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Feature funds

We hear from Fidelity about Sanjeev Shah's Special Situations Fund, which celebrated its 30th birthday in December 2009, and from Invesco Perpetual about Neil Woodford's AAA rated* High Income Fund.

Sanjeev Shah

Portfolio manager of the SW Fidelity Special Situations Fund

Sanjeev Shah has been the portfolio manager of the SW Fidelity Special Situations Fund since 1 January 2008. Sanjeev has been a portfolio manager with Fidelity since 2002, when he took on management of Fidelity UK Aggressive Fund. Prior to that, he had been an equity analyst with Fidelity since 1996. He spent three years with Unilever before joining Fidelity and holds an MBA from INSEAD and an MA from Cambridge University.

Neil Woodford

Manager of the SW Invesco Perpetual High Income Fund

Neil Woodford has worked at Invesco Perpetual for nearly 22 years, where he leads its UK Equities Team and is Head of Investment. In his long tenure as a fund manager, he has developed an impressive track record through both good and bad times in the stockmarket, and is one of the most highly regarded fund managers in the industry.

*The Invesco Perpetual High Income Fund is AAA rated by OBSR and Standard & Poor's as at 31 December 2009.

The SW Fidelity Special Situations Fund

Fund facts

Launch date: 18 September 2006

ABI sector: UK All Companies

Fund aim: The fund aims to achieve long-term growth from a portfolio primarily made up of UK company shares. The fund may also have some overseas exposure. Investments are not restricted by company size or industry and will largely be determined by the availability of attractive investment opportunities. The fund may also invest in other transferable securities (such as fixed interest securities), units in collective investment schemes, money market instruments, cash and deposits. Derivatives and forward transactions may also be used to assist in the efficient management of the portfolio or with the aim of enhancing returns.

Investment approach: Adventurous

Please refer to the *Pension Funds Investor's Guide* (ref 16540), which describes in full the investment approach definition and all the fund's risks. The definition and investment approach rating for specific funds may change in the future.

Contrary to popular thinking for 30 years

On 17 December 1979, Fidelity launched its Special Situations Fund. Since its launch 30 years ago, the fund has become the UK's most successful mutual fund ever. Much of the success of the fund has been due to the consistent contrarian stance of its two managers, Anthony Bolton and, more recently, Sanjeev Shah. The original portfolio included unfashionable companies and sectors, including those going under structural change and take-over situations. While the world is a different place today compared with 30 years ago, this still remains the case.

Sanjeev's investment style is best described as looking for unloved investment opportunities where he has a fundamentally different view to the consensus. His 'special situations' search includes companies with recovery or growth potential, which are undervalued by the market and typically under-owned by other investment managers. Indeed, other institutional investors may even have a short position on the stock in expectation of the share price going down.

Scottish Widows linked to the fund in September 2006.

Current positioning

On a macro basis, Sanjeev anticipates a low-growth environment over the next few years, and is focusing on finding stocks capable of delivering organic growth.

The media sector has fallen out of favour in recent years as it struggled with declining advertising revenues. However, he believes there is untapped value in this sector, and is holding some of the strongest franchises such as WPP, BSkyB and ITV, as well as a few niche-market operators. These stocks are increasingly benefiting from structural growth drivers, such as the shift to online, yet are close to their historic lows in terms of their stockmarket valuations.

Sanjeev favours technology companies and he continues to like real estate stocks too, citing the yield credentials of property that continue to be overlooked by investors in what is a very low yield environment.

Finally, he is underweight commodities, which he is finding expensive on a fundamental basis and he is more cautious than the market on the supply and demand environment for a lot of industrial metals.

Fund manager outlook

Concerted action by governments and monetary authorities has allowed a crisis to be averted, but Sanjeev suspects the domestic growth environment will be fairly muted going forward. Any company that can generate solid underlying organic growth will benefit and he thinks stocks that offer 'growth at a reasonable price' will do well in this environment. He has started putting more of the Special Situations Fund into those types of stocks and has also increased his quality threshold, and will continue to do so.

Earnings have been beating expectations but a lot of this has been driven by fairly aggressive cost cutting and Sanjeev believes evidence of volume growth is needed to drive earnings further. Valuations, however, remain reasonable, still towards the lower end of their historical ranges on both price-to-book value and free cash flow measures.

Sanjeev expects mergers and acquisitions (M&A) to become more frequent in 2010. The conditions are there for M&A activity to pick up as companies look to acquire growth in a low-growth environment. He thinks management teams that are keen to create shareholder value will increasingly consider M&A strategies.

For 2010, Sanjeev continues to be optimistic on equities and is finding a number of special situation opportunities that he believes can add value to the fund.

Past performance

The table below shows the performance of the SW Fidelity Special Situations Pension Fund over one year, three years and since launch.

	Percentage growth to 29 January 2010					
	One year	Quartile ranking	Three years	Quartile ranking	Since launch (18 September 2006)	Quartile ranking
SW Fidelity Special Situations Pension Fund	**35.62**	**2**	**-1.00**	**1**	**8.90**	**1**
ABI UK All Companies Pension Sector Median	31.00		-9.97		-2.78	

Source for performance figures: Lipper Hindsight as at 29 January 2010, on a bid-to-bid basis, total return, tax default, in £s.

