Colin Morton

Franklin Templeton

The Franklin Templeton UK Equity fund manager tells ***Jessica Tasman-Jones*** how he was 'positioned for Brexit without even realising it'

Blue-chip stocks have always been a favourite of Colin Morton for their "secure and reliable" characteristics. Consequently over the summer, the large-cap bias meant Morton was "positioned for Brexit without realising it."

Royal Dutch Shell, British American Tobacco and AstraZeneca are the top three holdings in the UK Equity Income fund, accounting for 4.3 per cent, 3.9 per cent and 3.8 per cent respectively. HSBC and BP also make the top 10 at 3.7 per cent and 3.6 per cent.

The Franklin Templeton UK equity manager is quick to state it was not a "thought out decision" and he "foolishly" did not believe the bookmakers would get the referendum result so wrong. But his large-cap bias has seen the flagship £271.8m Franklin UK Equity Income fund return 15.9 per cent since the referendum, according to FE data. The IA Equity Income sector returned 12.5 per cent over the period.

If he had thought Brexit was a possibility, Morton says he would have exited all domestic stocks. His holdings in Next and Restaurant Group dropped 20 and 27 per cent respectively in the weeks following the result. "I still like Next, I think it's a really well-run business." But he notes the company warned costs were due to rise 5 to 6 per cent while the pound was still at $1.30. Now the pound is only just above $1.20.

Regarding positive economic indicators that have followed the referendum vote, Morton is surprised that people had expected the repercussions of Brexit to accelerate so soon. "Half the population voted to leave anyway so they were probably quite happy on Friday morning." But he reckons 2017 will be a difficult year for the UK consumer as inflation kicks in. Regardless, Morton bought into the referendum's big losers, such as housebuilder Persimmon, landscaping business Marshalls and recruitment firm Michael Page. "I was the first to think Brexit wasn't going to be good news for the next 12 to 18 months for these companies," Morton says, but price drops in the realm of 40 per cent "was a bit too much".

He took some of the money off the table when they recovered to around 15 per cent below their pre-referendum price. "Not that I'm short term. It's just that some of these stocks had rebounded by 30 to 35 per cent."

Brexit wasn't the only important item on the UK equity team's agenda over the summer. In the first week of July, Franklin Templeton slashed its annual management change on the UK Equity Income fund as well as the £31.8m UK Rising Dividends and £95.1m UK Opportunities funds, to 0.45 per cent. The ongoing charge figure has also been capped at 0.55 per cent.

Already monthly outflows that characterised the first half of the year have shifted into inflows for all three funds on the change. For the three-month period since July, the UK Equity Income fund has seen £71.1m inflows compared with £1.9m for the three months prior, according to Morningstar data.

Its rating has also been bumped from bronze to silver by Morningstar, with research analyst Samuel Meakin highlighting the "predictive power of fund fees and their impact on performance outcomes".

The Rising Dividends fund was renamed and refocused in January 2015 to provide a product that is "a lot less reliant on a handful of companies", Morton says, with approximately 30 per cent of the fund in 10 to 15 ▷

CV

1983
Joined Wise Speke as a trainee stockbroker

1988
Joined Rensburg as a private client executive

1995
Became manager of the Rensburg UK Equity Income trust

2011
Morton's funds are merged into the Franklin Templeton Funds Oeic range

The numbers

£271.8m
Assets in the Franklin UK Equity Income fund

£59.2m
Inflows into the UK Equity Income fund in July, the month fees were cut

0.55%
Ongoing charge figure for the UK Equity Income, UK Rising Dividends and UK Opportunities funds

21
Years Morton has run the UK Equity Income fund

companies. Since Brexit the fund, which was previously the Franklin UK Blue Chip fund, has returned 14.3 per cent, compared to 13.7 per cent in the IA All Companies. It holds 3.5 per cent each in Imperial Brands, Diageo and Unilever.

Dividend cover for the fund is 1.9 times versus 1.4 for oil companies, which has worried investors as earnings per share take a hit and net debt per share rises, Morton points out. "With everything in life it must come with a compromise and that is you'll have lower dividends on day one in order not to have the risk of having these yields come from such a narrow number of companies."

Morton points out it currently holds nothing in income favourites BP, HSBC and Vodafone, nor mining stocks.

