaign to unlock value in a listed REIT that owns trophy assets in Manhattan and San Francisco, trading at a deep discount to NAV due to its mismanagement and inflated cost structure.

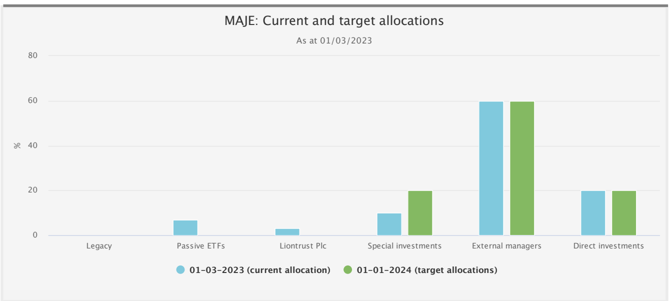
Secondly, there is an allocation to specialist external fund managers that can offer investors exposure to exceptional third-party managers in specialist areas. Currently, this makes up 60% of the portfolio. Owner-operated boutiques feature heavily to enhance investor alignment. For example, Paradigm BioCapital Partners, which is a SMID-cap biotech specialist seeking to capture opportunities following the 2021/22 market sell-off. The team include several physicians who understand both clinical and practical use, which can determine the success of clinical trials. Therefore, the value-add is on both the long and short sides, with payoff profiles based on the probabilities of clinical trials' successes. The underlying exposures are diverse and held through single names and custom basket indices, which helps to mitigate stock-specific risk in a portfolio featuring core and event-based positions.

Another focus for the Marylebone team is specialist credit. Opportunities are appearing through managers that can identify performing credit opportunities, which are still capable of facilitating debt payments. Currently, this makes up 20% of the portfolio and the underlying predictability of the cash flows means this is likely to grow. For example, the Millstreet Credit Fund is a Boston-based credit specialist focussing on credit instruments issued by smaller companies, with relatively small issue sizes of between $200m and $500m. The debt is high-quality, in the form of senior secured instruments, with short duration and high coupons. Consequently, this translates into the potential for strong total returns. The focus is on structural inefficiencies within this area of the market, which is subject to limited research coverage and competition.

The final allocation is to direct public equity investments. These are chosen based on what the team believe to be the best fundamental characteristics, including revenue growth, business quality, high return on capital and strong earnings and cash flows. The team have a strong history of bottom-up fundamental investing and their valuation discipline is a central part of the decision-making process. Again, the process is unrestricted and the team are led by the fundamental analysis, rather than being influenced by any geographical, sector or style biases. This results in a relatively concentrated direct equity allocation that includes a less-correlated group of 12 to 15 equity holdings, which are not commonly found as top holdings in more generic global indices. For example, the portfolio includes the subscription-based software company Adobe Inc., which has demonstrated its competitive position across several growing divisions and can generate significant cash flows. The company's strong balance sheet also means they can generate accretive capital opportunities, such as the $20bn acquisition of web-first collaborative design platform Figma. This sits alongside Howmet Aerospace Inc., which is a global supplier of advanced engineering for the aerospace and transportation sectors. The company is active across multiple production lines, which diversifies the potential for revenue growth. Dan also highlights management's excellent allocation of capital following the Covid-induced recession in the sector. Both examples were bought at what Dan sees as attractive valuations. The current direct equities allocation is 20%, which is at the top end of the long-term target range of between 10% and 20%.

In a recent meeting, Dan noted that the market uncertainty presents a unique opportunity to gain exposure to some very fundamentally strong investments at very attractive valuations. He states that the indiscriminate selling that occurred over 2022 has presented some of the best opportunities of the last decade. That said, Dan is not looking to time the market and is happy to have zero allocation to alternative asset classes, which he believes will not perform well over the long term. So far, the portfolio transition has been swift, with the sale of legacy positions financing the full allocation to the direct equity positions by 01/02/2023. As at 01/03/2023, the full sale of legacy positions was complete. The full allocation of external fund managers and to direct equity investment has been achieved, while it takes a little longer for the opportunities to arise for the special investments. Currently, these account for 10% of the portfolio and the goal is to see the allocation rise to 20% by the end of the year.