Past performance is not a reliable indicator of future results.

For all the latest news and commentaries on investment trends, emerging themes and fund insights from Fidelity, visit their website: **www.fidelity.co.uk/adviser/perspective**

The SW Invesco Perpetual High Income Fund

Fund facts

Launch date: 19 September 2001

ABI sector: UK Equity Income

Fund aim: The fund aims for long-term growth by investing mainly in high-yielding international securities (company shares, convertible securities and fixed interest securities), although it may include other investments that the fund manager considers appropriate. The fund invests solely through the Invesco Perpetual High Income OEIC fund.

Investment approach: Adventurous

Please refer to the *Pension Funds Investor's Guide* (ref 16540), which describes in full the investment approach definition and all the fund's risks. The definition and investment approach rating for specific funds may change in the future.

About the fund

At the core of the SW Invesco Perpetual High Income Fund's investment philosophy is a belief in active investment management. Fundamental principles drive a genuinely unconstrained investment approach, which aims to deliver attractive total returns over the long term. The fund's investment process aims to find companies whose outlook or growth prospects are not reflected in their valuations. To identify these companies the manager combines top-down and bottom-up research. These are then subjected to detailed fundamental analysis and valuation. The output from this analysis is then used to construct and review the portfolio with the aim of maximising exposure to the most attractively valued ideas within the fund's risk parameters.

The fund does not have an inherent style bias and this gives Neil Woodford the flexibility to invest across market, adjusting the fund's strategy according to market conditions. As a result, exposures to sector or market capitalisation are solely driven by what the manager believes to be the most compelling opportunities at a particular point in the economic or market cycle.

Current fund strategy

The current fund strategy is focused on investing in those areas where Neil sees undervaluation and the prospect of sustainable dividend growth, while avoiding companies where he expects earnings to disappoint. Much of the equity market strength in 2009 was based around hopes that a V-shaped recovery would see profits at economically sensitive businesses rise strongly.

2010 is a year when these companies need to deliver the earnings growth that is already reflected in share prices and Neil believes that in many cases this will not be achieved. In contrast, he has a high level of conviction in the companies that the fund holds, where underlying corporate performance in 2009 was largely robust, albeit that this did not always translate into significant share price appreciation.

Neil believes that ultimately share prices are determined by fundamental factors and that the consistent and sustainable earnings and dividend growth offered by areas such as pharmaceuticals, tobacco, utilities and telecoms will be reflected in share prices. The unusual scenario that currently exists, and that adds to his confidence in the outlook for the fund, is that these businesses are also among the cheapest stocks in the market at this time.

In the fourth quarter of 2009, the fund benefited from its bias towards quality growth companies, with strong representations in the tobacco and gas, water and multi-utilities sectors performing well. The fund's relative performance was also enhanced by its nil weighting in the bank sector, which underperformed the wider market during the period.

Fund manager outlook

In 2010, the UK economy faces a similar outlook to that which prevailed during 2009. The consumer is the key driver of economic growth and the potential for a sustainable rebound in activity appears limited. Household debt remains around record highs and to return to more normal levels will require a long period of adjustment. The one-off benefit that households enjoyed in 2009 through record low interest rates cannot be repeated and, at some stage, this debt burden has to start to be repaid.

The employment picture is also likely to be an ongoing challenge. While employment levels have shown signs of improvement in recent months, Neil expects public sector job losses to push the unemployment rate higher as 2010 progresses.

The scale of the government deficit will limit the ability of authorities to provide fiscal support, and cost cutting to help protect the UK's sovereign debt rating could characterise the coming year. In Neil's view, credit growth is vital to achieving a sustainable economic recovery and this, in turn, requires healthy banks willing and able to lend. However, the UK's financial system remains in poor shape, with over-leverage and inadequate levels of capital across the banking sector acting as constraining factors for the domestic economy and, in his view, precluding a V-shaped recovery. While de-leveraging by companies, consumers and banks continues, Neil believes there will be little or no economic growth.

Past performance

The table below shows the performance of the SW Invesco Perpetual High Income Pension Fund over one year, three years and five years.

	Percentage growth to 29 January 2010					
	One year	Quartile ranking	Three years	Quartile ranking	Five years	Quartile ranking
SW Invesco Perpetual High Income Fund	**11.68**	**4**	**-6.80**	**1**	**47.06**	**1**
ABI UK Equity Income Pension Sector Median	23.27		-12.87		19.69	

Source for performance figures: Lipper Hindsight as at 29 January 2010, on a bid-to-bid basis, total return, tax default, in £s.

Past performance is not a reliable indicator of future results.

For more information on this fund and other Invesco Perpetual funds available through Scottish Widows' Guided Pension Fund Range, as well as investment updates and webcasts, please visit the Invesco Perpetual microsite: **http://scottishwidows.invescoperpetual.co.uk**

Both the SW Fidelity Special Situations Fund and the SW Invesco Perpetual High Income Fund are available through all Scottish Widows pension products, except stakeholder pensions.

Views, opinions and forecasts expressed in this document are those of the fund managers as at February 2010. Investment markets and conditions can change rapidly and, as such, the views expressed should not be taken as statement of fact, nor should reliance be placed on these views when making investment decisions.

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