AVIVA INVESTORS

LONDON

Aviva Investors is the global asset management business of Aviva plc, one of the world's largest insurers, operating in 15 countries in Asia Pacific, Europe, North America and the UK with assets under management of $436 billion (£274 billion) as of June 30, 2012. 63% of assets are in fixed income, 14% in equities, 9% in real estate, 7% in mixed and 7% in liquidity.

Kirill Pyshkin is responsible for managing global equity funds. He joined Aviva Investors in 2008. Prior to that he spent 4 years as an equity research analyst working for Sanford Bernstein and JPMorgan on the sell side, and Credit Agricole Asset Management (Amundi) on the buy side. Kirill started his career as a management consultant in 2000. Kirill holds a PhD in Physics from the University of Cambridge, and MBA from Imperial College, London. He is a native Russian speaker and a graduate of St Petersburg State Technical University.

How much does the London office manage in equities?

"$50 billion in total including active quant and index equities of $33 billion. I personally manage $1.5 billion (£1 billion) in active global equities." (The remaining $15.5 billion is in UK and European equities).

How much does the London office manage in active US equities?

"We don't have dedicated US equity funds run out of London but within the funds that I manage, current allocation to US is around $750 million (£475m). I am the only person who manages active US equity allocation but we also have active quant and index US equities and a dedicated active US Equities management business in the US."

Which screens do you use?

"I use our own custom screens looking for dividend growth, sustainability of the dividend and attractive valuations. I also use HOLT, CROCI but screens are just one tool and they never drive my investment process."

Do you meet companies as part of your investment process?

"I always meet companies. I would never invest in a company I hadn't met. I prefer one-on-ones with senior management but will do a conference call if necessary."

Aviva owns Kentucky-based River Road Asset Mgt with AUM of $7 billion; do you confer with them?

"I know what they hold and vice versa. But my style is very specific. River Road tend to focus on small and mid cap US equities. I invest across the world, my portfolio is more concentrated and I focus more on large cap ($30bn+) companies with high and growing dividends. I would invest in smaller companies too if I see enough upside and it fits my process."

Please explain the global income fund you manage.

"The Global High Yield Equity and Global Equity Income funds are worth about $1.5 billion (£1 billion). It's a concentrated portfolio of 40 names, including 50% in the Americas. Typically these are blue chip, high-ROE companies with high and rising dividends. The portfolio itself is very well diversified across sectors and geographies and provides dividend yield 25-50% above the MSCI World Index with the idea to beat this benchmark with less volatility and risk."

What is the minimum yield threshold for your global income funds?

"I look for a minimum yield of 25% above the dividend yield of the MSCI world index – so 1.25 times the yield of MSCI World. For example, at the end of December the fund was yielding 3.7% in comparison with 2.7% dividend yield of the MSCI World - that is 33% above."

ESG is important to Aviva - do you use an ESG overlay service or do it in-house?

"We do it in-house but also use ESG data from the MSCI ESG service. The business generally believes that companies that conduct business in a sustainable and responsible manner are more likely to succeed over time, which of course is important for investment returns. We have established a Global Responsible Investment team and also have a network of over a dozen 'responsible investment officers', who are full time fund managers and analysts. They spend some of their time supporting the integration of ESG across all investment desks. They also have an element of their annual compensation linked to their efforts in this space."

In your global income fund, what's an average position?.

"The fund has 40 positions in a concentrated portfolio so 2.5% is an average position weight. The size of the position depends upon the level of conviction and some technical criteria such as liquidity, benchmark weighting etc. A large cap company would typically have a larger weighting than a smaller cap. I also monitor volatility as we aim to have less volatility and risk than the index. I actively manage volatility by limiting positions in more volatile stocks. The largest position could be 5% but I tend to stop at 4%. 1% could be the smallest position but in reality it is 1.5%."

Tell me about some of your largest positions – why you bought?

"If you look at my largest positions today, they are mostly blue chip holdings. My biggest active position is Altria, the Marlboro maker in the US followed by Roche, Ascendas REIT, Time Warner, BASF, Microsoft, Mattel, Sainsbury's, McDonalds and Pfizer."

Altria – 3.2% active position 3.5% of fund

"It's a core holding and some of the positions like Altria I keep as an anchor holding for the fund due to its stability of earnings and dividend. Then I'll take some positions where I can see much more upside but they would typically be smaller holdings which I keep for alpha generation. Altria is a leader in its market. Marlboro has by far the largest share in the US and what I like about it is that it is insulated from most of the regulatory and legal challenges that face Philip Morris International (PMI) in other markets. For example, PMI is being hit by proposals of the new EU directives on tobacco regulation but the US has already been through that process. So I believe that Altria's future is more secure than Philip Morris's even though it's the same brand of cigarettes. I used to have other tobacco holdings but I've consolidated everything into Altria because for me the US has passed the most risky times for tobacco stocks."

Microsoft – 2.7% active position - 3.5% of fund

"Microsoft is another core holding. It has recently been out of favor due to the weak consumer PC sales. But it has a strong Business division and is offering enterprises server tools – it is not just about consumer PCs. It is a very good dividend yielder in the US. It's even rarer to find a good yield among the US technology companies. The US market itself has one of the lowest dividend yields in the world and technology sector is one of the lowest yielders within the US. I try and find companies that are stable, with high and growing dividend and that are attractively valued. Mircrosoft is attractively valued, with secure and growing dividend and in my view, fears around PC weakness are overblown. This issue is less significant for Microsoft than it is for Dell and HP."