Fig.1: Current And Target Allocations



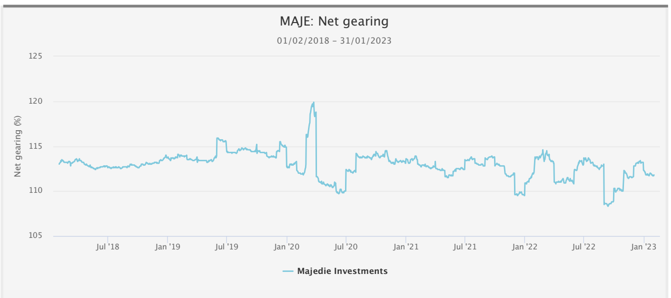
Source: Marylebone Partners

Gearing

MAJE's board continues to believe that structural gearing can act as a useful way of enhancing returns over the long term and, despite the recent investment management change, it is likely to remain a feature of the portfolio. Currently, MAJE holds a long-term debenture of £20.7m, financed at a relatively high rate of 7.25%, which was issued in 2000 and is set to mature in 2025. This equates to a potential net gearing level of 12%, according to JPM Cazenove, as at 27/02/2023.

The use of structural gearing is favoured over a short-term revolving credit facility to help achieve a more consistent level of gearing, where fluctuations are only dependent on NAV movements, rather than a nominal increase in leverage.

Fig.2: Five-Year Net Gearing



Source: Morningstar

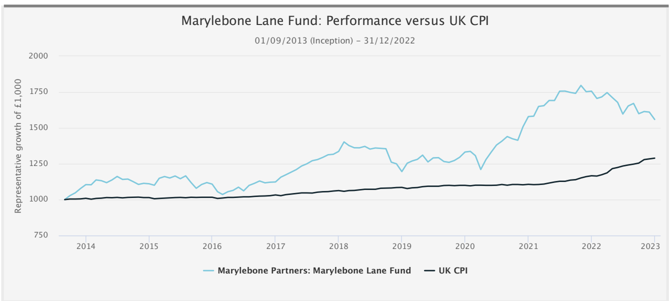
Performance

Following the appointment of Marylebone Partners as MAJE's investment manager at the start of 2023, the portfolio has evolved to provide a highly-differentiated investment solution, which is centred around a liquid endowment model. As we discuss in **Portfolio**, there has been a swift transition into the external funds, direct investments and a few special investments. However, the Marylebone team do not expect the portfolio to be fully representative of the long-term strategy until 01/01/2024 – partly due to the irregularity associated with the availability of special investment opportunities.

The revamped investment objective has been amended to include the pursuit of a high-conviction, long-term approach that is unconstrained by geographical limitations or any formal benchmark. Although equities will continue to lie at the core of the strategy, the underlying investments and returns' sources are likely to be highly differentiated, given the portfolio's construction. The lead portfolio manager, Dan Higgins, hopes to identify investment opportunities that can generate strong double-digit returns over an average investment horizon of three years. These include target returns of 20% from special investments, 15% from external fund managers and 15% from direct equity investments. This is reflected in the trust's inclusion in the Flexible sector. The success of the strategy will be measured against an independent total returns target of the UK Consumer Price Index (CPI) of +4% over five-year rolling periods. This includes an annual dividend, initially set at 3% of the net asset value, which will be paid quarterly.

The team at Marylebone Partners run other, similar mandates with CPI +4% targets, and the data provided by Marylebone below illustrates the performance of a similar strategy. However, it is important to note the specifics of the data. This is calculated by taking the actual performance of Class FEU Series 1 of The Marylebone Lane Fund in USD, then hedging to GBP using the prevailing interest rate differentials, therefore not benefitting from the depreciation of sterling over the period. This has assumed a pro forma allocation to special investments, using actual investments made for participating clients. However, at 30%, it is at the upper bound of the long-term strategic allocation range for the category. The performance is shown net of all fees and expenses are based on the proposed fee structure for the trust. The chart below shows the indicative performance of £1000 invested from the fund's inception date of 01/09/2013 up to 31/12/2022. This shows that Marylebone Partners generated a total return of 55.9%, compared to the UK CPI, which rose by 28.9% over the same period. Performance has lagged the CPI + 4% target, but this has been due to the sharp spike in inflation seen over the past ten months. We also note that the annualised volatility of the strategy, over the past five years, has been 10.1%. This is in line with other low-volatility strategies within the Flexible sector.

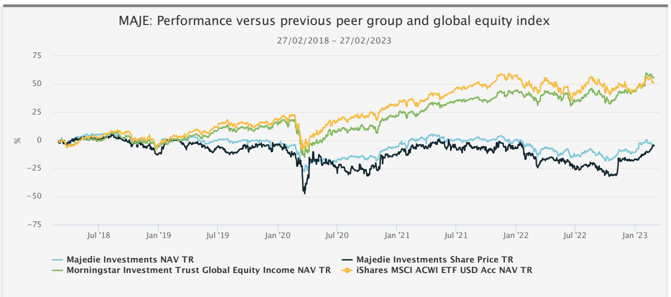
Fig.3: Indicative Performance Of Strategy



Source: Marylebone Partners
Past performance is not a reliable indicator of future results.