While the fund sits in the IA All Companies sector, Morton says the IA Equity Income sector still has its place, even though this has become a point of contention this year following several high profile funds dropping out of the sector.

"There's a bit of compromise involved in income and that's always been the case and there's nothing wrong with that," Morton says, estimating there is a 50:50 split in the industry over the sector definition. Franklin Templeton has responded to the IA consultation on the sector, which currently requires funds to achieve yield 110 per cent above the FTSE All Share, that it is happy with the status quo.

It's not the first time in his career that Morton has seen the IA Equity Income sector come into question, with fund managers previously concerned about companies favouring buybacks over dividends and the UK banking sector dominating the market.

"What makes this unique is the uncovered nature, particularly of the oils, of some of these dividends." He sympathises with managers with a mid-cap bias, but is happy running the Rising Dividends fund as an alternative for investors who are unsure about the sustainability of dividends in the UK Equity Income fund.

Morton is not "brave" enough to hold nothing in oils, but says it is not an area he has ever been "overly" overweight in. He bought into Shell while it was at £12.50 earlier in the year and yielding 8 to 9 per cent. "Even if the company halved the dividend, which they very well might have done, they would still be yielding 4.5 per cent." As luck would have it, Opec is now "showing its teeth" and the stock is benefiting from being a US dollar earner.

Morton has run the fund for 21 years – initially at Rensburg before the the firm was taken over by Franklin Templeton in a £45m deal in 2011. Morton, who champions the quality of life and housing in Leeds, where his team is based, quips that he thought the US company's executives were surprised to find restaurants in the Yorkshire city. "I think people have this impression they're coming to this industrial heartland." With fees pressure and technological changes he reckons more asset managers should consider leaving "costly" London.

Looking ahead, Franklin Templeton hopes to grow its assets with the drop in fees. "Early signs have been encouraging, but we'll have to look back in a couple of years time and hopefully see that the asset growth has more than outstripped the reduction in the fee," Morton says. Three other funds managed by the team retain their 0.75 per cent fee as they have capacity limits due to being in the small and mid-cap space, which means Franklin Templeton isn't looking to grow their assets.

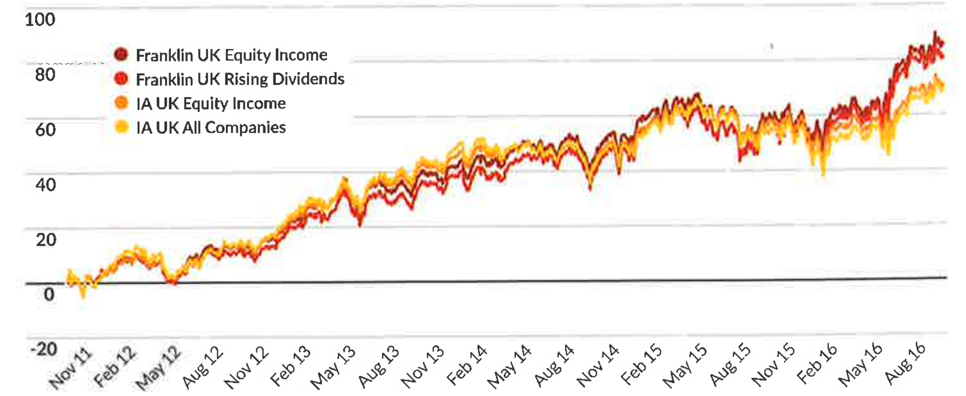
It's a big change from the 5 per cent upfront fees and 1.5 per cent annual management charge when Morton began in the industry at Wise Speke, now absorbed into Brewin Dolphin, in 1983. Partly because investors were less sophisticated and more 'mystified" by the industry, Morton says, though he admits many still are mystified by the industry.

"When something's compounding up in mid-teens nearly all the time nobody's too bothered when they're charged 1.5 per cent. Unfortunately I wasn't a senior stockbroker at that stage, I was churning around in a back office somewhere."

It was that back office where Morton "half fell into" his career. "Once you've got the bug for it, you don't feel like doing anything different.

What's fantastic about it as a job is that it's completely different on an ongoing basis. You really don't have a clue what's going to happen from one day to the next."

Performance of the Franklin UK Equity Income & Franklin UK Rising Dividends funds



Shows five-year performance of the Franklin UK Equity Income & Franklin UK Rising Dividends funds.

Source: FE