GAM Investment Meeting Notes

For accredited, professional, institutional and/or qualified persons only

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Global Environmental

Paul Udall, Investment Director, GAM Star GEO

- GAM Star GEO is somewhat ahead of the environmental sector benchmark indices year-to-date, predominantly due to its relatively small exposure to the renewables space. This area has been the hardest hit by the recent equity market volatility, especially solar and wind power stocks, notably in Asia. As such stocks generally have high betas and high growth expectations, falls can be attributed to fears of a global recession, as well as concern over falling government subsidies. Our positioning in alternative energy has been relatively low versus the benchmark weighting, which has helped the fund's relative performance. However, we are mindful of the fact that sharply declining capital equipment prices is the other side of the coin to the current weakness. This may lead to a rise in renewable energy adoption rates.
- The worst-affected stocks in the sector have fallen by 50% so far this year, which means that valuations are now very low. Along with equities generally, the environmental sector has been hit by rising correlations and volatility, although our discussions with companies reveal that cash flow volatility has not increased and earnings remain robust. That is, investors have reacted more to the overall macro environment than pure company fundamentals. Certainly there has been little differentiation between companies and our hope is that the coming results season will once again focus investors' minds on company-level developments, as there are a number of firms out there that continue to do very well. We have been looking to position the fund in such names.
- We have taken advantage of the sell-off by adding some high-quality blue-chip names to the portfolio. A number of these now feature among the fund's top 10 holdings. One recent addition is Johnson Matthey, which has a 50% share of the global catalytic converter market. The company should benefit from a spate of new regulation around the world that is targeted at reducing exhaust emissions. Importantly, this area is not dependent on government subsidies or incentives. Johnson Controls is another similar example, as is Tenneco and BorgWarner, both of which are high-quality US companies making emission control systems for trucks. They should benefit from growing US regulation aimed at lowering truck emission rates. We have also raised our holding in Shanks Group, a waste management company that benefits from strong growth in biomass and waste generally. The stock is particularly defensive and yet growing. We believe that such solid fundamental stories will perform well through the forthcoming results season.
- The Asian and emerging market stocks within the portfolio have been the weakest, despite company fundamentals remaining strong, so it will be interesting to see whether the forthcoming results season will reveal any weakness among Chinese companies, for example. Japanese stocks have proved the most defensive and we have tried to maintain a reasonable position within that market. In general, small caps have suffered as investors have rotated into large caps. We own some mid-cap railway stocks in Europe, which have also been impacted by this flight to apparent safety.
- We value companies in the sector on a fundamental cash flow basis, which allows us to set price targets. Based on this, we believe the entire portfolio has 40-50% upside from current levels. In my 12-13 years' experience of running this screen, prices have never before been so low relative to fundamental fair value, with the possible exception of during the financial crisis of 2008. The upside at the start of the year was 20-25%. However, the portfolio has since changed shape. At that time it had a greater bias towards lower-quality names, which were much more attractively valued than the blue chips. That has since changed as the higher-quality stocks have fallen in price. For example, Tenneco shows 40-50% upside to fair value. The stock is down 38% in the past three months yet there has been a 10% increase in analysts' earnings forecasts for the company.