Our guest:

Scottish Widows Investment Partnership

The canny Scots have long been renowned for their excellence in investment management. Indeed the Investment Trust movement grew up in the 1870s as a vehicle for world-wide collective investment (the emerging market funds of the nineteenth century) and was pioneered by a Scotsman, Robert Fleming of Dundee. Robert Fleming's fame is only overshadowed by his grandson, Ian Fleming, the novelist and creator of James Bond. Today Edinburgh is ranked as one of the largest financial centers in Europe with more than $1 trillion managed directly, including more than $500 billion in equities.

Scottish Widows was established in 1815 to provide benefits to widows from the Napoleonic wars. Today the Scottish Widows Investment Partnership (SWIP) is a wholly owned subsidiary of the Lloyds TSB Group following the merger between Hill Samuel Asset Management and Scottish Widows Investment Management in 2000. SWIP manages over $200 billion.

Simon Moss is one of four US fund managers at SWIP, responsible for $8 billion in US equities. He joined in 2007 as a generalist but tends to focus on industrials and technology. He started his fund management career at AGF in 1987 and moved to Nationsbank Panmure in 1993. He joined Gartmore in 1995 and moved to Philadelphia in 2001 .

What changes have you seen in US fund management since you started?
"I started looking at the US market in 1993 and the key change has been the consolidation of the fund management industry. Also, people focus more on cash flow and EBITDA ratios. There is more focus on technology than 10 or 12 years ago."

What is it like being based in Edinburgh rather than London?
"Most companies don't come up here but some of the best fund managers of US equities in the UK are based in Edinburgh so companies should come up to Edinburgh."

How is your performance measured? What's your benchmark?
"It depends on the fund. It is either the S&P 500 or the peer group. We did very well last year – the large cap was up 14.4% against the S&P 500. The small cap was 21% ahead of the S&P 600. "

Do you have investment constraints?
"As we have both large cap and small cap funds, we are pretty unconstrained as long as they are listed somewhere like NASDAQ or the NYSE. With market caps of less than $1 billion we are more concerned about liquidity issues but we certainly could invest in them."

How do you screen stocks?
"We have some quant screens and are trying to introduce more as part of an improvement of the investment process. We currently look at earnings momentum, rising CFROI using HOLT and EVA screens."

In a nutshell what's your investment philosophy?
"We like to look at the capital cycle. We like to invest in industries where capital is tight and where pricing power is improving. We don't like to invest in areas where there's a lot of capital. For example, the semiconductor industry which is hugely overcapitalized and the industry players have very little pricing power. We like areas such as engineering and construction. There are very few players in that market. There's a rising demand for infrastructure around the world and engineering and construction companies have seen pricing ability strengthen and margins expand. We're also looking for good management with good strategic vision and a passion for the business that execute well. We're looking for a business that plays to good strong secular themes where we like to feel we are working with the management and can understand where they are going. A favorite question of mine is 'where will the company be in three years' time?' We focus on cash flow and the balance sheet as well. We don't like companies that are always coming to the market to raise capital either by debt or equity."

Any sectors you don't invest in?
"No."

Average length of a holding?
"Ideally we are looking to invest with a two to three year time horizon. In my opinion, the US market, because of its size and the number of players involved, is quite perfect near term which means you have to take a longer term view to add value."

How do you regard US equities within the global equity markets?
"There are clearly concerns about a US recession and the knock on effect that might have with a global recession. US shares have obviously come back a bit recently but I am looking to avoid the US economy so I prefer to invest in those US companies with far more international exposure. So I am cautious on the US market because of the potential

for earnings risk, particularly the US-domestic related stocks."

Any sectors of the US market you currently favor?
"We like the energy area – based on rising global demand. We like the consumer staples sector – particularly international consumer staples as there is strong visibility of earnings there because of the weak dollar. We are very underweight financials as we still have very strong concerns about balance sheets in the financial area and the lack of transparency. We are also underweight consumer cyclicals."

Chances of a recession in the US?
"Pretty strong. More than 70% but I'm not quite in the camp that says it's definitely going to happen. There certainly seem to be some signs of weakening this quarter but I'd like to see some more results - as the results season is just kicking off – so I'd like to hear what companies' views are."

Talking about US companies, any particular favorites and why?
"Amongst stocks that we like as a long term play are in areas such as the engineering and construction. We like stocks like **Foster Wheeler** and **Shaw** which are playing in the power generation space as there's a huge shortage of power generation in the States and those companies are very well positioned to benefit from that. We like **Activision** in the technology space as that's a strong secular theme as computer games have grown very strongly over the last few years as people spend more on games than on films and music and I think that will continue going forward. Because of concerns about the US economy, we are overweight utilities so we like **Constellation Energy** which is domestically based but is very exposed to rising electricity prices. We believe electricity prices will have to rise in the States to pay for the capacity in power generation that needs to be built in the next few years and Constellation is very operationally geared to that. We also like **Occidental Petroleum** which is a big holding of ours. It has a very strong asset base and has been very good at producing oil at a very low cost. That's been a long term holding."

How many US companies do you meet a year?
"Typically we meet around 200 a year – 25% in Edinburgh, 15% in London and the balance in the US. This includes company meetings, companies we meet at conferences and one-on-ones. When one is only talking about one-on-ones they are split roughly 50% in Edinburgh and 50% in the States and the occasional one-on-one down in London."

How does meeting management affect your investment making decision?
"It is quite essential to meet management. I like to discuss with them where they are going to be in three years' time, the strategy and structure…I just like to see the whites of their eyes. Have they got a passion for the business? Are they excited about what they are doing? It also gives me a chance to question them about what's going on in the industry generally and get a better feel for what is happening. I'm not interested in talking about what the quarter's doing which a lot of our American competitors tend to do a lot of. I'm more interested in strategic positioning and where the business is going to be in three years."

Who do you want to meet from a company?
"I like to see the CEO ideally as it's the CEO who should be pulling the strings but I'm quite happy to see the CFO obviously!"

Any tips for companies when presenting their case to investors?
"Come across here and meet institutions. Be consistent through good and bad times. **Cooper Industries** used to come every year but I don't know if they still do. We have companies that come in every year and it helps build a dialogue. Companies might get frustrated that they go in and see an institution and they might not buy the shares immediately but consistency helps build up trust between the institution and management. And when we buy, we are more long-term oriented than most US-based investors. I tend to think companies would prefer to meet with longer term investors rather than the short-term traders. The biggest share of corporate access is often given to the biggest commission generators which is not always what companies want."

Tips for US companies visiting one-one?
"Let the fund manager set the agenda. We usually prefer questioning rather than the slide show. It keeps management fresh and we can address the points that we want to cover. Have slides just in case though as it can be useful to go through as background information. The quality of IR is pretty good in the US. The best IRs are the ones who've done operational work at the company. Patricia Murphy at **IBM** is a good example. They have a better feel for the business. **Honeywell** had a good IR who's now moved to an accounting function. **Schlumberger** rotate IR too. Those are the best at IR, those with operational experience rather than those who've come at it from accountancy or PR."

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