GAM Investment Meeting Notes

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

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Global

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- The polarisation between winners and losers in the technology sector continued last year, with the emerging themes of mobility, cloud computing, video and social networking typically performing significantly better than the incumbent names. For example, in 2011 Apple's stock gained 25% and ARM rose by 40%, while RIM, Nokia and Hewlett Packard fell 75%, 51% and 40% respectively. We expect this polarisation to continue, which means that we would expect GAM Star Technology to outperform the MSCI World Information Technology index in the coming months.
- Volatility in single stock names within the technology sector is a fact of life but points to a need for an active trading approach to investing rather than a passive one. One example of this is Netflix – an online media streaming service for films and television programmes in the US. Last year the stock was up 70% from the beginning of the year to mid-July, but then lost three quarters of its value by the end of 2011. It is currently up 37% year-to-date. This kind of volatility means that we need to try to anticipate newsflow, remaining agile and able to capitalise on sudden changes.
- The fund outperformed the benchmark last year. This was partly due to the fact that approximately two-thirds of the fund was invested in what we believe to be rapid growth areas, whereas the index was only about one-third invested in these themes. The fund's performance was also boosted by exposure to a number of new companies entering the market, and we anticipate this area will become increasingly interesting as 2012 progresses. For example, we benefited from our holding in Invensense – a US-listed, French company that makes motion sensor semiconductors. Its sensors, for example, allow mobile devices to change their orientation from portrait to landscape when they are moved. The stock gained 32% in 2011 and is up 38% so far this year.
- We were also attracted to the growth story behind Jive Software, a social networking software company for enterprises designed to enhance communication and information flow between employees. This software is currently being used by a number of large companies, including SAP and Apple. We believe Jive Software offers a good way to expose the fund to the social networking trend without being directly exposed to names like Facebook, Twitter or LinkedIn. We introduced Fusion-io to the portfolio last year. The stock gained 27% during 2011 and has risen 16% year-to-date. We believe that it is important to tap into these off-benchmark stocks and identify companies that are at the forefront of new technologies.
- As we head into the reporting season, there is a lot of nervousness in the market about potential earnings downgrades – not only for the technology sector but for companies in general. We expect fourth-quarter earnings to be strong for some of the cutting edge technology companies with better-than-expected guidance. However, there are two areas where we think there is risk. First, the IT services industry is much more exposed – and so vulnerable – to general macroeconomic conditions. Second, the PC chain is also at potential risk following the flooding in Thailand, which has caused major disruption to the production of hard disk drives (HDDs). In the fourth quarter of last year, production capacity was down to approximately 110-120 million HDDs versus an average quarterly market consumption of 150-180 million. This is having a knock-on effect throughout the PC chain. As a result, we have seen some PC unit downgrades and are likely to see weak numbers and guidance from PC-related businesses, particularly given the ongoing move to mobility.
- We hold nearly 10% of our portfolio in the two major HDD manufacturers – Seagate and Western Digital. Both stocks performed very well at the end of last year and are continuing their positive performance this year. They are enjoying a phenomenal pricing environment – on a retail basis, drives are priced nearly 100% higher than they were three months ago and these companies have increased their gross margins by 10-12 percentage points. A major change in the industry from five to three players over the past three months reinforces our investment case – Seagate has purchased Samsung's HDD business and Western Digital has purchased Hitachi's. Seagate and Western Digital now represent 80% of the market and are extremely cheap with 20%+ free cash flow yields and earnings multiples of 5-6x. For this reason, we continue to believe they are extremely interesting investments and therefore maintain a strong overweight to them.