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Boutique with superior ambitions

Manager focus

Cartesian's partners say they only exist to outperform, finds **Ian Fraser**

The 17th century French philosopher René Descartes, famous for the dictum cogito ergo sum (I think therefore I am), always maintained a healthy scepticism for the conventional wisdom of the day.

The Edinburgh-based asset management boutique Cartesian Capital Partners – whose name is no coincidence – is trying to apply similar analytical rigour to the world of equity investing.

A 50/50 joint venture between its four partners – David Stevenson, Andrew Kelly, Jeremy Hall and Susan Rafferty – and Glasgow-based Ignis Asset Management, Cartesian was launched in December 2005. Today it runs three UK equities funds: a UK opportunities fund, a long/short equity hedge fund and a 130/30 fund, which goes 30 per cent short and 130 per cent long.

Based on the top floor of a Georgian townhouse in Edinburgh's Melville Street, Cartesian has a pared down, almost ascetic, approach to fund management.

The partners believe the boutique only deserves to exist if it provides what investors want – superior investment performance. "Our business only exists if it outperforms," says Mr Hall.

Unusually for fund managers, Cartesian's three investment staff (Ms Rafferty oversees administration) do not try to hide the fact they worked as actuaries and accountants in earlier lives.

They believe this ensures they are more alert to "red flags" such as low earnings quality than the average investor.

All four cut their investment teeth at Colin McLean's SVM Asset Management, also based in Edinburgh.

They like to describe their approach to stock-picking as "agnostic and unconstrained",



The four partners: (left to right) Andrew Kelly, Susan Rafferty, David Stevenson and Jeremy Hall

and have a strong mistrust of market sentiment and what they see as the herd-like instincts of most fund managers.

Instead, they try not to deviate from an objective analysis of a company's true state of health and use the annual report and accounts as their main tools.

They then try to assess whether it is overvalued or

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David Stevenson
Cartesian

undervalued by the market. They eschew company visits. "They usually offer a limited and stage-managed view of the company," says Mr Kelly.

Cartesian's dislikes include companies that use aggres-

sive accounting, which are over-dependent on financial engineering or short-term funding and use off-balance-sheet vehicles. This probably explains its decision to short sell the shares of the troubled UK banks HBOS and Bradford & Bingley in early 2008.

It is sceptical about whether the equity market rally that commenced in early March is sustainable and believes the green shoots of recovery detected by its peers may turn out to be yellow weeds.

Mr Stevenson says: "The signals from the non-financial world remain mixed. On the positive front, confidence indicators have improved from low levels.

"However, company announcements still make reference to very challenging conditions. Many companies will only achieve expectations through aggressive cost-cutting.

"The high levels of borrowing have not been reduced during the last 12 months and remain uncomfortably stretched and, as a consequence, we expect any recov-

ery to be slow and drawn out."

Given these bearish views, it comes as no surprise that Cartesian has continued to invest defensively – which has meant its performance in the first six months of the year has taken a real knock.

However, it seems confident it will recoup this in the latter half of the year on the assumption that markets will fall back from what Cartesian sees as unrealistic highs.

"We currently favour companies with reliable customer demand and strong balance sheets, such as food retailers," says Mr Stevenson.

"Spending on life's necessities is one thing that is sustainable." Stocks held in the long-only fund include Tesco, Morrisons and AB Foods (owner of the Primark clothing chain).

Even though Cartesian remains cautious about financials, it has held both Royal & SunAlliance and Amlin since mid-2008, in the belief the non-life insurers will fill the void that has been left by AIG in the

UK insurance market.

However, it believes gold and gold-related shares “look like one of the worst bubbles around”.

Cartesian’s UK equity long/short fund has returned 37.1 per cent since launch in April 2006, despite shedding 25 per cent of its value in the first six months of 2009.

The UK opportunities fund, launched in December 2005, had a searing first year gaining 28 per cent versus a FTSE 100 index that gained 14.4 per cent during 2006. However, it has marginally underperformed the index in 2007, 2008 and the first half of 2009.

Despite having £600m (€694m, \$965m) under management, the

four partners are Cartesian’s only employees—administration, compliance and distribution are outsourced to Ignis in Glasgow (formerly known as Resolution Asset Management).

Even though the arrangement works well, the boutique has decided to cap its assets under management at £2bn, a figure it is confident of reaching by 2010 or 2011. Of this, it expects half to be invested in long only funds, the remainder in long/short.

“We have no desire to create a £20bn empire,” says Mr Kelly.

“The only true capacity constraint is in the short book,” he adds.

The firm secured its first institutional mandate in December 2006, a £96m prize from Northern Trust, which was acting as intermediary for an unnamed institutional investor. The following year it formed a relationship with Russell Investments, for which it now manages six segregated accounts.

More recently, Mr Stevenson and Mr Kelly were invited by Skandia to manage one 10th of the Skandia UK Best Ideas and Skandia Strategic Best Ideas funds while Mr Hall’s 130/30 fund secured a tranche of money from Gartmore’s multi-manager fund.

They believe the herd in-

stinct is damaging the industry and suggest many of the 350 UK all companies funds are me-toos and closet trackers that only owe their existence to the product-bias and distribution skills of their parent banks or life insurers.

Given that the segment is so saturated, they wonder why so many new funds continue to be launched, and speak with derision of the recent rash of recovery funds.

Mr Kelly says: “Wouldn’t customers be better served if fund management groups focused on sorting out their existing funds? The industry needs to take a long hard look at itself.”