Pfizer – 2.5% active position or 3.2% of the fund

"We hold Pfizer as a result of a thematic piece of work from a medical doctor that we hired to do analysis for us of the biggest areas of concern in emerging markets. He came up with five big problems that would be evident in emerging markets in five years time. Then we ranked the largest pharmaceutical companies against exposure to those areas. These include things like type 2 diabetes, oncology, cardiovascular diseases and some others and Pfizer had the biggest aggregate exposure to those areas outside the two specialist companies which were Roche (Oncology) and NovoNordisk (Diabetes). Pfizer had the biggest exposure to emerging markets as a general pharmaceutical company, so Pfizer was a specific play on emerging markets."

Any particular sectors you favour?

"I try not to make big active bets on sectors or countries. I'm a stock picker."

Any sectors you don't like?

"Utilities and telecoms. Regarding Utilities – for me, the most important criteria is dividend growth as opposed to the absolute yield. So I try to focus on companies that pay high but growing dividends and in utilities I see very little opportunity for growth. In my view dividends are not sustainable and payout ratios are stretched. The only good thing about utilities is that their yield compares favorably with US Treasuries but that's about it in terms of attraction.

Telecoms also present a very depressing industry picture considering already high penetration of wireless services. There is some hope for growth reinvigorated by wireless data but the number of fixed lines is falling and that was the more profitable business. I don't see many growth opportunities in telecoms either.

It is interesting that many income funds focus on utilities and telecoms as their biggest source of yield, but these two sectors are actually some of my biggest underweights. Instead I'm trying to source yield from industrials, energy, healthcare, and financials. There is a growth bias to my income fund."

Recent sales + why?

"I recently sold Intel as it is directly impacted by the weakness in PCs. Ever since Apple introduced the iPad, sales of PCs have been very weak. Last quarter (Q3 2012), was the first time when we saw a decline in notebooks - in the past, desktop units would decline but notebooks still grew but in Q3 both categories declined for the first time. This is because more and more people are buying tablets. You can see how CPU sales have collapsed since Apple introduced the iPad. I feel the situation for Intel will get worse because even if they are successful in entering the tablet market, the ASPs for the CPU will go down. Now also ARM has been successful in providing an alternative processor targeting Intel's original fiefdom. Intel is therefore under pressure both from loss of market share and weak ASPs. Finally, as a result of weak demand their fabs are underutilized which hits the gross margin and at the same time there is an arms race between them, Samsung and TSMC to see who is going to outspend each other in terms of capex. It's not a great combination.

PG&E is another recent sale. This is a Californian utility which had a fatal explosion as its gas pipe blew up and people were killed in San Bruno. Typically, when that happens the company could be in the penalty box for many years. Given the capricious nature of politics in the state, the accident will impact the California regulator's future decision. It means that in addition to yet unclear penalties, the dividend will be constrained and I certainly don't expect any growth in the dividend from PG&E and generally very little positive newsflow. As a result I now don't have any utilities in the main funds – that was my only one."

What's your average holding period?

"Three years is the average length of a holding. I run a high conviction, low turnover fund, which is exactly why I like to meet the management. I try to find out as much about the companies I buy as possible to limit any nasty surprises in future and have a good understanding of their long term strategy."

What's your market cap cut off?

"I generally won't buy companies with market caps below $2 billion."

Do you have a price target when you buy a stock?

"I typically look for minimum 15% upside. I have a price target for all my holdings and monitor them daily. When the stock is approaching the target, I re-evaluate it. If I don't see further upside I sell. The principle for the fund, is one stock in and one stock out. The sale decision is driven by valuation or by dividend being at risk.

As an income investor, in each region I try to get yield higher than the market. The US market's yield is 2.2% and my yield is 3.2%. In the UK, it is 3.6% and my yield is 4.6% etc. It would be easy to construct a higher yielding fund by focusing more on the UK and Europe but we would like to offer diversification by geography and sector and focus on stock picking. We are looking for the best companies in each sector."

Active Share Ratio?

"It will be very high (80-100%) as I don't hold anything I don't like and I only have 40 positions."

How many companies do you meet a year and where?

"I met 125 companies in 2011 and a similar number in 2012. I meet two thirds at conferences in the US, Europe and Asia and the rest in London. I make two or three long trips a year sharing time between the US and Asia. I normally meet 20-30 companies per trip at conferences or visiting company offices."

Best US companies at IR? (What do you look for when meeting management?)

"US and Canadian companies are pretty good at IR especially when compared to some Japanese and Chinese companies. They're very professional and well prepared. Intel, Time Warner, JPMorgan, Toronto Dominion, Blackstone are particularly impressive to name a few. From meeting the management I aim to get to know the company and its industry better, perhaps it is exposed to a beneficial theme or a trend or there is a company specific reason to own the stock. For example, the company may be withdrawing from a lower margin business and therefore margins overall should rise."

Can you invest in Canadian stocks?

"I can and do invest in Canadian stocks for example I hold TD. But I consider TD more a US investment. For me it's a play on the US market. Despite the fact that it's a Canadian retail bank, it has more branches in the US than in Canada. It has the benefit of strict Canadian regulation – very high capital, very high deposits but is a play on the US market recovery."

Predictions for 2013?

"I think the market will go nowhere until March when the debt ceiling issue is resolved. I expect between 5 and 15% upside for the US equity market, more for emerging markets and European equities because of relative valuations. Overall 2013 should be a good year for equities. The overvalued fixed income market is helping and we are already seeing some inflows into active equities. High yield equities specifically are a good alternative to fixed income as the dividend yield in many markets is now above the government bond yields. Global equity income funds offer an excellent combination of income with a potential for capital appreciation, which for the last three years has given double digit total returns."