In light of this change, we believe that there is very little to be gained from an in-depth analysis of MAJE's past performance, as it will not be representative of the strategy moving forward. However, for completeness, we include MAJE's performance over the past five years. As can be seen, MAJE generated a NAV total return of -5.2% over the period. This compares against the 55.6% generated by MAJE's former peer group, the Global Equity Income sector, and the 51.1% generated by the MSCI All-Country World Index over the same period.

Fig.4: Five-Year Performance



Source: Morningstar
Past performance is not a reliable indicator of future results.

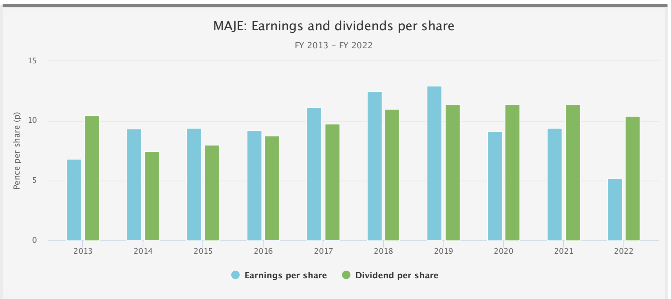
Dividend

The new manager is targetting annualised total returns of at least 4% above the UK Consumer Price Index, measured over five-year rolling periods. The annual dividend will be included within MAJE's total returns and will be paid on a quarterly basis. This is expected to comprise 0.75% of the relevant quarter-end net asset value (NAV), leading to an annual dividend of approximately 3% of NAV.

We note that the trust has a comparatively high level of revenue reserves, at £21m, which is 3.5x the current annual dividend distribution. The strength of these reserves will underpin the trust's dividend policy in periods during which the income from investment is insufficient to cover the annual distribution. The board considers the dividends paid to shareholders to be an important part of total shareholder returns, however, we expect them to remain prudent by focussing on the sustainability and progressiveness of the dividend, with the goal of paying it out of the current year's earnings.

MAJE's historical dividend yield is, currently, 4.1%. The board paid 10.4p in dividends for the 2022 financial year, which is a 9.6% reduction compared to the previous financial year, as shown in the chart below. The reduction in the final dividend reflects the reduction in net revenue and the special dividend reflects the new dividend policy of paying 0.75% of NAV quarterly.

Fig.5: Earnings And Dividend Per Share



Source: Majedie Asset Management

Management

Marylebone Partners LLP was founded in 2013 and is owned by its partners. The investment team consists of five highly-experienced professionals, including Marylebone's founding partner and Chief Investment Officer, Dan Higgins. Dan has a wealth of experience through his previous roles. He was CIO of Fauchier Partners, a US alternatives investment manager, which had a strong track record for preserving capital in difficult market conditions. In this position, he built up a network of high-quality hedge funds' managers, which forms part of the Marylebone's ideas network and can provide an eclectic range of specialist investment opportunities. Furthermore, he gained extensive experience of the closed-ended fund structure through the firm's flagship listed vehicle, The Absolute Return Trust Limited. Prior to this, Dan was a senior fund manager at Mercury Asset Management, where he ran equity portfolios for large pension fund clients.

Dan is supported by two fellow partners and senior investment analysts, Robert Elliott and Olivia Macdonald. Robert joined Marylebone in 2014, having previously advised distressed companies on operational and financial restructurings at THM Partners. Prior to this, he was a lawyer focussing on corporate finance and M&A transactions. Olivia joined the team in 2017 following on from a position in The Wellcome Trust's investment team, where she focussed on private and public direct investment opportunities. Prior to this, she held positions in both sell-side equities research and asset management at Goldman Sachs.

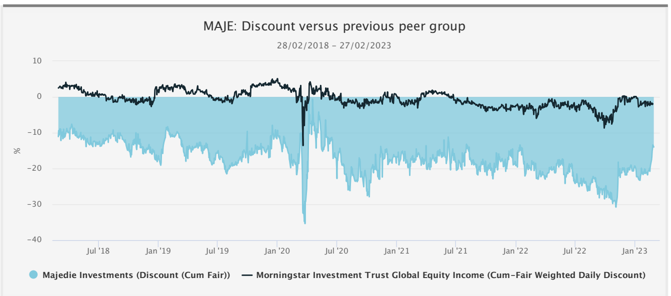
Two additional Investment Analysts, James Bloomer and Arjun Menon, are responsible for covering underlying portfolio positions across the primary strategies and monitor a wide range of potential investment opportunities.

