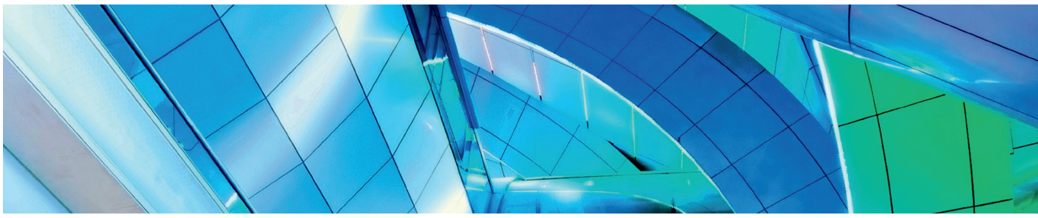
SYZ WEALTH MANAGEMENT



FOCUS

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INVESTING AGAINST THE FLOW

HIGHLIGHTS

— Buy low, sell high. This investment strategy, which consists of purchasing inexpensive shares and selling them at a higher price once investors realise their true value, is the only way to outperform the market in the long run.

— It requires an understanding of why good companies are sometimes undervalued, so that «hidden gems» can be distinguished from «value traps».

— A longer investment horizon must be adopted in order to give good investment ideas the time they need to pay off.

MICHAEL CLEMENTS, CFA

European Equities Expert

"Patience is a real virtue, as shares are usually held in a portfolio for three or five years-often at low price levels. Investors need to be loyal and composed."

GIVE TIME SOME TIME

Every fund manager wants to outperform the market. But how can one make a difference against the hundreds of competitors fighting to get ahead of the herd? One way is to have more information than the competition, but, in this age of instant information, it is either impossible or illegal. Another option is to do a better job at analysing the information, also quite a challenge considering the massive amount of research carried out daily by thousands of analysts worldwide. Therefore, the only realistic solution to beat the market seems to be to adopt a longer time horizon in order to allow good ideas sufficient time to deliver on their promises.

BUYING LOW

As every wannabe investor knows, the key to success is to buy low and to sell high. This self-evident fact hides a painful truth: buying low is easier said than done. Indeed, it requires great courage to resist peer pressure and avoid fashionable but expensive stocks. More importantly, it also entails buying companies that nobody likes or investing in times of panic. Above all, it means being patient. Very patient. It involves doing your homework and then waiting for the right time to buy. Waiting for the market to fall, so you can find a good entry point. And then wait some more, years sometimes, until the market changes its mind and analysts realise what a great company your investment really is.

AVOID CHEAP BECOMING CHEAPER

Unfortunately, cheap stocks can stay cheap for a long time. If you're a fund manager, you can convince your investors to show some perseverance and wait until the rest of the market sees the light. Of course, you need to hold your nerve to stay on the side-lines when the rest of the market rises and companies which you consider way too expensive continue to make daily gains. What your investors will never accept, however, is to see your "hidden jewels" stocks turn out to be "value traps" – companies that look cheap but are in fact suffering from a structural deterioration in their business model. As a result, when investing for the longer term, it is absolutely essential to minimize downside risk and avoid sharp drawdowns. The way to achieve this is through extensive and demanding analytical research in order to understand the drivers of the company's performance, assess the soundness of its balance sheet and perform in-depth "worst-case scenario" simulations.

CHERRY-PICKING COMPANIES FOR THE LONG RUN

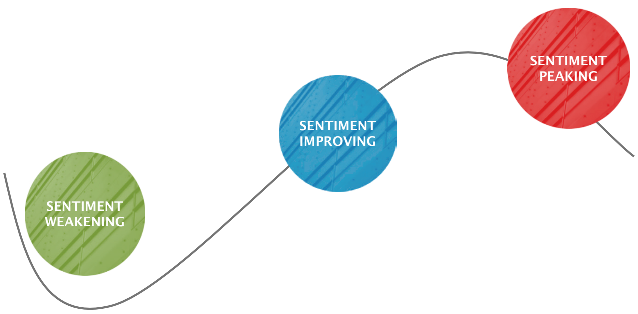
The two key criteria for selecting the right stocks are quite straightforward. The first rule is to buy high quality companies and the second is to buy them at an attractive valuation. This seems self-evident but, as is often the case, it's easier said than done. What makes a company good? If you're going to invest for the long term, you need a business that has a fundamentally sustainable competitive advantage. This can mean a strong brand, like LVMH, market dominance that gives pricing power, like Legrand, a low cost provider, like Easyjet, or having a technological advantage, like Sanofi. In order to get the other side of the equation - attractive valuation - right, you need to focus on free cash flow generation as it's the real engine to wealth creation and is less susceptible to accounting manipulation.

UNDERSTANDING WHY IT'S CHEAP

Unfortunately, good companies generating a lot of free cash flow that are attractively valued do not grow on trees. It's therefore important to understand why at times this may be the case. There are basically three possible reasons : negative investor sentiment against the country or the sector (as was the case for Spain after 2008) ; negative sentiment due to cyclical or "flight to safety" reasons when investors indiscriminately rush out of equities ; or company specific fears around its business model. Once the reason for the cheap valuation is determined, you can assess whether it's justified or not.

THE SENTIMENT CYCLE

Long-term contrarian investing relies on sentiment ; and sentiment follows a cycle that in turn will guide the investment cycle.



The sentiment weakening phase is usually triggered by a crisis, and represents the long-term buying stage, when positions are initiated by contrarian investors. Gains are unlikely to be made at this stage, which should be viewed more as an opportunity to buy low than to sell high, as this stage can last for years. Examples that lead to building these types of positions are the Spanish crisis and, more recently, the emerging markets confidence crisis and the oil price collapse. Besides a weakening of country- or sector-wide sentiment, one can also look at company-specific opportunities by monitoring for the most short-sold stocks, as was recently the case with Swatch Group. Such long-term stories can represent about one third of the total portfolio and, similar to a pharmaceutical company, are the future performance pipeline for a contrarian fund.

The improving sentiment phase is potentially triggered by a number of catalysts, and is the the point when stocks start to take off. This stage is when good investment ideas come to fruition and is the real driver of outperformance. For instance, as the market has become more confident since the start of the year on the outlook for construction in Europe stocks such as Legrand, Schneider or Rexel, which feature at the end of the building process, are now taking off.

Of course, no investment strategy would be complete without an exit policy. For a contrarian investor, the sell or profit-taking signals start blinking when we reach the sentiment peaking phase, which usually happens when there is a positive consensus about a sector or market and share prices are fully valued. We currently see such a situation in the auto industry.

Investors sometimes worry that a long-term focused contrarian portfolio will also take years to show a good return. Actually, what tends to happen in practice is that whilst it is true that the part of the portfolio which is invested in stocks that are currently suffering from negative sentiment trade sideways or even down in the short term, this is more than compensated by the good returns generated by stocks in the sentiment improving or sentiment peaking phase. This helps to minimise drawdowns and also dampens volatility.

THE PROOF IS IN THE INVESTMENT PUDDING

Like all good investment ideas, contrarian investing relies on basic common sense and appears simple enough. Of course, what appears effortless in fact requires a huge amount of work, courage and discipline. More than anywhere else, patience is really a virtue as positions are usually held for 3 to 5 years, many of them at the initial low price stage, which requires nerves of steel and loyal investors. But significant outperformance and low volatility are the rewards to be reaped.