Karl Seigling

CADENCE CAPITAL

PROFILE

Karl Siegling is Managing Director and Chief Investment Officer of listed investment company Cadence Capital (ASX:CDM). Karl and his team also run the Cadence Capital Fund and the Cadence Cayman Fund. Previously with Deutsche Morgan Grenfell and Goldman Sachs, he holds a Bachelor of Commerce and LLB from the University of Melbourne and an MBA in Finance.

RETURNS

For the year to 30 Apr 14, Cadence Capital returned 12.17%, outperforming the All Ordinaries Accumulation Index by 1.74%. In the eight years and seven months prior to this date, Cadence Capital generated a gross performance of 19.19% per annum, outperforming the All Ordinaries Accumulation Index by 12.74% per annum. .

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Cadence Capital has an open mandate that covers all ASX-listed stocks, but only about 650–700 of these companies make a profit in any given year. Of that pool, about 90% of those stocks are what we call 'truly average', which we're not interested in. What we're looking for are the 5% of that pool that are cheap in any given year and the 5% that are expensive.

Stocks prices tend to be cyclical in nature. Sometimes they're cheap and sometimes they're expensive. So for example, after the GFC the diversified financials, including the funds management businesses, were cheap, enjoying strong earnings growth on quite reasonable multiples. That's when we started to build our positions in this sector.

STOCK PICKS

HENDERSON GLOBAL PLC
MACQUARIE GROUP

** Cadence Capital did not participate in last year's report.*

In fact, our portfolio has a strong flavour of financials and diversified financials. We discuss our two largest holdings below but we also hold National Australia Bank, ANZ Bank and a number of other stocks in the sector.

Whilst these sectors were cheap, their underlying performance was strong. And they benefit from some nice structural tailwinds – Australia has the fourth largest superannuation pool in the world, for example – which are giving these companies a boost.

Many fund managers that invest in a stock that doubles, as has our investment in Macquarie for example, are required to sell down so that their portfolio doesn't get too concentrated. But our open mandate allows us to let the profits run and take full advantage of the swing from cheap to expensive.

HENDERSON GROUP

That backdrop provides the context for our biggest position, Henderson Group (ASX:HGG), a global fund manager based in the UK but listed in both countries. It was spun out of AMP many years ago at around a dollar a share.

That dual listing seemed like a good idea at the time but the company fell between the cracks. The English viewed it as Australian and the Australians thought it was English. So for a long time, there was very little analyst coverage of this business, and for a company of its size, largely remains the case today.

But while no one was watching, Henderson was doing something rather clever. It recognised that offering low margin index hugging funds wasn't a great business model. So for the last few years it has transformed itself, focusing on absolute return and alternative investment products that deliver a far higher margin. And it's doing so whilst maintaining a similar cost base.

Henderson has thus moved from a commodity-like business to one that adds a great deal of value and generates higher margins, without suffering from an increase in costs. The company has £79.2bn (AU$125bn) in assets under management and in the last quarter had net inflows of £3bn, driven by retail clients in Europe, UK, the Americas and Asia.

The second factor references that last point; Henderson earns almost all its revenue beyond Australian shores. For those that believe the Australian dollar is likely to fall it's even more compelling.

The company also earns a substantial proportion of its revenue in Europe, which is only now emerging from a harsh and deep recession. So investors are buying a much-improved global business, hedged against the Australian dollar, but that will also benefit from a European turnaround.

When we first purchased Henderson it was trading on a PER of around 12 at a time when local fund managers were changing hands at 18 or 19 times earnings. Henderson's PER has risen to around 16 lately but it's still cheaper than the local fund managers and, in our view, offers more attractive growth prospects and protection against an Australian economic slowdown.

MACQUARIE GROUP

Our second stock is Macquarie Group, which has also been a favourite of ***Intelligent Investor Share Advisor*** *[a Strong Buy at $22.97 on 5 Aug 11 no less – Ed]*. Macquarie fell from around $100 a share to $16 and we started to build our position at about $23. At that price the company had $10 per share of cash and we estimated the funds management business to be worth about $13 per share. Effectively, the rest of the business came free.

The interesting thing about Macquarie now is that two of its divisions – capital markets and securities trading – are market-facing and dependent on the skills of the people that work in them. These businesses by nature are cyclical. In its heyday, the capital markets division made over $1bn in a year but during the post-GFC lows lost well over $100m. It's now making about $300m, so that's almost a $450m turnaround in one division.

We believe Macquarie's earnings in these businesses will continue to grow and that the company will be re-rated. During former testing times, Macquarie opportunistically purchased funds management and annuity-style businesses, and these should command higher PE and cashflow multiples. Indeed, with a share price around $60 now, that process is already underway although in our view it has further to run.

The other factor to consider is that, in a similar vein to Henderson, Macquarie generates 68% of its earnings overseas and is thus a hedge against a falling Australian dollar and a play on recovering overseas economies.

When you see a company growing earnings and undergoing a share price re-rating, you often see significantly higher share prices. We don't believe the Macquarie recovery has finished yet.

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