Discount

MAJE is, currently, trading at a 14.4% discount to NAV. This is significantly wider than the trust's former peer group, the Global Equity Income sector, which is trading at a simple average discount of 3.9%. However, we would argue that there is scope for MAJE's discount to narrow, given the significant change in investment strategy following the appointment of Marylebone Partners as the trust's investment manager, in January 2023. Despite equities lying at the heart of the strategy, Marylebone's underlying investment and return sources are highly differentiated, which is reflected in MAJE's inclusion in the Flexible Investment Trust sector. We believe it is difficult to make a direct comparison to any existing proposition in the listed sector today. Given the uniqueness of Majedie's new strategy, it may be reasonable to expect the discount to trade closer to par if the managers deliver on their target and the trust builds a strong following from investors.

Since the announcement of Marylebone's appointment in November 2022, the discount has narrowed significantly, as shown in the chart below. We believe this can be attributed to new investor interest; however, it may take more time for investors to get comfortable with the new manager while they build up a new track record. Despite the swift transition of the portfolio so far, there will, inevitably, be some lag regarding the availability of suitable special investment opportunities.

Fig.6: Five-Year Discount



Source: Morningstar

As we discuss in **Charges**, there is a new annual management fee of 0.9% of the market capitalisation of the trust. The fee being paid on market cap incentivises the manager to narrow the discount from the current levels. Although there is no formal discount control policy in place, the board continually monitors the discount and does have the ability to buy back shares, if deemed appropriate. To ensure the liquidity of the trust, the 2022 AGM saw the directors given the power to buy back 7,944,519 shares, or 14.99% of the trust's existing share capital. No shares have been bought back under this authority.

Charges

MAJE's latest ongoing charges figure (OCF) is 1.34%, according to JPM Cazenove. This compares to the trust's former peer group, the Global Equity Income sector, having a simple average OCF of 0.84%. However, under the new management of Marylebone Partners, the management fee will be changing to a tiered annual management fee of 0.9% of the market capitalisation of the trust up to £150million; 0.75% of the market cap between £150 and £250 million; and 0.65% above £259 million. However, the market capitalisation for the calculation of this fee is subject to a cap of a 5% premium to the trust's net asset value. In addition, Marylebone Partners have fully waived the management fee for the first six months, whilst making a significant contribution to the cost of marketing the trust. We expect this new fee structure to lead to a greater alignment of interests, as it incentivises the investment manager to narrow the discount over time.

In light of the significant changes to the strategy, as at 17/02/2023, MAJE has been admitted to the Flexible Investment Trust sector, which has a higher simple average OCF of 1.13%. It is reasonable to expect that on a look through basis, the cost of the underlying investments will have an impact on the future OCF of the trust. However, since the rebalancing of the trust is still taking place, we are unable to quantify it at this stage. It is worth noting that the specialist investments, typically, have a performance fee associated with them and often no management fee, which helps minimise high costs during turbulent market conditions. MAJE's latest KID RIY is 2.28%. This compares to the Global Equity Income sector's simple average of 1.49% and the Flexible sector's 2.51%. However, at the time of writing, MAJE's figure also includes the interest on the debenture, which has two years remaining to maturity. We note that calculation methodologies can vary between individual trusts.

ESG

Dan and the team are aware of how ESG characteristics can impact the long-term potential of investments. Therefore, ESG considerations are fully incorporated across their research process. The long-term investment horizons of their underlying holdings means that the team consider ESG characteristics, particularly in the case of industries that are undergoing transitions. As a result, the team do not seek to exclude investment opportunities based solely on ESG characteristics and, instead, the team actively engage with companies and external fund managers in ways that can help drive positive change. With respect to their direct investments, the team evaluate a company's people and culture, strategy and operating practices and governance and disclosures. External fund managers are assessed on their firm and team, investment philosophy and process, and the portfolio outcomes.

The investment team draw upon third party data, including ESG research and insights from Morningstar's Sustainalytics, and independent research and views from within their extensive network. This allows them to form their own opinions on sustainability issues. As a result, the investment team believe they are unlikely to come across any investments that fail to accommodate basic ESG criteria or which leave the portfolio exposed to major controversies. However, at this stage, it is hard to comment on the status of MAJE's sustainability characteristics, as the portfolio remains in its transitionary phase and the new strategy has not yet been awarded any external ESG ratings, at the time of writing.

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